

**RECOMMENDATIONS TO THE GOVERNMENT OF  
MONTENEGRO  
FOR  
2015 ECONOMIC POLICY**

## CONTENTS

I. INTRODUCTION .....	3
II. INSTITUTIONAL ENVIRONMENT AND DEREGULATION .....	6
III. RECOMMENDATIONS CONCERNING AGRICULTURE AND FORESTRY .....	13
IV. RECOMMENDATIONS CONCERNING INDUSTRY .....	19
V. RECOMMENDATIONS CONCERNING SERVICE SECTOR.....	28
VI. RECOMMENDATIONS CONCERNING EDUCATION AND LABOUR MARKET .....	41
VII. RECOMMENDATIONS CONCERNING FISCAL POLICY.....	54
VIII. RECOMMENDATIONS CONCERNING FINANCIAL SYSTEM .....	60
IX. RECOMMENDATIONS CONCERNING INTERNATIONAL ECONOMIC RELATIONS AND INTEGRATION.....	69
X. RECOMMENDATIONS CONCERNING ECOLOGY AND SUSTAINABLE DEVELOPMENT .....	79
XI. RECOMMENDATIONS CONCERNING OTHER AREAS.....	91

## I. INTRODUCTION

GDP growth rate of some 2.5% is expected in 2014, pointing to the growth lower than projected, but mostly as the result of some external factors we were unable to influence, such as the Ukraine crisis and the floods in the region. Surely, this was the result of some internal vulnerabilities like low competitiveness, widely spread illiquidity, high prices in some key segments, high interest rates, insufficient support to the export, and the like.

Fiscal deficit will be lower than the one recorded in 2013, and it may be stated that fiscal consolidation measures started giving positive results. Current account deficit in the first six months of 2014 recorded increase compared to the same period of 2013, pointing to our low competitiveness. Public debt approximated the 60% level, but its growing tendency significantly slowed.

All indicators point to Montenegro's deficit exit of recession that affected it in 2012, but the growth is still slow and should be speeded in the upcoming period. Still, it should be expected that the expected growth rate is higher than the growth in the EU and in the region.

Montenegrin economy will face a number of risks in the upcoming period: maintaining fiscal stability, spill over of negative effects from abroad, a high level of real sector illiquidity, low competitiveness, high interest rates, non-diversified exports, high current account deficit and the like.

In the conditions of Euroised small economy, such as Montenegrin economy, adjustment instruments and available funds are highly limited. Therefore, the 2015 economic policy' accent should be put on structural reforms which will promote growth and development and create stability. The most important economic policy measures should refer to the continuation of fiscal consolidation, gradual change in development model, improving Montenegrin economy's competitiveness, speeding of the EU accession negotiations, continuation of structural reforms and privatisation, passing of systemic laws in line with the best international practice, continuation of deregulation and removing of business barriers, and the like.

In the fiscal policy area, significant efforts have been made in fiscal consolidation, shown through amending the legislation, increase in public revenues, reduction of shadow economy and decreasing fiscal deficit. Still, the key risks in the upcoming period will still remain in the fiscal sphere due to public debt, although its growth

has been significantly slowed. From long-term perspective, it would be necessary to decrease the share of public spending in the GDP, and to gradually decrease the share of current budget expenditures to the favour of capital expenditures.

The banking sector is burdened with a high share of non-performing loans, and consequently the inadequate level of lending and high interest rates. The Central Bank of Montenegro (CBCG), in cooperation with the Ministry of Finance and the World Bank, prepared the Bill on Voluntary Financial Restructuring, known as the Podgorica Approach. It would be useful to adopt the Bill in the short term.

One of priority tasks in the upcoming period is drafting of the economic development strategy. Significant attention should be directed towards improving the economy's competitiveness, gradual change in development model, passing of systemic laws in line with the best international practice, continuation of deregulation and removing of business barriers, and the like. It would be important to change growth model, from the one driven by the domestic demand to the one to be driven by export expansion. Although this requires time, it seems that not much has been changed during the last several years.

Special attention must be paid to the preservation of the financial stability, which should be a joint task of the CBCG, the Ministry of Finance, the Securities and Exchange Commission and the Insurance Supervision Agency.

Pursuant to its legal obligation, the CBCG hereby proposes a set of Recommendations to the Government of Montenegro for 2015 Economic Policy. Analyses of the selected areas contain short background, the deadline for their implementation, the analysis of the most important possible risks in the upcoming period, and overview of the selected area and proposed operational measures for their implementation.

The recommendations are grouped into the following areas:

- Recommendations concerning institutional environment and deregulation;
- Recommendations concerning agriculture and forestry;
- Recommendations concerning industry;
- Recommendations concerning the service sector;
- Recommendations concerning education and the labour market;
- Recommendations concerning fiscal policy;
- Recommendations concerning the financial system;

- Recommendations concerning economic foreign relations;
- Recommendations concerning environment and sustainable development;  
and
- Recommendations concerning other areas.

## II. INSTITUTIONAL ENVIRONMENT AND DEREGULATION

<i>Key recommendations</i>	<i>Implementation timeline</i>
Increase public administration efficiency, particularly at local levels;	Continuous
Aiming to attract investors, each local administration unit should create facilities programme	Short
improve anti-monopolistic policy functioning	Continuous
Continue the application of Regulatory Impact Assessment (RIA) methodology in passing new legislation	Continuous
Continue combating shadow economy	Continuous
Strengthen the mechanism of restitution and expropriation	Short
Introduce automatic bankruptcy	Short
Sanction all investors breaching privatisation process contractual obligations	Continuous
Strengthen financial support in creating new and developing existing SMEs through the Investment and Development Fund	Continuous
<i>Main risks</i>	<i>Risk direction</i>
Further deepening of real sector illiquidity	Growing
Low collection due to illiquidity	Stable
Inefficiency and slow administration in implementing legislation	Stable
Slow court procedures in resolving commercial disputes	Stable
Unresolved property and legal relationships in implementing the projects of state interest	Stable
Highly monopolised market	Stable
Lack of detail planning documents, detailed urban plans and good cadastre records	Stable
Local barriers (multiple and high utility taxes and fees)	Stable
Presence of informal employment, particularly during the summer tourist season	Stable

### *Background*

Active policy of continuous improving of a sound business environment and favourable investment climate is the key for attracting foreign and domestic investments and they are of utmost importance for the growth and development of the country, and consequently to improving the citizen's quality.

Although full of economic challenges due to problems transferred from the crisis years, the last two years marked a successful beginning of many reform processes for improving business environment. The steps on creating better conditions for both investments continued through different activities and reforms of Montenegrin institutions in 2014.

The Council for Improving the Business Environment (the Council) continued with the reform projects in 2013 and 2014 with a view to creating efficient administration with shorter procedures and transparent deadlines for resolving demands and more favourable climate for domestic and foreign investors.

With a view to reducing operating costs, the Council prepared the paper called „*Analysis of local fiscal adjustments*“, containing recommendations for improving investment climate at the local level, primarily the removal of duty for utility equipment of construction land, as the main barrier for the realisation of investments. This fee is one of the highest in the world, posing a real obstacle for investors. The Government accepted the Analysis, as well as the scenario to abolish the duty since 2016, after the preparation period given to local administrations.

With the view of better cost-effectiveness analysis and analysing the decisions of policy makers from the aspect of implications in the business environment and effects on the state budget, the Department for Business Environment Improvement gave opinions on 590 regulations since formal introduction of the Regulatory Impact Assessment (RIA) methodology into the Montenegrin regulatory system on 1 January 2012.

The new revised Action plan for the implementation of recommendations from September 2013, of total of 1887 recommendations, some 1446 recommendations were implemented. Of the total number of accepted recommendations, some 835 were planned since the adoption of the Action plan, while it is planned to implement the remaining 611 recommendations in the coming period.<sup>1</sup>

The Law on Bailiffs came into force in early 2011, and the first bailiffs started working in 2014, thus completely implementing the Law. Public bailiffs (13 of them) started working in the jurisdictions of primary courts in Podgorica, Pljevlja, Berane, Herceg Novi, Kotor, Plav, Rožaje and Žabljak. It is expected that the

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<sup>1</sup> Report on the operations of the Council for Improving the Business Environment, regulatory and structural reforms in 2013

bailiffs will largely contribute to more efficient, faster and shorter execution proceeding, less burden on courts, more professional and competent execution of execution tasks, which finally leads to right on trial in a reasonable deadline.

Montenegro joined the COSME<sup>2</sup> project in June 2014, which will be highly beneficial for the development of SMEs in Montenegro and for creating a favourable environment for creating business. The COSME project started in January 2014 and it will last until end-2020, with the total budget of 2.3 billion euros. The objective of the programme are financial support to SMEs, more favourable conditions for business creation and growth, promotion of entrepreneurship and fostering entrepreneurship culture in Europe, increasing viable competitiveness of companies in the EU, cross-border support to functioning of small businesses and easy access to markets.

With a view to fostering the development of entrepreneurship and SMEs in Montenegro, the EU will use its WB EDIF<sup>3</sup> programme to finance SMEs that have capacities and large potential for the development and increase in employment.

The results of numerous activities carried out for the improvement of business environment are also recognised in the World Bank 2014 Doing Business Report, in which Montenegro improved its ranking by seven places and is currently ranked at 44<sup>th</sup> place. According to the report, Montenegro recorded reforms in two areas: dealing with construction permits and registering property. On the other hand, its rank deteriorated in three indicators: starting a business (-11), trading across borders (-11) and paying taxes (-5). This data clearly indicates that further reforms have to be taken with a view to creating favourable environment for starting a business.

The Heritage Foundation Economic Freedom of the World Index ranked Montenegro at the 68<sup>th</sup> place out of 178 ranked countries, with the economic freedom score of 63.6, being 1.0 point higher than last year, with notable gains in business freedom and investment freedom.

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<sup>2</sup> COSME (The EU programme for the Competitiveness of Enterprises and Small and Medium-sized Enterprises) is an EU project implemented from 2014 to 2020 with a view to improving competitiveness and viability of SMEs, fostering the entrepreneurship culture and promoting the SME sector's growth and development.

<sup>3</sup> WB EDIF is a Western Balkans Enterprise Development & Innovation Facility programme with the value of 140 million euros. The Fund's initial capital is 38.5 million euros. Of this amount, the EBRD provided 19 million, of which 3 million euros were provided by the Government of Italy. The EIF provided 14.5 million euros, of which the EU provided 9.5 million euros, and the DEG provided 5 million euros.

Shadow economy represents significant problem as it jeopardises sound business environment. Therefore, the Government of Montenegro required from the Committee for combating shadow economy to draft the Action Plan for Combating Grey Economy to describe activities on suppressing shadow economy in 2014. The main objective of Committee for combating shadow economy in the upcoming period will be zero tolerance following the principles of non-selectivity and full transparency, applying a rigorous penalty policy. After the analysis of the coverage and purpose of measures, and suggestions of Committee members, the Proposal of the Action Plan for Combating Grey Economy for 2014 was made. Its structure follows the relevant areas, these being: legislative activities, operating activities, institution building (IT and human resources), cooperation and education. Each area has been appointed a relevant institution (institution-coordinator), responsible for realisation of the measure, including the institutions that participate in the realisation, effects and objectives of measure implementation and the timeline for implementing the measures.<sup>4</sup>

The Foreign Investors' Council published the fifth issue of the "White Book" for Montenegro in June 2014. Despite significant progress in several years, Montenegro still suffers some critics by domestic and foreign investors. There are many business barriers viewed are slow and lengthy procedures, particularly at the local level. The White Book published the MFIC index, which gives an evaluation of the simplicity and effectiveness of doing business in Montenegro based on the investors' perspective. The overall rating is 6.3, i.e. up by 0.4 compared to last year. The areas where progress has been recorded include rule of law, property development and labour market/employment are the focus areas, while, on the other hand, taxation has been showing negative trends.

Regardless of numerous activities taken to improve the business environment, there are certain deficiencies and problems that need to be removed in the upcoming period. There are still business barriers in Montenegro including complicated and expensive administrative procedures, infrastructure and financing.

### ***Operational measures***

Continued implementation of regulatory reform should enable the removal of business barriers and creation of better conditions for exercising the rule of law. This will further reduce possibilities for corruption and ultimately create better and

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<sup>4</sup> Action Plan for Suppressing Grey Economy 2014

more stable business environment. More efficient court proceedings and efficient implementation of the law will encourage foreign investors to invest their capital to Montenegro.

Many laws aiming to improve business environment were passed in the past few years but there is some inconsistency in their application. With a view to removing business barriers and maintaining a stable business environment, the relevant authorities have to provide efficient application of the enacted laws.

There are still investors' objections to the lack of professionalism of public administration officers and inefficiency of the administration work. Therefore, the public administration's training system should be improved with a view to enabling the acquiring of skills, competences and providing continuous training. Moreover, administrative procedures should be improved, implying shorter deadlines for acting, collecting documents *ex officio*, and determining actual fees in accordance with administration costs.

Efforts should be made to establish a better quality corporate management, focusing on principles of protecting minority shareholders and "social responsibility" (stakeholder corporate management principle).

There are many instances of new owners not adhering to all provisions of privatisation contracts, sometimes generating additional costs to companies and the government budget. The authorities should control and keep systematised records of contracts' implementation and timely respond by taking appropriate actions.

The application of the RIA methodology should be continued. Its implementation is essential, since it is a complex tool aiming to enable *ex ante* evaluation of new legislation (laws and secondary legislation). Recommendations given under the "Guillotine of Regulations" project should also be implemented in accordance with the Action Plan.

Each local administration should create its facility programme for foreign investors, with a view to improving business environment. The package of measures might include tax facilities to new investments, establishing business areas, creating municipal zoning plans, efficient local administration, and the like. For the purpose of faster and more efficient procedures, local authorities should establish working bodies to be available to investors for the purpose of faster and more efficient procedure. Moreover, the authorities should introduce tax facilities for employing certain categories of unemployed persons in underdeveloped local

administration units. With a view to attracting investments and facilitating the start-up of businesses, in the municipalities in the North in particular, the number of necessary permits and approvals for the start-up and the number and amount of local taxes should be reviewed and unnecessary taxes should be abolished.

The one-stop shop system should be improved for obtaining construction permits in all local government units to reduce the number of days waiting for the construction permit and ensure that the actual deadline for obtaining construction permit in practice corresponds to the legally prescribed deadlines.

Unresolved property relations often represent big problem for the investors particularly in the realisation of state interest projects. Therefore, restitution and expropriation mechanisms should be improved for the purpose of creating more favourable legal basis for encouraging investments.

Many companies behaving as monopolists or oligopolies may lead to a highly unfavourable situation from the aspect of consumer welfare so it is necessary to prevent any misuse of dominant position. Thus, it would be necessary to completely open the market in all segments where competition is limited by fostering investments into these areas and creating more favourable investment conditions.

Taking into account a significant share of the foreign labour force, the procedure for obtaining working permits should be shortened and accelerated. In addition, it would be useful to examine the possibility of interim working permits being valid from the period of filing the application until the permit issuing. The government should also examine a more restrictive policy of issuing working permits in sectors with available labour force in the Montenegrin market.

Illegal employment is a significant problem, mostly present during the summer tourist season. Therefore, it would be necessary to improve inspections to resolve the problem, and raise the employers' awareness on the importance of legal employment, since it thus creates a lot of damage to employees due to non-paying of contributions and social insurance, on one hand, and lower budget revenues, from the other hand. It would be necessary to substitute foreign labour force with the domestic one. There is strong potential to decrease unemployment rate in this area.

With a view to mitigating the illiquidity problem, the CBCG remains with the recommendation to introduce the automatic bankruptcy principle. Thus, the real

sector would be cleared and the financial sector's stability would be improved by transferring mortgage claims to banks' equity. In order to give companies sufficient time to eventually exit the blocking on one side, and to prepare all necessary preconditions on the other side, we believe that the abovementioned law should be passed with the grace period of one year. In the upcoming period, the key precondition should be performing intensive training of bankruptcy administrators.

### III. RECOMMENDATIONS CONCERNING AGRICULTURE AND FORESTRY

<i>Key recommendations</i>	<i>Implementation timeline</i>
Complying with the sustainable development principle and increasing the agricultural production volume with particular focus on organic production and promotion of the Montenegrin food production specificities.	Continuous
Support investments in village development, including infrastructure	Medium
Encourage the development of higher quality products with higher profit, and strengthen production in protected area (greenhouses)	Continuous
Stimulate consort appearance of small and local producers with recognised products at the market	Continuous
Value forest wealth to a higher degree, adhering to the sustainable development concept	Continuous
<i>Main risks</i>	<i>Risk direction</i>
Migration of rural population and de-agrarization resulting in depopulation of villages	Growing
Insufficient labour force and training	Growing
Undeveloped infrastructure in rural areas	Stable
Breeding of inadequate assortment	Stable
Inadequate forest management and fire danger	Stable

#### ***Background***

The agriculture sector (agriculture, forestry and fishing) has a significant but still not a satisfactory position in overall Montenegrin economy. Agricultural area accounts for 38% of total territory of Montenegro. Agriculture is the most represented activity and most frequent source of income for rural population. It is also the main or partial source of income for 48,870 agricultural households.<sup>5</sup> With some annual fluctuations, the share of gross value added (GVA) of agriculture in total GDP (at current prices) dropped from 11.3% in 2000 to the respective shares of 7.9% and 7.4% in 2011 and 2012. In total funds available, the average income per household from agriculture<sup>6</sup> amounted to 5.5% in 2011 and 4.3% in 2012.

<sup>5</sup> Source Monstat: Data from the Agriculture Census 2010

<sup>6</sup> Source Monstat: Household Budget Survey, and the data is taken from the publication “Montenegro in Figures 2013”

Agriculture, Forestry and Fishery Division increased the number of employees by 10.6% in 2013 compared to 2012 but gross and net wages recorded decline from 17.9% to 16.7% in the same period. Montenegrin agriculture is characterized by traditional production, unfavourable structure of the agricultural sector, low productivity, which makes Montenegro a large importer of food.

During the previous period, the analysis of the legal framework was completed and benchmarks for the initiation of negotiations were obtained. Due to their complexity, the agriculture sector, i.e. Agriculture and Rural Development Department (as chapter 11) represent one of the most difficult chapters in the negotiation process, as this activity poses an array of challenges and responsibilities that must be fulfilled in the future, in order to achieve full compliance with the EU acquis.

Acquis in the field of agriculture and rural development covers a large number of binding rules, most of which are directly applicable. Agricultural policy of Montenegro is based on the Law on Agriculture and Rural Development from 2009 (OGM 56/09), which lays down the objectives of agricultural policy, and also provides a general framework for the development and support of agriculture and rural areas. However, to meet the criteria obtained for the start of negotiations, the Ministry of Agriculture and Rural Development must prepare a number of strategies and laws that will aim to establish clear guidelines for the development of certain areas of agriculture, as well as securing funds for further development. Some of the main strategic documents are the Agriculture and rural development strategy (2014-2020), as well as the Strategy of adopting the acquis in the area of food safety.

The Strategy of regional development in Montenegro (2014 – 2020)<sup>7</sup> states that there are significant and underutilized natural resources and benefits that represent the potential for growth if they are properly managed. These include primary sectors (agriculture and forestry) that are directly related to the development of manufacturing food industry, wood processing and the like.

Key activities in the agriculture sector in medium and long term should be directed towards upgrading the volume of agricultural production and creating incentives for the revitalization of villages.

Exploitation of the pre-accession funds for rural development is of particular importance for Montenegro, which will provide significant support to agricultural

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<sup>7</sup> To be more precise, it is the Draft Strategy from May 2014

producers, as well as support the strengthening of administrative capacities. The process of withdrawal of money from European funds for investments in domestic agriculture started as of September 2014. By 2020, through projects like the IPARD, it is possible to withdraw a total of 49 million euros of EU funds earmarked for agriculture. The main challenge in the coming period is to spend the money on real projects, or how to manage these projects. It is therefore of utmost importance to develop Agricultural Development Strategy 2014-2020 in accordance with EU requirements which must be consistent with the basic elements of a common European policy. It also has to give a clear direction for the development of agriculture in Montenegro.

The use of pre-accession funds for rural development is of particular importance for Montenegro. They will provide a significant support to both agriculture producers and strengthening of administrative capacities.

In the past few years, the following key documents regulating the forestry sector were passed: the National Forestry Policy, the Law on Forests, and the National Action Plan for Combating Illegal Activities in Forestry. Results of the first National Forest Inventory show that forests account for almost 60% of Montenegro's territory<sup>8</sup>. The Forestry Development and Wood industry strategy until 2014 was passed in 2014, which should resolve the issue of sustainable management of this resource, and the issue of increasing wood stocks. Montenegro forests are a recognisable symbol of ecologic state through its quality, functions and products and simultaneously they represent good basis for the rural development and increase of the employment in rural areas.

### *Operational measures*

The Government must continue to support agricultural production, particularly the one of the most developed countries in the world. Incentives provided to the development of agriculture are important for poverty reduction and stopping of migrations. It is obvious that Montenegro must not leave agriculture only to market, but an entire programme of support is needed that would be based on improvement of competitiveness of producers, sustainable management of resources, and Improvement of the quality of life in rural areas. Sustainable development and management of adequate resources would support a balance between economic growth, environmental protection and social aspects. Promotion

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<sup>8</sup> Ministry of Agriculture and Rural Development: National Forest Inventory of Montenegro - summary, Podgorica, 2011.

of specific, local products with distinctive quality of both domestic and foreign market is of particular importance.

Montenegro has received benchmarks for the chapter 11 - Agriculture and Rural Development. In order to harmonize agricultural development policy of Montenegro with the Common Agricultural Policy (CAP) of the EU<sup>9</sup>, it is necessary to adopt a strategy of development of agriculture and rural areas for the period 2014-2020<sup>10</sup>. However, the CAP is divided into two columns, one of which includes the regulation of markets and direct support for payments and other supports rural development measures. New agricultural policy of the European Union in particular recognizes "small farmers" and provides greater freedom for rural development measures. This is a positive matter for the Montenegrin farmers who will be able to count on considerably greater financial support after the accession of Montenegro to the European Union. Implementing and adopting of the EU legislation, agriculture of Montenegro can significantly raise the level and be ready for any challenges in future, which are clearly stated in the *Overview of CAP Reform 2014-2020*<sup>11</sup>.

Uneven regional<sup>12</sup> development is one of the key reasons for the low development in Montenegro in relation to the EU, that is, uneven development of the north, central and the coastal region, where the northern region, which occupies 52.8% of the territory of Montenegro, with around a third of the total population, is the least developed region in the country. Agriculture and rural development represents one of the priority areas of this region, as outlined in the Regional Development Strategy 2014-2020. The northern region has a high potential for agricultural development and food production, production of products with designations of origin, geographical indication or designation for organic products, as well as indigenous mountain products and the like. Investments in the northern region are expected during 2014, through MIDAS program, in amount of about 4 million euros. The development of agriculture in this region would enable income, increase employment in less developed areas and would also affect revitalization and reduction of migration population.

Poor rural infrastructure is characteristic of many rural areas in Montenegro, in particular for inaccessible remote areas. This has a negative impact on the

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<sup>9</sup> European Parliament adopted four of the *acquis* from the reforms (CAP – Common Agricultural Policy) in November 2013

<sup>10</sup> The first draft of the Strategy is delivered to the European Commission in April 2014

<sup>11</sup> European Commission, Agricultural Policy Perspectives Brief, December 2013.

<sup>12</sup> Division of Montenegro into three geographic regions (northern, central and coastal region) was done in the Spatial Plan by 20120, Regional Development Strategy 2010-2014 and Law on Regional Development.

economic and social status of these areas and contributes to depopulation of the rural areas. Mitigation and seizure of this negative trend is possible only with the strong support from the Government's budgetary resources, especially through the budget for agriculture. Measures to improve the quality of life and diversification of economic activities in rural areas intended for the reconstruction and development of villages and rural infrastructure development, may partially affect the affirmation of agriculture and improving the conditions for the realization of agricultural products. Achieving sustainable development of rural areas is one of the most important challenges of the overall development of Montenegro. This corresponds to a document *National Development Plan of Montenegro 2013-2016*, where *National Development Plan policy areas* are identified, while agriculture and rural development are located in the direction of sustainable growth. At the same time, *Regional Development Strategy 2014-2020* defines priority development sectors. Within one of the priority sectors, agriculture and rural development emphasizes the provision of adequate living standards for the rural population through restoration measures and rural development and infrastructure construction.

During the next period it is necessary to redirect the production structure to products that carry potentially higher profit as early cultivation of fruits and vegetables and increase production in greenhouses. Organic food production is also a chance for development of agriculture in Montenegro. Currently, Montenegro uses very low potentials for the production of organic food, and what needs to be determined is what is going to be produced, i.e. which organic food can bring profit to farmers. By stimulating production of organic products and recognizable brand the concept of ecological state is implemented. Continuous support for organic agriculture will contribute to strengthening the competitiveness of Montenegrin organic food producers. As stated in the *National Action Plan for the development of organic production 2012-2017*, continuous education of producers and advisors for organic production will be implemented. This is supported by the adoption of the *Law on Organic Production*<sup>13</sup>, regulating organic production, labelling organic, ecological and biological products, control of organic production, as well as other issues of importance for organic production.

It is necessary to work continuously on the development of production at agricultural holdings. The development of agricultural holdings is in accordance with the *Law on Agriculture and Rural Development* (adopted in July 2009), which envisages the establishment of the accounting data system for selected agricultural

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<sup>13</sup> The Parliament of Montenegro adopted the Law on 20 November 2013.

holdings on the basis of certain criteria (type of production, size, and the like). Agricultural Census 2010 provides a good basis for the establishment of FADN system (accounting data network on farms), which Montenegro has to develop in line with the *acquis*. According to the agricultural census, out of 48,870 agricultural holdings, 5,448 keep records of income and expenditure. In order to plan future activities in agriculture and program support to agricultural producers and to fulfil the preconditions for the withdrawal of funds from the EU, it is necessary to create a register<sup>14</sup> of agricultural producers. Ministry of Agriculture and Rural Development has prepared and adopted Rules of Procedure on the agricultural holdings, which is an important step towards establishing a legal basis for the creation of a database in agriculture. Registry represents a database that contains information about the holdings and their resources, and will also feature the unique identification of the users who submit an application for the support. It will also be an integral part of the IACS (Integrated Administration and Control System), which is the responsibility of all EU countries.

Consortium performance of small and local producers recognizable at the market should be stimulated.

Forests are the basis for the creation of added value in the area of wood processing, renewable energy, food production and tourism. The *Forest Management Plan 2014 - 2023*, states that forests are of vital economic importance for the population in rural areas and represent a major source of income and energy for heating. One of the general objectives of the Plan is to increase GDP of the forestry sector, wood industry and other industries that depend on the forests from 2% to 4% of GDP. Forestry, wood and non-wood products are an integral part of the rural economy and rural development. Increasing economic contribution is possible by increasing the volume of logging (with the necessary investments) and by increasing the value added in the chain of wood processing. The potential of the forest sector should be used towards the stimulation of connecting producers of wood with wood processors, all in order to export products of higher level of processing. It is necessary to work continuously on strengthening human resources in forestry, using the help of international institutions and projects. In the period 2014 – 2020, a part of the EU - IPA funds for the rural development and other purposes shall be provided for the development of forestry thus it is necessary to attract funds for the development of underdeveloped segment by corresponding measures and plans.

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<sup>14</sup> Currently there is a register of agricultural policy holders that does not provide adequate information on the number of employees in agriculture - Source: Ministry of Agriculture and Rural Development "Program of the Ministry of Agriculture and Rural Development for 2014."

## IV. RECCOMENDATIONS CONCERNING INDUSTRY

### 1. Metal industry

<i>Key recommendations</i>	<i>Implementation deadline</i>
Withdrawal of the state from the metal industry	Short
Find a strategic partner for the Bauxite Mine	Medium
<i>Main risks</i>	<i>Risk direction</i>
Potential breach of contract with company Uniprom, if the company fails to settle the obligations	Growing
Endangering the reputation of the country and the investment environment due to unresolved issues with former strategic investors	Growing
Further deterioration in the fiscal position due to potentially new state expenditures for solving problems of the metal industry sector (lawsuits of the CEAC, subsidies, social programs, and the like)	Constant
Failure to meet the environmental standards of operation and high costs of environmental remediation	Constant

### *Background*

Metal industry, both in the international market and in Montenegro, is facing extreme problems in recent years. Inherited problems were not resolved by privatizations, and the global economic crisis has only worsened the situation. The physical volume of industrial production, as one of the branches mostly affected by the crisis, generally decreased since 2008, with the exception of 2010 and 2013, when growth was recorded partly due to the low base from the previous year. Over the last six years, share of production of basic metals in total industry has significantly reduced, from 41.3% in 2008 to only 12% in 2013.

There decline was primarily the result of insufficient and non-profitable production in KAP, which was caused by a number of factors (the global crisis, the price of aluminium on the world market, poor choice of strategic partners, redundancy, high production costs, outdated equipment, and the like).

After several years of problems and activation of guarantees, the **KAP** was sold to company Uniprom. However, in the meantime, the Cyprus court declared it competent and banned the sale of the KAP's assets. As a result of increased risk,

after the decision was adopted, the deadline for the settlement of obligations has been extended to the new buyer. After the expiry of extended deadline, new buyer paid only a part of the funds and requested an additional extension.

**Bauxite Mines Nikšić (in bankruptcy)**, a company which had previously been related with KAP through production and raw material supply, which potentially can be the situation also in future, continued to operate with expressed problems also during the last months of 2013 and in 2014. The bankruptcy is declared in mid-November 2013 and liquidation in late February 2014. The first call for the sale of the company's assets (14 million euros) failed, and the second call is expected. Meanwhile, in May, the six-month contract for the purchase of ore was concluded with the company Neksan from Nikšić. However, in late August 2014, Neksan announced that production will be suspended for several days, with a request to the Government to provide money for employees' severance pay and to waive claims for VAT on unsold ore. All ore produced so far is only stocked, and Neksan does not want that sold it due to low prices at the market.

In recent years, **Steel Mill (Toščelik)** has faced significant problems in financing production and the unfavourable situation at the steel market, which resulted in a significant reduction in production volume. In the context of completion of the Restructuring program, The Government of Montenegro provided a guarantee for the loans in the amount of 26.3 million euros for severance payments to employees, modernization and mitigation of technical and technological production barriers. Nevertheless, there was a need for modernization of production, in order for a company to be more competitive at the market and to create conditions for operations without losses. The social program was implemented in order to address the problem of redundancy of employees. However, due to record losses incurred in 2009-2010, poor performance of the company and the inability of the owner to pay off debts to creditors, the bankruptcy have been introduced in mid-April 2011 and in May the government had to repay the loan. The bankruptcy meant termination of the contract with the current majority owner.

In May 2012, company Tosyali from Turkey becomes the new owner of the Steel Mill, which bought the assets of the bankrupt Steel Mill in amount of 15.1 million euros. The production began in July 2012, with the establishment of a new company – Toščelik, in the form of a limited liability company. The plan of the new owner was to invest about 35 million euros in the next three years, to increase the number of employees to 550 (from 308) and finally to increase production from 120,000 tons to 400,000 tons. Toščelik ended 2012 with a loss amounting to 3.5

euros. The investment period is later extended from three to five years, with a planned investment of around 6.7 million euros during 2014 (already done), and the rest of about 29 million euros in the period 2015-2016. Investments initiated in September 2013, which interrupted production. Work on the setting up of a dust removal system is finished, which created conditions for the production in Steel Mill in compliance with environmental standard as well as work on the reinforcement of the roof structure with the construction of the foundation for a system for reactive power compensation. The furnace is mounted in the Forge, and the dynamics is such that the work should be completed and production should begin in autumn 2014. Until then, new staff cannot be hired and the existing staff is working on the installation of equipment. Meanwhile, employees receive regular salaries, all taxes and contributions are paid, as well as suppliers and contractors. Toščelik ended 2013 with the los in amount of nearly 4.9 million.

### ***Operational measures***

The Government needs to take a position on the issue of fulfilment of obligations by Uniprom. Further, the Government should give strong guarantees that the future investor will actually invest. The condition for survival of KAP is the modernization of production equipment and technology, in order to obtain an efficient product that meets the standards and is cost-competitive at the international market, as well as resolving the electricity issue.

The state should be withdrawn from the metal sector and leave it to the private sector.

At the same time, a solution for the renewal of business activities in the Bauxite Mine should be found, as well best quality strategic investor.

## 2. Energy

<i>Key recommendations</i>	<i>Implementation deadline</i>
Start of construction of new large energy capacities in cooperation with leading strategic partners	Long
Construction of small energy capacities that use renewable energy sources	Medium
Recruit overall energy potential of Montenegro, which meets the principles of sustainable development and have no negative impact on the environment	Long
Increasing energy efficiency, primarily in industry, services, transport and households	Continuous
Promotion of new technologies and standardization in the construction of residential buildings, as well as in the heating and / or cooling systems: substitution of direct transformation of electrical energy into heat and using new technologies acceptable from the standpoint of environmental protection	Continuous
Modernization and revitalization of existing and construction of new infrastructure for the production, transmission and distribution of energy on the principles of international technical standards in order to minimize losses and facilitate sustainable development	Medium
Higher the level of use of alternative energy sources (solar energy, wind energy, biomass, and the like)	Continuous
Realization of project of strategic stocks of petroleum products in accordance with EU energy policy	Medium
Transparent pricing of electricity and the continuation of the program of social protection in the process of reforms in the energy sector, in order to protect standard of the most vulnerable parts of the population	Continuous
<i>Main risks</i>	<i>Risk direction</i>
The delay in the implementation of new capital investments and revitalization of existing key electricity producers	Growing
Insufficient training for operational activities (construction of basic and environmental units), inadequate "know-how" in the field of energy, especially when it comes to research activities	Constant
Inadequate quality of investment projects analysis	Constant
Despite adopted Law on Energy Efficiency, Montenegro still does not have mechanisms of financing and sources of funding (grants, budget sources, international organizations, and the like) which would allow long-term consideration of further development of energy in accordance with the principles of the Law on Energy Efficiency	Constant

## ***Background***

Based on the document "Energy Policy of Montenegro by 2030," updating and upgrading of the former Energy Development Strategy by 2025 was done due to the failure to adjust to the real situation and needs of its further development. We created the Energy Development Strategy by 2030 (White Book), which was adopted by the Government of Montenegro in July 2014. The new strategy has undergone the public discussion and it includes the impact assessment on the environment.

Energy policy of Montenegro by 2030 identifies three main priorities: (i) the security of energy supply (ii) the development of a competitive energy market and (iii) sustainable energy development. The importance of the energy sector and energy independence can be seen from the economic, social and security point of view.

Adopted Strategy by 2030 envisages investments of about 4.2 billion euros or 10% of GDP per year, which clearly indicates that the energy sector is one of the strategic sectors of the Montenegrin economy. New projects could represent one of the main drivers of the new development cycle of the Montenegrin economy. It would provide an additional diversification of the Montenegrin economy, which would be more export-oriented. A new wave of investments would have a multiplier effect on other businesses, new jobs, higher incomes and a better living standard. This would have a positive effect on reducing the current account deficit, which was significant in previous years. Additional contribution to potential development of the energy sector stimulates integration of Montenegro into the regional and European energy market. By announced projects of connecting electricity systems, Montenegro could be strategically well-positioned in the region.

Current production capacities of electricity in Montenegro do not meet the overall demands of the domestic market<sup>15</sup>. Announced normalizing of production in KAP, could again challenge regular electricity supply. Dependence from the import in previous years was much expressed. Increasing capacities in the production of electricity is a necessity, not only for economics, but also for the preservation of minimum energy independence, where the question of energy independence is even more important in the midst of the current geopolitical developments.

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<sup>15</sup> The exception occurred in 2013, as a result of reduced production of KAP, as well as in 2010, for the same reason and record production in TP Pljevlja, thus, net import was almost zero.

The importance of energy independence can be seen through the stability of electricity prices, due to the fact that they are increasing<sup>16</sup>. The stability of electricity prices affects the competitiveness of Montenegrin products and services. It should be noted that the share of electricity in the consumer price index after basic food products is the largest and represents a major expense for households. Increasing costs of households, whose net earnings decreased, reduced disposable income.

Low energy efficiency is very present in big industrial companies and transport sector, which in previous years used most of the final consumption of electricity. Excessive and irrational use of electricity, or low energy efficiency is present in the household sector, which accounts for about 30% of total electricity consumption. Also, there are large transmission losses. The entire energy chain, from production, through transmission and distribution, to final consumption is characterized by a relatively low level of energy efficiency. Development needs of the economy and population for energy have increased and production is insufficient. Thus, increase of production and improvement of the energy balance became a strategic goal of development.

Major progress has been made in order to harmonize national legislation in the field of energy with EU legislation by adopting the Energy Law, the Energy Efficiency Law and the Law on Exploration and Production of Hydrocarbons. This regulation largely implements the EU acquis.

Energy development in Montenegro is mostly based on the development of the energy sector, including revitalization of the existing large hydropower plants and thermal power plants, or the construction of new hydropower plants and expands the capacity of thermal power plant.

These analyses indicate that Montenegro has huge unexploited energy potential in renewable energy sources - hydropower potential, wind potential, photovoltaic power, biomass power plants, cogeneration and biomass incineration of mixed municipal solid waste. Great attention is paid to the construction of small hydropower plants which relatively quickly can be put into operation and have no harmful effects on the environment. This includes revitalization of existing and construction of new ones. Wind farms also have the potential, and that potential sites are specified. Realization of the project on landfill gas cogeneration in Podgorica is in progress. Bearing in mind the various types of waste and the

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<sup>16</sup> Measured by the CPI, annual growth rate

possibility of its "recycling", as well as effects on the ecology and tourism, this form of generating energy is of strategic importance.

The largest part of hydropower potential, wind power and coal findings is located in the northern region of Montenegro, which is economically less developed than the rest of the country. Thus, utilization of these resources could be a chance for development of the northern region. Valorisation projects could affect the deceleration of negative demographic trends in this part of Montenegro.

In early 2009, the electricity market was open to all consumers, except for households that will open by 2015, in accordance with the provisions of the Treaty on Establishing Energy Community<sup>17</sup>. The Montenegrin operator of the electricity market (COTEE Ltd.) was founded on the basis of decision of the Montenegrin Government in December 2010 that defines initiation of the energy activity aside from CGES. Montenegro signed the Protocol on the United Nations Framework Convention on Climate Change and the Kyoto Protocol in 2007. However, the modalities and terms are yet to be agreed. The Government, in cooperation with UNDP, created the first National Report on Climate Changes, which identifies the main polluters.

Montenegro has no access to international resources of natural gas, has small coal reserves and it has to import oil products. Retail sales of oil products is liberalized, but liberalization of the entire energy sector is at an early stage and competition is still very limited, and the institutions of the energy sector require need further development.

### ***Operational measures***

Adopt Action Plan for the implementation of the Energy Development Strategy by 2030.

The key priority will be the construction of new capacities. Montenegro has a substantial potential, a capacity to build a new thermal power plant facility. Attract reputable investors through projects such as the construction of big hydro power plants, thermal power plants and high voltage interconnectivity undersea cable.

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<sup>17</sup> Montenegro signed the Agreement on Energy Community in 2005.

Montenegro does not produce liquid and gas fuels and it is fully import-oriented. Consider the creation of conditions for the realisation of 90-day supply stocks of oil derivatives in accordance with the EU Energy Policy.

It is necessary to continue researching oil and gas in the Montenegrin Coast fully respecting ecological standards.

Consider the option of gasification by connecting to the Adriatic-Ionic gas pipeline in accordance with the EP priorities for 2011 since the construction of the “South Flow” has been terminated.

The following measures should be implemented in the field of energy efficiency:

- Continue the revitalisation programme of HPP “Piva”, the revitalisation programme of HPP “Perućica”, as well as revitalisation of TPP “Pljevlja”.
- Work on reaching an agreement with the neighbouring countries on the use of common hydro potential (e.g. waters of Bileća Lake). In the case of HPP Boka and/or HPP Kruševo, do the necessary research for routing investments.
- Continue the project of developing a transmission network at the regional level.
- Develop a database and a high-quality statistical support for the consumption and distribution within the Energy Efficiency Action Plan.
- Protect the state and consumers from potential negligent behaviour of concessionaires. Oblige concessionaires to repair and maintain facilities on a regular basis through the introduction of mandatory provisions in the concession agreement.
- Continue the programmes of increase of energy efficiency of public institutions and government bodies (schools and nurseries, hospitals and health care centres, etc.), as a long-term reduction in budget expenditures.
- Promote energy efficiency within households sector and continue the programmes of subsidising loans for the use of renewable energy sources.
- Rational use of energy in transport and implementation of energy efficiency measures are priorities. Encourage, through the reduction in duties, the use of modern technologies in vehicles that reduce the emissions and/or make valuations according to the level of energy efficiency.

With a view to better utilisation of renewable energy sources, it would be necessary to:

- Continue activities on the valuation of the hydro potential of Montenegro;
- Continue modernization and development of the distribution network, which would allow more stable transmission and easier access to the new projects into the distribution system;
- Improve the distribution network at locations where the construction of small hydro power plants and wind power plants is planned. Provide funds for the construction of auxiliary facilities (electric substation, overhead transmission line);
- Speed up the preparation and adoption of spatial planning documentation for all proposed power plants and simplify the procedures for obtaining construction permits (both at state and local levels) aimed at faster project implementation;
- Adopt a ten-year working program for the development of renewable energy sources;
- Prepare project for the hydro power plants maintenance after the expiration of concessions;
- Accelerate the harmonization of legislation in order to facilitate obtaining the necessary permits for the construction of wind power plants and strive for broader utilization of solar energy and biomass.

## V. RECOMMENDATIONS CONCERNING SERVICE SECTOR

### 1. Tourism

<i>Key recommendations</i>	<i>Implementation deadline</i>
Find a balance between mass and high-end tourism valorisation, as well as price and offer;	Medium
Stimulate investments in the construction of high-end hotel facilities and upgrade the existing accommodation capacities, including small and family hotels	Ongoing
Diversify tourist offer and extend the season	Ongoing
Work on building of the MICE capacities (Meetings, Incentive, Conventions and Congresses, Events and Expositions) in tourism and its promotion	Ongoing
Revitalise rural areas (develop rural, eco and other forms of tourism)	Ongoing
Work on the improvement of road and auxiliary infrastructure (water supply, electricity, waste water, solid waste, parking space).	Ongoing
Work on the improvement of tourist infrastructure (ski lifts)	Ongoing
Continuously raise the quality of Montenegrin tourism through education of new staff and professional development of the existing staff	Ongoing
<i>Main risks</i>	<i>Risk trend</i>
Inadequate competitiveness in prices	Increasing
Short season	Stable
Lack of high-quality hotel facilities and other high-quality commercial accommodation facilities	Declining
Insufficient differentiation of products and services and underdeveloped offer for the target groups of tourists	Stable
Too high reliance of small number of markets	Stable
Inadequate utility and local infrastructure	Stable
Insufficient number of highly qualified domestic staff, particularly management in the tourism sector	Stable

## ***Background***

Tourism globally represents a key for development, well-being and prosperity of the state. Its importance reflects in the appearance of an increasing number of destinations opened for investments, whereas tourism becomes a key driver of social and economic progress, creation of income, opening of new job positions and infrastructure development.

Montenegro's tourism sector, i.e. *accommodation and food* as a comprehensive activity remains the most dynamic and most perspective industry in the entire economy of the State. The association representing tourist agencies and tour operators from 32 European countries, the ECTAA, declared Montenegro favourite destination in 2015.

Montenegro's economy trending largely depends on the movements in the sector of *accommodation and food services* (in the previous classification, title of this sector was *hotels and restaurants*), thus, it is necessary to work continuously on providing high-quality and internationally comparable data and/or information, which would be the basis for high-quality decisions on the future development. Monstat released a series of calculated TSA (tourism satellite accounts) data, such as: GVA of tourism activities, tourism direct GVA, internal tourism expenses, internal tourism consumption, and a variety of other data. Tourism statistics improved due to the availability of statistical data on foreign cruise ships in Montenegro, with a series of nautical tourism data (the number of foreign vessels for leisure, sport and recreation), the introduction of research module on survey on tourist spending of households in Montenegro, and the like.

Tourism is a sector that creates together with other sectors an overall picture of the Montenegrin economy. According to the previous years' statistics, tourism sector has continuously shown good results. In 2013, 1.49 million tourist visited Montenegro whereas 9.41 million overnights were realised which is y-o-y increase of 3.6 and 2.8%, respectively<sup>18</sup>. The Monstat showed that 342.906 tourists visited Montenegro in the first six months 2014, which is y-o-y increase of 1.7%, while 1.7 million overnights over the same period indicated to the y-o-y decline by 0.7%.

The growth in tourist overnights and arrivals are expected also in the following period. However, regardless of the achieved results, we should continue with the more qualitative promotion and valorisation of all resources owned by the state,

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<sup>18</sup> Source: Ministry of Finance, Spring analysis of macro-economic trend and structural reforms – 2014, June 2014

taking into account the provision of equal development of all regions that have tourist potentials. According to the latest estimates of the World Travel and Tourism Council (WTTC) for the upcoming decade (2014-2014), Montenegro is ranked first measured by the increase in direct share of travel and tourism in GDP (8.8% annually)<sup>19</sup>.

Numerous investment that are in the realisation stage or that are being planned will contribute to strengthening of this sector: Porto Montenegro, the resort “Porto Novi“ in Kumbor, Luštica Bay Resort project, Bjelasica and Komovi project, the project of valorisation of the island Lastavica with the fortress Mamula and the like. The opening of the hotel Regent Porto Montenegro is important as it will affect substantially the promotion of Montenegro as a high-end tourism destination.

Program activities related to the development of tourism are defined in the Master Plan according to which Montenegro should become a developed tourist destination with a unique product that is offered throughout the whole year and with a balanced economic development of the north and south, with equal contribution of the increase in revenues from the tourism sector. North region should be strengthened through the use of its natural resources and organisation of numerous tourist activities that will attract tourists.

Despite the progress that has been made in the past, there remain problems in the sector: the lack of offer, transport infrastructure, inadequate number of parking lots, heavy traffic jams during summer season, the problem with waste management and disposal, overcrowded beaches, short season, water supply problems in some municipalities and other. Price competitiveness of tourism has been threatened lately due to high prices in accommodation and also auxiliary services like beach furniture, parking prices, restaurant and cafe services and the like.

### ***Operational measures***

In addition to the progress made in the previous period, Montenegro is still challenged by the deficit in the capacities for high-end tourism development. Therefore, an ongoing work is needed to strengthen tourist image through the diversification and increase in the quality of tourist offer for high-end tourism. This

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<sup>19</sup> WTTC, League table summary

can be achieved by constructing luxury hotels which will have numerous activities and which will be opened throughout the year to attract high income generating guests. The expansion and construction of these types of hotels should be equally presented in all regions of Montenegro. However, the needs of low-income generating guests should also be met through diversified tourist offer.

The development of high quality accommodation facilities and the increase of their share in total capacities should be set as an objective that will enable the increase in adequate use of economic potentials. Hotels and similar accommodation facilities, which should represent the backbone of the tourism industry account for a substantially lower share in relation to the private accommodation (hotels and apartments - 18.1% of beds, and private accommodation 38.4% of the total number of beds).<sup>20</sup> As hotels and similar accommodation facilities generate more revenue per guest, there is a need to build a high-quality profitable hotel sector because the demand on the international market focuses on high-quality hotel accommodation.

As Montenegro aims to develop high-end tourism, it is necessary to improve the existing capacities, complement them with the appropriate content that would meet high expectations of guests, at the same time investing in the construction of new hotels that would fully meet the standards of high-end tourism. Considering that four-star and five-star hotels generate high income and operate most of the year (10.7)<sup>21</sup>, incentives should be created to open more hotels that can gather guests from various countries supressing simultaneously grey economy and non-earmarked use of accommodation.

An enormous natural potential gives a chance to meet requirements of various profiles of tourists. Hunger for adventure, discovering nature through various tourist offers can be important also for high-end tourism. Former hotel facilities both in the coastal and north region have very good position a change to be set in motion again. Re-use these facilities through good investors or through public and private partnership would substantially affect the extension of the season as all regions will be equally attractive throughout the year. Moreover, engagement of additional facilities would significantly influence the increase in revenues from tourism.

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<sup>20</sup> Source: Monstat, Accommodation capacities, by the type of the accommodation facilities, August 2011. Number of beds which is not included in shown results and which refers to: hostels, motels, tourist settlements, camps and the like (See the source)

<sup>21</sup> Specified in the Action plan for the tourist season preparation, p. 19

A significant effort has been made over the past period to promote Montenegrin tourism. However, tourist offer still has seasonal character. Promotion of the tourist product should be intensified towards target groups (hikers, cyclists, divers and tourists who are interested in "wellness", sailing, sport), because this type of Montenegrin tourist offer became distinctive only few years ago. An enormous potential is also found in the development of cruising tourism where additional efforts should be made to build better infrastructure and promote this type of tourism. In addition, it should be continuously work on adequate use of potentials of religious, sports, health tourism, eco and cultural tourism, which may be an incentive for the extension of the tourist season. Tourist offer diversified in such a way, better organisation of pre and post season and adjustment of tourist products to the needs and expectations of tourist i.e. different target groups would enable the extension of the tourist season throughout the year, improve regional development, and increase total tourist spending. An increasing participation of diplomatic and consular representative offices and Montenegrin missions abroad in the promotion of tourist offer should be highlighted.

Since the Montenegrin tourist season is mostly limited to summer - winter contents, developing MICE tourism can represent a significant step towards the prolonging of the season, bearing in mind that travelling takes place mainly during months outside the main tourist season. Significant benefits in the future can be expected from this type of tourism through the construction of higher category hotels, which have the organizational and technical infrastructure for the implementation of certain types of events and gatherings, upgrading of air connections and continuous good promotion.

The continuous revitalisation of rural areas, construction of infrastructure and adequate use of natural resources in the north in particular represent a chance for further tourism development and the expansion of tourist offer. The creation of various tourist offers like agro-tourism, ecotourism and rural tourism are a backbone for the development of underdeveloped regions in Montenegro. The connection of agriculture and tourism, especially through the connection of agricultural farms and tourist offer would create economic and cultural transformation of villages. Joint cooperation of farmers and hotel management would enable better placement of agricultural products and better promotion of our traditional products. It would also affect a reduction of migration and an increase in employment in rural areas with the creation of significant economic benefits.

Human resources are an important element for the tourism sector development. The development of qualified and professional staff should follow the increase in

tourist capacities and diversification of tourist offer. Good cooperation between tourist offer and education system is needed to obtain qualified staff through organised trainings and professional practice that would meet the specific requirements of this industry. Special attention should be paid to the development of qualified staff because they are the ones to present in the best possible way tourist product and overall tourist offer. When it comes to human resources in tourism, certain activities are directed towards providing seasonal labour force, while others relate to defining curricula that will match needs of the tourism industry and the labour force offer in terms of both quality and quantity. Special attention should be paid on the engagement of domestic labour force on seasonal jobs. Implementation of this measure could substantially affect the decline in overall unemployment rate, while specific jobs in the tourism industry would be “left” to experts.

Gradual work on diversification of tourist market is needed as overreliance on small number of markets represents large vulnerability.

The developed transport infrastructure is an important precondition for the tourism development. Problems with traffic and transport infrastructure primarily refer to insufficient and poor quality transport infrastructure and connectivity with certain destinations, traffic jams during the season, long queues at the borders and the like. The resolution of the issue of waste waters and solid waste treatment should be continued, as well as the problems in the electricity supply especially during the tourist season should be resolved. Although the conditions in these segments have improved over the years, continuous investments in transport and utility infrastructures are necessary because they represent important segments that can substantially affect the overall tourist offer of Montenegro.

A study that would position Montenegro in the segment price-quality of offer compared to the most important competitors should be drafted and take adequate measures based on the obtained results.

## 2. Transport

<i>Key recommendations</i>	<i>Implementation deadline</i>
Continue the improvement of the transport infrastructure by using all available financing sources through EU arrangements such as IPA funds	Ongoing
Increase the level of transport safety	Ongoing
Continuous work on the repair of critical points aimed at reducing the number of traffic accidents	Ongoing
Make efforts to ensure regular maintenance of public roads	Ongoing
Modernisation and reconstruction of the existing railway infrastructure in order to increase average speed and diminish traffic delays	Ongoing
Improve cross-border cooperation in railway sector by investing in the expansion in railway	Long
Work on the improvement of intermodal (combined) transport in order to facilitate cargo transport and reduce transportation costs	Ongoing
Continue with the development of maritime transport capacities	Long
Work on the implementation of standards concerning environment protection and minimise negative impact during the realisation of infrastructure projects in this industry	Ongoing
Development and promotion of bicycle traffic	Ongoing
Continue the strengthening of institutional and legislation framework and its harmonisation with the EU directives and requirements	Short
<i>Main risks</i>	<i>Risk trend</i>
The number of road accidents is still high as a result of inadequate level of transport safety in Montenegro	Increasing
Low levels of technical equipping of the infrastructure and staffing in this industry	Stable
Risk of a substantial public debt growth in the case of the highway construction	Increasing
Slower development of tourism due to the inadequate transport infrastructure	Stable
Negative impact of transport on environment	Stable
Weak connectivity of individual types of transport with the region	Stable

## ***Background***

Transport plays an important role in the economic development of Montenegro. Due to its close connection with the development of sectors like tourism, trade, agriculture, forestry and other sectors that contribute to the GDP growth, the need to develop efficient transport system is recognised as one of the key areas for preserving sustainable growth. It also affects the degree of integration of the country, both in regional and wider international environment. Therefore, the construction, modernisation and reconstruction of transport system are very important for connecting Montenegro with the rest of the world. Modern transport includes infrastructure and technology that are extremely expensive, with high fixed costs, long repayment period of investments, and therefore it is often the case that there is no private interest for the adequate development of this industry.

Since Montenegro is in the process of pre-accession negotiations with the EU, it is necessary to have in mind a general objective of the European transport policy, which is reflected in the improvement of the functioning of economic, safe and sound and competitive transport, with an emphasis on environment protection.

Although Montenegro reported positive results in the area of transport infrastructure improvement, it still substantially lags behind the needs of a dynamic economy. Identifying these bottlenecks is of great importance both for the further economic development of the state and the regional integration of Montenegro. In the area of international services, the share of revenues from transport comes second (after the revenues from tourism). According to the latest available data (first six months of 2014), the share of revenues from transport (both cargo and passengers) made up 26.7 percent of total revenues from services. The largest part of revenues refers to maritime and air transport (56.3 percent of total revenues).

The economic crisis has negatively affected the efficient use of transport capacities. However, positive indicators of the majority of transport segments were realised in the previous year and during the first six months 2014. The latest available data (first six months 2014) showed the growth in the passengers and cargo transport in road, railway and air transport, while the decline in port turnover was recorded in maritime transport.

With regard to the railway transport, the Railway Law was adopted and it became effective since January 2014, as well as the Law on Safety, Organisation and Efficiency of Railway Transport. The Railway Law governs the manner and the conditions for organising and regulating railway transport, maintenance and

protection of infrastructure as well as the conditions and the manner of transportation in railway transport. It also defines the obligation of passing Strategy of Railway Development for period of ten years, which will be implemented through the National Programme of Railway Infrastructure. This programme refers to the period of three years and the obligation of passing annual programmes of development, maintenance, reconstruction and modernisation of infrastructure. In the first quarter 2014, the Government adopted a Programme for the construction, maintenance, reconstruction and modernisation of railway infrastructure for 2014. The Programme defined the projects for reconstructing regional highways and motorways in Montenegro, the programmes of reconstruction of crossroads, bridge rehabilitation, landslides, resolution of bottlenecks, construction of the tunnel Tifran on the highway Podgorica-Ribarevine-Berane, as well as the construction of third lanes. The Law on Combined Freight Transport was passed in Q2 2014, fostering the possibility of developing intermodal transport, by setting out specific incentives in the form of releasing from annual fees for using public roads, and exempting from specific permissions and limitations.

With a view to realisation of the most important road transport infrastructure project in Montenegro, the Contract on design and the construction of highway route Smokovac-Uvač-Mateševo between the Government and the Chinese company has been signed, as well as the Bill on the Highway Bar – Boljare. The project is important for connecting the Montenegrin coast with the north, and via border with Serbia, connecting with the central Europe, which would directly affect the equal development of all regions, tourism, the use of natural potential and the development of total economy, while the Law should regulate the realisation of the project, exemption from VAT, customs duties on the equipment and facilities for the construction of highway and other issues referring to construction permits, preparation works, taxes, fees for quarries, and the like. With a view to aligning Montenegrin legislation with the *acquis communautaire* in the area of road transport, the Law Amending the Law on Road Transport was passed, It, *inter alia*, protects the transporters licenced by the relevant authorities to perform local and commuting transport, clearly defines the taxi transport to eliminate illegal competition to licenced bus transporters, and introduces the “shuttle” transport as the new means of transport as transport of passengers from the airport to town centre and/or hotel.

Progress has been made in maritime transport. After the purchase of two boats in 2013, and in order to increase commercial fleet for the needs of AD “Barska Plovidba) two additional boats were purchased in 2014 which delivery is expected

by the end of the year. These investments will strongly contribute to Montenegro's maritime industry's impact to the state's economic growth.

There were tangible results in environment protection. Since maritime industry is one of the largest environment polluters, the Law Amending the Law on Protection of Sea Pollution from Sea-going Vessels was adopted. The objective of the Law is to reduce and prevent the pollution of the seas from vessel's displacement of different liquids or indirectly through the atmosphere. The law has introduced more severe penalties from 1,000 to 40,000 euros. Passing of the Law is aimed at full compliance with international regulations in this area. The Law on maritime safety was also adopted, and it regulates maritime transport safety measures to ships, sailors and other participants in maritime activities, as well as actions of searching, rescuing, piloting, and inspection.

With the adoption of the Master Plan for a state-owned company Airports of Montenegro by 2030, the Government has defined a strategy for the development of the airports' infrastructure in order to improve the capacity and quality of services in air transport. The plan includes the implementation of a set of development airport capacities, which will provide safe, sound and environmentally responsible air transport, based on relevant environmental standards. Analysing the current state of affairs in transport infrastructure, the Government adopted the Information on priority development projects in transport in February 2014 that, inter alia, defines priority investments from the Master Plan.

Regarding the safety aspect, it is important to note that the situation on Montenegrin roads is still troublesome, with significant number of traffic accidents, dead and injured persons in road transport. Although the number of traffic accidents trended down in the period 2010-2013, the number of dead persons was still high. The number of traffic accidents decreased by 35 percent relative to 2012, but the number of injured and dead persons increased by 5.2% and 60.9%, respectively. According to preliminary Monstat data for the first six months of 2014, the number of traffic accidents increased by 13.3%, while casualty accidents increased by 6.4% compared y-o-y. A 2013 Action Plan for the implementation of the Strategy for Road Transport Safety Improvement was adopted. Bearing in mind that road transport safety is one of the fundamental elements of the transport system quality, the Action Plan envisages the continuation of reconstruction and repair of critical points, construction of third lanes, removal of bottlenecks, rehabilitation of bridges, landslides and slopes on public roads, construction of tunnels, which would create conditions for safe transport, reduction of traffic accidents and risks for passengers.

Although the evaluation of achieved results in almost all areas of transport was positive, they need further investments due to the fact that, according to the latest available data, the gross value added of this activity (transport and storage) in the total GDP amounted to 4.7 percent in 2012. It is necessary to improve transport safety, ensure a more efficient use of the existing capacities, transport services quality, development of transport infrastructure in line with the economic development needs, further implementation of investment projects, and better connection of Montenegrin transport system into the Trans-European Transport Network.

### *Operational measures*

With a view to improving this activity, it is necessary to constantly work on eliminating transport deficiencies, namely: complete the reconstruction of initiated sections of motorways and regional roads, modernize traffic signals in order to raise the level of traffic discipline, eliminate hot spots in the affected areas, as well as address the problem of bottlenecks.

Make a list of priorities in the choice of investments in this area, and complete the necessary project documentation to be able to take advantage of the EU funds or to make private investors interested in private-public partnership.

It is necessary to improve the maintenance of the busiest roads in the country. Extensive precipitations in Montenegro during winter lead to the creation of landslides, mudslides and escarpments in the affected areas. The experience of the countries in the region affected with floods in 2014 additionally warns to problems that bad weather conditions may cause to the transport infrastructure.

Reforms are needed in the area of infrastructure, particularly road infrastructure, in all municipalities. Construction of the highway and improvement of motorways, regional and local roads in Montenegro would have multiple benefits, from the assistance in goods transport, through increase of the sea ports' and airports' importance and value, to easier travel of tourists throughout Montenegro both in summer and winter tourist season. Moreover, improved road infrastructure would enable better connection with the countries of the region. For that reason, particular precautionary measure might be timely rehabilitation of identified risks and providing adequate transport equipment in the case of natural disasters.

In order to eliminate traffic jams on roads, particularly during the summer season, it would be necessary to find the best manner to finance already recognised projects for constructing roundabouts in large coastal towns, construction of passenger bridges at the places with the most frequent number of tourists. Moreover, with a view to providing better connection of all regions, the introduction of bus transport from Podgorica and Tivat airport to all municipalities should be introduced, which would have positive contribution to the tourist offer.

Railway infrastructure should be improved and the already started projects continued by investing, and investments should be made into railway connections in order to increase the average speed and reduce delay in transport, particularly in extreme winter conditions. With a view to improving railway transport and better connection with the neighbouring countries the construction of regional railways should be considered.

Take advantage of the signed ECAA agreement (European Common Aviation Area) by continuing activities related to the opening of new air lines, which represent the economic benefit of tourism and promote Montenegro as an attractive tourist destination.

Continue implementation of the Master Plan for the development of the state-owned company *Airports of Montenegro*. Continue the investments in the modernization of Montenegrin airports. It is necessary to provide all the necessary conditions for the smooth functioning of air transport during bad weather (heavy snows, ample precipitations, fog). Realise priority investments from the Master Plan referring to expanding and reconstruction of manoeuvring surfaces on both airports and the apron at the Tivat Airport, and the construction of new terminal building for expanding capacities at the Tivat Airport due to higher interest of tourists for arrivals through this airport.

In the maritime transport, Montenegro should continue progressing towards becoming a full member of the Paris Memorandum (Paris MoU - The Paris Memorandum of Understanding on Port State Control), which involves the harmonization of the inspection of navigational safety with the Paris MoU. The membership will contribute to the decrease in the number of sailed in vessels that do not satisfy safety standards, and to increased degree of sailing safety as well as to environment protection.

The sale of the Container Terminal and General Cargo Bar resulted in common interests with the new owner on positioning the Port of Bar as a cruising destination. Since this position resulted in port's better position to gain the primacy for developing cruising tourism, investments are needed into adequate infrastructure for the reception of passengers, increase in the number of births, infrastructure for collection of waste and waste water, and the like.

Since Montenegro has the infrastructural conditions for using combined transport and that the Law regulating the area was passed, it would be necessary to improve possibilities for its development. It would be necessary to construct new and reconstruct the existing terminals for combined transport at the railway stations, which will foster further development of the transport to the most important transport directions. The share of this type of transport in total transport is rather low, and its development and promotion would be a significant comparative advantage for the state.

Given the negative impact of transport on the environment, ecological cycling should be promoted as a healthy lifestyle. Bearing into mind that the of bicycle parking project has been initiated, funds for the construction of cycling lanes should be sought, which would contribute to reduction of traffic jams, and decrease of household budget costs

Continue the process of harmonization of the national institutional and legal framework with the requirements and standards of the European Union, and strengthening of administrative capacities for their implementation. In that direction, it would be necessary to provide additional implementation of safety conditions and technical rules in road and maritime transport, and interoperability rules in railway transport.

## VI. RECOMMENDATIONS CONCERNING EDUCATION AND LABOUR MARKET

### 1. Education

<i>Key recommendations</i>	<i>Implementation deadline</i>
Involving all institutional and individual stakeholders from the educational system in activities defined under the educational strategies to achieve the goals of the reform	Short
Developing cooperation between educational and labour market institutions	Ongoing
Developing standards of education in accordance with the principles of the National Qualifications Framework and on the basis of information on the labour market needs	Short
Keeping enrolment policy that allows a reduction of the structural imbalance at the labour market	Ongoing
Encouraging and recognizing scientific-research work in higher education institutions	Ongoing
Developing connections with foreign educational institutions and inclusion into international science-research projects	Medium
Developing and promoting the concept of lifelong learning	Ongoing
Involvement of local governments, employers' representatives, business associations and other NGOs in activities of the education reform	Short
Involving organizations dealing with social inclusion in the education reform activities	Short
Supervising and controlling the implementation of reforms at all levels of education by comparing indicators of achieved and planned results at all education levels, with the key role being that of the Ministry of Education	Ongoing
<i>Main risks</i>	<i>Risk trend</i>
Lack of financial resources due to the economic crisis for the full implementation of planned activities	Increasing
Lack of trained and motivated staff in the education system for the realization of the planned tasks	Stable
Inadequate education programs which are not in line with the labour market needs	Stable
Insufficient cooperation of partners in the education process (educational institutions, local administrations, entrepreneurs, NGOs)	Stable
Extensive approach in transferring knowledge to the participants in the education system (the traditional method of presenting the subject, without building skills and inelastic with respect to changes and demands of the labour market), learning by reproducing the content	Stable
Lack of representation in the educational process of the scientific-research work	Stable
Lack of material and technical equipment of educational institutions	Stable
Financing university units by increasing the number of students paying education – development of quantity to the detriment of quality and labour market needs	Increasing
Delay of the education system reform to meet the labour market needs	Increasing

## ***Background***

Reform of the education system in Montenegro began in 2000, and the adoption of so-called “Book of Changes of the Education System of Montenegro” sets out the vision of education, directions and goals of strategic development.

The content of the reform is defined in the key documents/strategies: from preschool through elementary and vocational to higher education. All documents mean strategic development directions, which are realised through action plans in the defined period.

Significant improvements have been made despite complex demands of the educational reform in the initial phase, confirmed by reports of the competent representatives of the Union responsible for the analysis and monitoring the state of affairs. This is particularly important bearing in mind that this is a long-term process in one of the most important areas – the social-economic development pillar of each modern community with rather wide application.

In addition to the other ones, the following important strategies in the area of education are currently implemented in Montenegro:

- Strategy on the Development and Financing of Higher Education in Montenegro (2011-2020),
- Strategy for Development of Vocational Education of Montenegro (2010-2014),
- Strategy of Early and Preschool Education (2010-2015),
- Strategy of Inclusive Education (2014-2018),
- National Lifelong Career Guidance Strategy (2011-2015).

In addition to these, a set of other activities is being realised, these being directed to creating a quality, functional and decentralised educational system.

Services of experts engaged in different EU programmes were used at all educational levels. They provided necessary knowledge and professional support for the realisation of reform objectives. Their services were mostly financed from the Union funds, earmarked funds, grants, and partially from domestic sources.

Since 2011, Montenegro has been using the Tempus Programme through which some 7 million euros were invested into university education. It has established the

platform for cooperation among Montenegrin university education institutions and institutions from the region and the EU, and with representatives of the economy and civil sector. So far, Montenegro participated in 38 projects, with 26 being currently realised. Participation in these projects contributed to improved academic and administrative capacities for managing the EU projects. According to Ministry of Foreign Affairs and European Integration data, so far 270 scholarships were realised through the Erasmus Mundus Programme (supplement to the Tempus Programme) and more than 2.5 million euros were utilised for student mobility.

A memorandum of understanding was signed in May 2013 on the participation of Montenegro in the centralised actions under the EU Lifelong Learning Programme.

Signing of the Agreement between the EU Montenegro on participation in the *Erasmus+* Programme was proposed in June 2014. The main objective of the *Erasmus+* Programme is support to boosting individuals' skills and employability, and to modernizing educational system and training, thus funds for knowledge and skills development increased significantly – to 14.7 billion euros to the period 2014-2020.

The capacities of the academic and administrative staff in some higher education institutions have been improved through the cooperation and implementation of projects with higher education institutions in the European Union. Procurement of modern equipment and new teaching aids has substantially improved the working conditions.

The lower educational level institutions in Montenegro also recorded positive trends. In addition to the improvement of teaching capacities through different forms of trainings and professionalization of knowledge, new schools and premises have been constructed, many school facilities were repaired, and significant efforts were made in meeting concrete tasks according to planned strategies. Schools procured IT and other cabinet teaching equipment, as well as increasing number of books in libraries significantly. The Agency for teaching books and facilities prepared books for children with disabilities and the Guideline for teaching in line with the IDEP (Individual development-educational programme). Books were also printed at the Braille alphabet for visually impaired children.

With a view to affirming highly lacking professions from secondary vocational education, the Ministry of Education and the Chamber of Economy awarded 61 scholarships to first-year pupils educated at three-year curricula, which need has been shown by the labour market (construction, agriculture, hotel management,

electrical-technics, car mechanics). The Municipality of Bar also awarded 10 scholarships to pupils educated at the hotel management curricula.

The EAM prepared the analysis whether the number of enrolments for specific educational profiles should be increased, decreased, or remain unchanged relative to the previous year.

Since the start of the reform, the number of pre-school institutions, children and employees significantly increased. Thus, the number of educational units increased from 69 (in the 2000/2001 school year) to 119 (in the 2013/2014 school year), which followed the increase in number of employees (from 1,173 to 1,709) for the reception and stay, pre-school education and attainment of 11,946 children (in the 2000/2001 school year), i.e. 116,461 children (in the 2013/2014 school year).

High attention is paid to inclusive education, socialisation needs and preparation for education and employment of persons with specific forms of disability and/or special needs. Entrepreneur centres have been established in three secondary schools in the north-east of Montenegro.

Within the activities referring to the education of persons from marginalised groups, due attention was paid to representatives of the Roma, Ashkelia and Egyptian (RAE) population and their inclusion into the educational system. RAE population children have been provided with the books for the first educational cycle (I-III grade), free transport (140 children) from the place of their residence (Konik Camps I and II) to six schools in Podgorica Municipality, and the children in the Konik Camp (Podgorica) with the largest RAE population receive free school accessories.

Of the important events, it would be important to note that the set of systemic laws in the area of education was passed in 2013: General Law on Education, Law on Primary Education, Law on Gymnasiums, Law on Vocational Education, and Law on Tertiary Education, which follow the necessary reforms. Although education and culture is one of rare areas where there is no strict legislation, and the Member States retain their sovereignty and the right to individually regulate educational policies, the abovementioned amendments to the legislation simultaneously mean the compliance of our legal system with the *acquis*.

The implementation of the Higher Education Research for Innovation and Competitiveness Project (HERIC), an important project financed from the World Bank Loan through the Ministry of Science and Ministry of Education, started in

2013. The objective of the Project is to strengthen the quality and relevance of higher education and research in Montenegro through reforming the higher education finance and quality assurance systems and by strengthening research and development capabilities.

Moreover, Montenegro joined the EU Framework Programme for Research and Innovation – Horizon 2020. It is a continuation of the EU Seventh Framework Programme for research and technological development (FP7). This is the largest EU programme for research so far, with the budget of 77 billion euros. The objective of the Programme is to provide competitiveness of the entire European Market by strengthening economic growth in Europe and opening new jobs, based on higher investments into science and research.

In addition to advantages, the current situation has the following disadvantages:

- The number of students in Montenegro has constantly been increasing. Compared to 2003 (when Montenegro joined the Bologna process) the number of students increased 8 times, significantly affecting the structural imbalance between the offer and demand at the labour market.
- Over 80 percent of high school graduates continue their education at higher education schools instead of entering the labour market, which is resulting in the inability to meet the needs of the labour market. This resulted in hyper-production of some professions with high shortfalls for some lacking personal due to low interest for some crafts, which is compensated by engaging foreign labour force. This shortfall is present in strategic development branches, like tourism, construction and agriculture.
- Higher education enrolment policies are not in line with the labour market needs.
- Education quality in Montenegro is very different, both at the level of higher education institutions and at the level of different study programmes in same higher education institutions. The situation is the same in the lower education levels.
- Academic units are being established apparently without enough critical appraisal of the possibilities of their sustainability over the long term, both in personnel and material-financial terms;
- Scientific research is underrepresented in the higher education process.
- The concept of lifelong learning is still not sufficiently promoted and developed.
- International cooperation and academic mobility is not satisfactory.
- Teaching staff at all education levels is not fully competent.

- The results on PISA tests pointed to specific drawbacks of the education system in Montenegro. The Action Plan for improving pupils' results at the PISA tests 2014-2018 was passed.
- There are no precise standards referring to knowledge checks and therefore rather different assessment criteria are being applied in practice.
- Insufficiently developed Information system in education.
- Insufficient inclusion of children from marginal groups (RAE population) into the education system and insufficient awareness of their parents on the importance and legal obligation to attend school.
- Insufficient cooperation of educational institutions with local administration.

### *Operational measures*

The aim of the reform is to develop an effective quality system of education and research that will enhance the social and economic development of the society, respecting the principles of citizens' equality.

The education reform implementation in Montenegro requires respecting planned tasks and deadlines set out in the abovementioned strategies i.e. implementing action plans as realistic as possible.

In this regard, in order to achieve the objectives it is necessary to:

- Work continuously on securing and improving the quality of the higher education primarily, and of other educational levels.
- Connect vertically and horizontally different education levels or enable mobility and advancement of knowledge through a compatible connection between the education levels.
- Develop standards of education, which will enable the accurate comparison of educational qualifications and verification of education acquired in a formal and informal way.
- Strive for linking higher education and the labour market and increasing entrepreneurial-innovative characteristics of education.
- Continuously adjust enrolment policy to the labour market needs to avoid hyper production of hard-to-employ population and reduce structural imbalances at the labour market.
- Create realistic assumptions for increasing the participation of the population with the higher education, so that the share of this population aged 30 to 34 would be at least 40 percent in 2020.

- Develop a lifelong learning model based on good international practice.
- Develop a research-oriented higher education. Increase funds for this purpose. Use the funds available from foreign sources, with full respecting and meeting required criteria.
- Permanently materialise theoretical and practical knowledge of the teaching staff at the all educational levels.
- Contribute to the promotion and encouragement of mobility and interests of teachers and students to use training opportunities and professional development abroad.
- Participate largely in the research projects of foreign educational institutions to gain knowledge and experience.
- Develop the cooperation of educational institutions with local representatives of the Montenegrin Employers' Federation and the Montenegro Chamber of Skilled Crafts and Entrepreneurship to create educational programmes based on the real labour market needs and the affirmation of occupations provided by secondary vocational education. Increase funds for informing primary school pupils and their parents and for popularisation of crafts.
- Develop cooperation with all institutions dealing with social inclusion and create the material and technical conditions for increasing participation in the education system and social inclusion of persons belonging to this category.

There is a need for a continuous control and coordination of activities of all participants responsible for the implementation of reforms that should be implemented by the Ministry of Education. It is necessary to make the requirements for establishing a faculty and for the control of their work more severe. Therefore, this raises the issue of the quality and the level of knowledge offered by faculties having only a few permanently employed professors.

Given the large number of institutions engaged in informal education, it would also be useful to carry out the accreditation of these institutions.

## 2. Labour market

<i>Key recommendations</i>	<i>Implementation deadline</i>
Substitution of foreign labour force with the domestic one	Medium
Aligning educational system with the labour market needs	Ongoing
Developing cooperation with employers and intensifying their involvement in the active employment measures programmes	Ongoing
Raising employers' awareness on opportunities of hard-to-employ population at the labour market	Ongoing
Increasing the funds for the realisation of active employment measures performed by the EAM at the labour market	Short
Developing training programmes, retraining and additional qualification of unemployed workers	Short
Continuation of stimulating the employment through employment financing programmes provided by the EAM	Short
Developing programmes and active employment policy measures to favour employment in the northern region	Short
Stopping the migration of active population from the northern region	Medium
Adopting the demographic development strategy	Short
Providing inclusion and socialisation of hard-to-employ population	Medium
<i>Main risks</i>	<i>Risk trend</i>
Structural mismatch of the labour force supply and demand	Stable
Problem with the evident shortage of staff with a high school diploma	Stable
Unresolved status of a large number of business entities in Montenegro whose accounts are frozen	Increasing
Limited resources for active labour market measures	Stable
Reduced potential for the creation of new jobs as a result of slower economic growth	Stable
Regional unemployment	Increasing
Low level of activity, especially among the persons with university degree	Increasing
High share of long-term unemployed persons	Declining
High rate of youth unemployment	Increasing
Increased employment of foreign labour force to the detriment of the domestic one	Stable
Large volume of unregistered employment	Declining

## ***Background***

The global economic crisis has significantly affected the labour market. This can be sustained by the trends at the labour market, which is still exposed to the negative consequences of the crisis and recovers slower than other markets.

Basic features of trends and condition at the labour market are: high long-term unemployment; high unemployment of young persons; clear disproportion between supply, demand and employment; seasonal nature of employment; a substantial increase in the number of unemployed university graduates; relatively large numbers of foreign workers, large regional differences in unemployment and a large number of unemployed persons who are considered as a category difficult to employ.

According to the latest available data from the Labour Force Survey (Monstat) fundamental developments and condition at the labour market in the period 2010 - 2013 are reflected in the following:

- Activity rate of the population aged from 15 to 64 years ranged from 59.3% (2010) to 58.9% (2013). For men, the rate ranged from 67.1% to 65.1%, while among women the rate ranges from 51.7% to 52.8%. There is a disturbingly low level of activity.
- The employment rate in the same period ranged from 47.6% to 47.4%. For men, this rate ranged from 54.3% to 51.9%, whereas for women it ranged from 41% (40.7% in 2011) to 42.8%. The employment rate should also be higher.
- The unemployment rate slightly changed from 19.8% (2010) to 19.9% (2011 and 2012) and fell to 19.6% in 2013, with an estimate of 48.8 thousand of unemployed persons.
- Activity rates of employment and unemployment of young people (15-24 years) in this period best illustrate the negative situation. Namely, the activity rates were ranging from 25.1% (2010) to 23.2% (2013). Employment rate is very low - about 13.5%, while unemployment rate is extremely high: at the beginning of the period it amounted to 45.5%, while at the end of the period it amounted to 41.6% (about 8.4 thousand unemployed persons).

In particular, high unemployment of qualified young persons - university graduates increased in 2013 (from 20.6% to 27.16%). In November 2013, the Government adopted an Action plan for Youth Employment in 2014.

On the other hand, according to the Employment Agency of Montenegro, the total number of registered unemployed persons at end-2013 amounted to 34,514 or 10.5% more compared to 31,232 unemployed persons registered at end-2012. The share of women in overall unemployment increased from 47.4% to 48.8% (due to the increase in their number, from 14,812 to 16,855).

The difference between the estimated (Labour Force Survey - Monstat) and the number of registered unemployed persons (the Employment Agency of Montenegro) amounted to 14.3 thousand persons or 41.4% of the registered number.

Unemployment of young persons increased, namely: up to 25 years by 13.7% (from 6,204 to 7,058), in the age group from 25 to 30 years by 35.2% (from 4,947 to 6,688), while the number of unemployed persons of over 50 years decreased by 3.7% (from 9.626 to 9.270).

At the same time, long-term unemployment declined (persons who are registered as unemployed over one year). At end-2013 it was by 0.8 index points lower than at end-2012 (55.7% - 56.5%).

The economic crisis has caused a drop in demand at the labour market. This is reflected in the lower number of job vacancies, as a result of the reduced volume of activity. Thus, after returning to the positive trend of increased advertising of job vacancies in 2011 and 2012 (from 39,168 in 2010 to 44,958 and 45,323), job vacancies as an expression of absorptive power of the market or employment opportunities reduced by 16.5% in 2013 compared to 2012. The largest decline - 54.3% was recorded in job vacancies for persons with high education (4,505 - 9,851). This is explained by the fact that employers are able to take advantage of free engagement of university graduates in a wide program of professional education for persons who acquired higher education. At the same time, there was a decrease in job vacancies for persons with secondary education (14.6%), while for semi-qualified labour force recorded nearly three times higher demand (8,038 - 2,772).

In 2013, there was a fall in employment through the Employment Agency. A total of 15,021 persons were employed. Compared to 2012, when 21,704 persons were employed, this number declined by 6,708 or 30.8%. These numbers do not include university graduates, employed in accordance with the vocational education

program for persons with high education. Thus, overall, real employment in 2013 amounted to 18,947 persons, or 12.3% less in relation to the previous year.

However, according to Monstat average number of employees on a monthly basis in Montenegro in 2013 amounted to 171,474 or 3.0% more than the average number of employees on a monthly basis in 2012. In 2013, compared to 2012, most sectors (fifteen out of the nineteen) increased the number of employees. Observed in sectors, the highest growth was recorded in administrative and support services sector (33.1%), followed by agriculture, forestry and fishing (10.6%) and accommodation and food services (8.5%), while the largest decline in employment was recorded in the sector of electricity, steam and gas (2.0%) and manufacturing industry (1, 2%).

The number of employed foreigners, which grows over years, represents a significant feature of the labour market. In 2013, the Employment Agency of Montenegro issued 8.6% more work and employment permits for foreigners in relation to the 2012 (22,498 – 20,712).

Several strategies relating to education and preparation for the employment are ongoing. They will have a long-term direct or indirect impact on labour market trends. These are all strategies in the area of education, the National Strategy for Employment and Human Resource Development 2012-2015, National Strategy for Lifelong Career Guidance 2011-2015, four local employment strategies in Berane, Mojkovac, Bijelo Polje and Pljevlja. The implementation of the Strategy for the Development of Small and Medium Enterprises 2011-2015 is ongoing.

### ***Operational measures***

National Strategy for Employment and Human Resources Development 2012-2015, which is in progress, aims to create better conditions for job vacancies and investment in human capital in order to raise the level of employment and improvement of the economic competitiveness of Montenegro. In this regard, it is necessary to ensure continued financial, technical, staff support in meeting the priorities of the Strategy. In particular, it is necessary to work on the development of programs and measures of active employment policy which will encourage the employment in the northern region, in order to stop the negative demographic trends. Therefore, it is necessary to adopt a strategy of demographic development.

In Montenegro, there are many foreign workers while, at the same time, there is a high number of unemployed persons. There is a need to limit the inflow of foreign labour force for those professions that can be performed by domestic labour force. At the same time, there is a need to provide substitution of foreign labour force by the domestic ones, through additional training and retraining programs.

For more than 15 years, the Employment Agency is implementing various programs of active employment policy measures with significant positive impact for the participants and the labour market.

The Employment Agency operates through the work with school youth (preventive work since they are not included in the work processes yet), with unemployed persons and employers, as well as those who are employed but since they have a redundancy status they lose employment status or intend to change business. Special attention is devoted to the multidisciplinary approach in dealing with difficult-to-employ persons.

In order to improve the skills of the labour force, it is necessary to promote the concept of lifelong learning and improvement. It is necessary to open more Centres for information and professional counselling (CIPS) which would increase the availability of career guidance services in all municipalities and to increase the number of professional associates in those Centres.

It is necessary to encourage cooperation between corporate sector and institutions of formal and informal education.

Aimed at improving labour market and approaching contemporary practice, it is necessary to promote flexible forms of employment through: part-time employment, contract for working at home, etc. This would reduce illegal and create regular employment.

In order to continuously stimulate employment and entrepreneurship, it is necessary to introduce tax relieves and incentives for new investments and employment in underdeveloped regions and municipalities.

Due to poor participation of persons with disabilities in the labour market it is necessary to further motivate employers to hire difficult-to-employ persons, disabled persons and others, through active employment policy programs in order to increase their employment and social engagement. It is necessary to strengthen the awareness of employers to strive to employ difficult-to-employ persons to the

extent possible, as determined by the professional commission, to include them in work processes. This would change the common practice for employers to settle their largely prescribed liabilities in cash.

## VII. RECOMMENDATIONS CONCERNING FISCAL POLICY

<i>Key recommendations</i>	<i>Implementation deadline</i>
Continue with the consolidation of public expenditure and restrictive fiscal policy	Ongoing
Gradually decrease the share of the current budget and increase the share of the capital budget	Ongoing
Prepare a new Public Debt Management Strategy, which would include debt repayment plan and an updated projection of public debt sustainability	Short
Extremely restrictive approach to the issuance of new state guarantees	Short
Continue strengthening fiscal controls and further strengthening of mechanisms of internal and external audit of all budget expenditure units	Ongoing
Increase control and transparency of financial operations of local governments' units	Ongoing
Find mechanisms to reduce debt of local governments' units	Short
Increase control the operation of state companies, in order to reduce negative outcomes and transfers of budget resources	Ongoing
Continue activities on combating shadow economy	Ongoing
Intensify activities aimed at reducing the amount of tax debt	Short
Intensify activities in order to improve the tax culture of taxpayers, increase fiscal discipline and reduce tax evasion	Short
<i>Main risks</i>	<i>Risk trend</i>
Continuous budget deficit	Declining
Continued growth trends in public debt and issued guarantees that may jeopardize fiscal sustainability	Increasing
Financing or co-financing of large infrastructure projects (additional burden on the fiscal position and fiscal sustainability jeopardizing)	Increasing
Expensive and limited financial sources	Stabile
Realization of state guarantees	Increasing
High illiquidity of the economy	Increasing
Failure to implement the projected growth rates	Increasing
The emergence and spill over of new exogenous shocks due to the development of instability in the Euro area	Stabile
Social pressures and negative demographic trends	Stabile

## ***Background***

Implementation of the measures by the Government of Montenegro adopted in 2013 as additional consolidation measures (freezing pensions, further reducing of a part of discretionary expenditures and introducing higher rate of income tax for earnings above the average) continued in 2014. These measures have been implemented in order to increase budget revenues, and consequently reducing the budget deficit and establishing long-term sustainability of public finances.

The objective of fiscal policy is the consolidation of public finances with the priority of reducing budget deficit through the increase of revenues, as well as rational use of allocated funds that, along with reducing the risk of issued guarantees activation in the previous period, will contribute to the change of the public debt trend.

The implementation of the Law on Amendments to the Law on Personal Income Tax started as of 1 January 2014, and these amendments prescribe that a taxpayer who carries out certain activities<sup>22</sup> cannot be granted the right to pay the annual lump sum. In this regard, the taxpayer who paid tax in a lump sum during 2013, and continues to perform this activity in 2014 was required submit to the Tax Administration income estimation for 2014 by 15 January 2014, for the calculation and payment of monthly advance payment of tax on income from self-employment activity for this year.

In April 2014, the Law on Budget and Fiscal Responsibility was adopted, which, among other things, regulates the planning and execution of the budget, loans and guarantees. The law aims at improving the overall system of public finances and the harmonization of regulations pertaining to the field of public finance with the relevant regulations of the European Union. In accordance with the EU acquis, it introduces the numerical fiscal rules institute, medium-term budgetary framework, fiscal strategy, inspection and appropriate penalties. The Law prescribes introduction of fiscal rules including the budget deficit of 3% of GDP and the level of public debt of 60% of GDP. It foresees the introduction of penal liability, which in the case of violations of the law prescribes fines from 200 to 4,000 euros. The Law on Budget and Fiscal Responsibility provides further improvement of the

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<sup>22</sup> Lawyer, notary, auditing, accounting, healthcare, consulting, project activities and the activities of the surveyor, public officers, other professional and intellectual professions, hairdressers, billiard clubs, entertainment, gaming, retail and wholesale, catering, hospitality, financial intermediation and real estate activities, except for trade and catering activities carried out on the counter, in a temporary facility, other prefabricated or mobile facility.

public finance system by strengthening fiscal accountability, transparency and medium-term and long-term sustainability of public finances.

In parallel with the policy of fiscal adjustment, activities were intensified in combating shadow economy. The proposal of the Action plan for combating shadow economy for 2014 is prepared. It is designed according to the following activity areas: legislative activities, operational activities, strengthening of institutions' capacities (IT, human resources), cooperation and education. Aimed at eliminating unfair competition and weakening the competitiveness of companies that operate legally, the Commission for combating shadow economy will continue its activities. The fundamental commitment of the Commission in the future will be zero tolerance rates respecting the principle of non-selectivity and full transparency, with the application of stricter penalty policy. Having in mind the context of the crisis and liquidity problems of a large number of tax debtors, significant efforts are focused on collection of residual tax debt.

In 2014, there was an increase in public debt, which, according to preliminary data of the Ministry of Finance, at the end of the first half of the year reached a level of 57.5% of GDP. By the end of 2014, further increase in debt is expected due to the need for additional funds in order to pay certain liabilities and cover the deficit for 2014. Expensive sources additionally burden future servicing of liabilities and potentially create fiscal instability factors. Also, it is certain that in the years when Eurobond issue mature (2015 and 2016) there will be a need for new borrowings, because the total amount will not be possible to pay out regular income, which will cause the growth of state debt also in the coming years. However, the encouraging fact is that the growth of public debt slowed down considerably.

Bearing in mind that guarantees represent potential public debt, very cautious and restrictive approach is necessary in the next period with respect to the issuance of new guarantees.

It can be concluded that serious and comprehensive fiscal consolidation measures, that gave positive results, have been taken. They are visible primarily in the reduction of the budget deficit, reducing shadow economy and slowing growth trends in public debt.

## *Operational measures*

In the forthcoming period, it will be necessary to create pre-conditions for stronger growth through fiscal consolidation and increased level of fiscal sustainability, which can be achieved through continued implementation of structural reforms, further reducing of business barriers, as well as through the implementation of significant projects in the sectors of tourism, energy and agriculture and infrastructure development.

In order to reduce public expenditure, it is necessary to conduct a thorough analysis of all budgetary expenditure position within the current budget. In this regard, it is important to continue with strengthening of fiscal controls of all expenditure units, as well as control of financial affairs of state companies.

Activities relating to recording obligations of expenditure units on an accrual basis should be finalised, which means transition to accrual accounting which provides an overview of obligations of all units in real time, with the aim of more efficient resources management, as well as their planning.

Expenditure of the government administration still represents a high expenditure category in the budget. Therefore, it is necessary to control and ensure effective implementation of the Human Resources Plan, which defines restrictive employment

Financial viability of the Pension and Disability Insurance Fund is an important fiscal consolidation. Pensions represent about a third of fiscal expenditures and slightly more than 11% of GDP. Despite well-designed reforms in this area in the past, demographic structure and increase the number of pensioners represents a risk. In order to reduce the deficit of the Pension and Disability Insurance Fund, it is necessary to find a model for ensuring a higher level of sustainability of the pension system.

The public procurement system represents an area for savings, reduction of unnecessary expenditures and setting priorities, by which full implementation these advantages would materialize. Accordingly, it is necessary to promptly adopt the Law on Amendments to the Law on Public Procurement in accordance with the relevant EU regulations, in order to introduce centralized public procurement system.

In order to maintain macroeconomic stability and ensure fiscal sustainability, special attention should be focused on stopping of the public debt and issued

guarantees growth trend. The problem of state debt is an important issue that needs to be prioritized in future.

It is necessary to prepare a new Public Debt Management Strategy, which would include debt repayment plan and an updated projection of public debt sustainability. It is necessary to maintain a policy of high share of debt with fixed interest rate, as well as the dominant borrowing in euros with those institutions with which the selection of borrowing currency is possible.

Solutions created by the EU document “*Six pack legislation*” should be implemented, which refers to the treatment of extreme fiscal policy imbalances, in order to ensure long-term balance of the budget, and also to apply the requirements of the EU acquis in this area.

In addition to the analysis of public expenditure, adequate management and maintenance of the continuity of effective control of the budget revenues is of great importance.

It is necessary to continue with the stricter implementation of the Law on the Prevention of Illegal Business, in order to reduce the level of the shadow economy, which will provide an increase in budget revenues and reduction of the level of tax debt. Also, it is necessary to continue with the implementation of an effective collection of public revenues with increased control of the taxpayers and implementation of all legal measures to taxpayers who do not pay their obligations in accordance with applicable regulations. That is, it is necessary to increase the taxpayers discipline and define the penalties for repeat offenders.

Complete the activities necessary for the adoption and implementation of the Public-Private Partnership Law in order to maximize the effectiveness of limited strategic resources-capital, both in the public and private property.

It is necessary to establish a transparent database of projects that are related to the budget, in order to achieve a quality analysis of fiscal risks, which would primarily assist the effective decision-making process when making decisions on priority investment projects. In accordance with the annual budget law, monitoring of implementation of investment projects initiated in order to monitor expenditure of planned funds should be reinforced. A detailed analysis of every big infrastructure project is necessary in order not to endanger the fiscal sustainability.

Over the past few years, the Central Bank pointed to the need to implement the OECD guidelines regarding transfer prices related to tax evasion. International

companies often avoid tax burden using the system of transfer prices in cross-border transactions. They transfer profit, through this mechanism, in a country where tax rates are lower, in order to pay less tax on company profit. The OECD has made a number of recommendations which should be implemented and which relate to: giving more power to the tax authorities in relation to access to the banking information; strengthening rules related to reporting on foreign investments; abolition of tax contracts concluded with tax haven and ensuring the efficient exchange of information, and the like.

## VIII. RECOMMENDATIONS CONCERNING FINANCIAL SYSTEM

### 1. Banking and non-banking sector

<i>Key recommendations</i> <sup>23</sup>	<i>Implementation deadline</i>
Intensify activities on the development of the regulatory framework relating to the establishment, operation and control of factoring companies, as well as to improve the existing legal framework in the area of control of leasing companies' operations	Short
Define the maximum level of permitted contractual interest rate in accordance with the law or other regulation	Short
Encourage mechanisms for the insurance market development in order to provide additional capital in the financial sector	Ongoing
By proposing the appropriate regulations, improve supervisory capacities of financial market regulators for faster harmonization of the regulatory framework and fulfilling obligations towards the EU accession	Ongoing
<i>Main risks</i>	<i>Risk trend</i>
High exposure and economic ties of Montenegro with the region and the EU, and the fact that foreign banks make the Montenegrin economy, including the financial sector, vulnerable and sensitive to negative developments in the region	Stabile
High real sector illiquidity	Increasing
Still present high percentage of non-performing loans	Stabile
High lending interest rates of banks and MFIs	Increasing

#### *Background*

In the first half of 2014, the banking system was stable and liquid, which, among other, is reflected in the parameters of liquidity and solvency, which were above the prescribed level in the reporting period.

Restrictive lending policy of banks is reflected in the increase in cash and generally the overall level of liquidity. The solvency ratio was 15.83% at end- June 2014, which was higher, compared to the previous year (14.44%) as well as at the annual level (15.50%). After the completion of the recapitalization in 2013 totalling 22.9 million euros, in the first six months of 2014 two banks were recapitalized in the

<sup>23</sup> Key recommendations do not comprise recommendations under the jurisdiction of the CBCG.

amount of 16.5 million euros. A domestic bank has recently started its operations, thus, the banking system of Montenegro now consists of twelve banks.

Banks' deposits grow, leading to improvements in the credits to deposits ratio. At end- June deposits grew by 2.3% compared to end-2013 or 6.8% at the annual level. Deleveraging of banks, which was expressed in the previous period, was slow in the first half of 2014. At end-June 2014, loans accounted for only 10.1% of total banks' liabilities.

In the first six months of 2014, total banks' loans decreased by 1.6% compared to the previous year-end. At the same time, during the first six months of the current year a total of 358.6 million euros of new loans were granted, which is 4.5% more than in the same period of the previous year.

Non-performing loans still represent the greatest vulnerability of the banking sector and a potential source of risk to financial stability. Non-performing loans amounted to 402.6 million euros or 4.9% lower than at end-2013 or 8.8% higher than in the previous year. Non-performing loans accounted for 16.94% of total banks' loans and their share in total loans decreased by 0.6 percentage points compared to end-2013, i.e. 1 percentage point at the annual level. However, despite the improvements recorded in June, during the first six months of this year, the share of non-performing loans in total loans averaged 17.20%. Only in March and June this indicator was lower than 17%. There is a noticeable positive trend that is reflected in the increasing coverage of non-performing loans by the value adjustments. Total value adjustment from banks amounted to 180.5 million euros or 44.8% of non-performing loans of banks, which was more than in the same period of the previous year (40.4%).

Reduction in the volume of non-performing loans through the implementation of the voluntary financial restructuring represents a key challenge in 2015.

Past due loans accounted for 21.55% of total banks' loans or 7.1% more compared to end- 2013, while in relation to the same period of the previous year they were 11.8% lower. Past due loans of the corporate sector accounted for 35.7% of total loans granted this sector, i.e. 66.3% of past due loans of the entire banking system. Past due loans of the household sector accounted for 16.3% of total loans to this sector, i.e. 28.3% of past due loans of the entire banking system.

In 2015, a major challenge will be the reduction in lending rates of banks and MFIs. At end-June 2014, the average interest rate on total banks' loans was 9.5%

while the average interest rate on new loans was 10.1%. The Central Bank continuously monitors the interest rates trend and it recommended to banks to lower interest rates on new loans in the upcoming period.

The Central Bank has repeatedly submitted a recommendation to the Government of Montenegro to prescribe maximum permitted contractual interest rates, to prevent the conclusion of the usurious contract.

### ***Micro-credit financial institutions (MFIs)***

Balance sheet of MFIs at the end of the second quarter of 2014 amounted to 41.7 million euros and it increased by 20.3% compared to end-2013 or 12.3% observed annually.

MFI loans amounted to 39.4 million euros, which was 7.3% more than at end-2013, while they declined by 1.1% in relation to the same period of the previous year. During the first six months of 2014, MFIs granted a total of 17.3 million euros of new loans, which was by 11.7% more compared to the same period of the previous year. The majority of new MFIs loans (92.5%) related to loans granted to the household sector. The largest source of MFIs funding was through borrowings. Total borrowings amounted to 15.1 million euros, which was higher in relation to the previous year-end (21.4%) as well as in relation to June 2013 (19.5%).

MFIs capital amounted to 24.8 million euros or 22.4% more than at end-2013 and by 8.3% in relation to the same period of the previous year. Of the amount of total capital, 56.8% related to capital from donations, 23% to issued capital and 16.1% to retained earnings. At the aggregate level, MFIs ended the second quarter of 2014 with a profit of 729,000 euros.

Lending interest rates of MFIs are high and are subject to constant monitoring by the Central Bank. At end- June 2014, the average interest rate on total loans was 26.12%, while the average interest rate on new loans amounted to 26.63%.

### ***Insurance market***

On the Montenegrin insurance market, insurance operations are carried out by eleven insurance companies and five companies dealing only with non-life insurance and six life insurance companies.

At end-June 2014, total balance sheet of insurance companies amounted to 165.4 million euros and recorded growth of 5.8% compared to end-2013. Solvency of companies, measured as the capital to solvency margin ratio<sup>24</sup> was at a satisfactory level (243.63%).

Gross insurance premium amounted to 7.7 million euros in June 2014. In the total gross premium non-life insurance had dominant share (84.6%), while life insurance accounted for the remaining 15.4%. In June 2014, in the structure of non-life insurance gross premiums, insurance premiums from liability due to the use of motor vehicles (50%) recorded a dominant share, followed by other property insurances (16.1%), accident insurance (13%), motor vehicles insurance (8.9%) and property insurance against fire and other hazards (6%). In the structure of life insurance, the largest share was recorded by life insurance (88.4%).

At end-June 2014, insurance market generated a gross profit of 4.1 million euros

### ***Lease market in Montenegro***

In Montenegro there are six leasing providers, namely four leasing companies as legal entities and two banks.

In Q1 2014, the number of new contracts was by 2.8% higher than in the same period of the previous year, i.e. 40% lower than in Q4 of the previous year. The highest number of new contracts was concluded with legal entities (66.3%), while the contracts concluded with natural accounted 33.7%. Of the total number of new contracts, 95.7% related to financial leasing (96.9%) in the value of signed contracts. Remaining number or the value of new contracts related to operative leasing.

Looking at the value of new contracts in Q1 2014, 62.8% of total value of the concluded contracts related to the purchase of passenger vehicles, 22.4% to the purchase of construction machinery and equipment, 13.3% to the purchase of commercial vehicles, while 1.5% related to the purchase of ships.

The number of active contracts at 30 June 2014 was 2.53% lower than in the previous year. The largest number of active contracts was concluded with natural

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<sup>24</sup>Defined by the amendments to the Insurance Law from 2012

persons (51%), followed by legal entities (48.7%), while the contracts concluded with entrepreneurs accounted for only 0.3%

### *Operational measures*

In order to stimulate lending activities of banks, it is necessary to work on creating a favourable investment climate and stimulating business environment. In this regard, it is necessary to continue with reforms to increase the competitiveness of the Montenegrin economy, especially in the areas of tax policy, corporate governance and the rule of law.

The greatest vulnerability of the banking sector is still a high level of non-performing loans. Therefore, it is necessary to adopt as soon as possible a draft proposal of the Law on voluntary financial restructuring, and to work intensively on the implementation of solutions from the abovementioned law, after its adoption.

Bearing in mind the fact that high interest rates represent one of the factors which stimulate increasing of non-performing loans, and thus may adversely affect the financial stability of the country, the Central Bank recommended banks to reduce lending interest rates. Therefore, it is necessary to define maximum allowed level of contractual interest rate in line with the law and other regulations.

It is necessary to regulate the business of factoring companies through the adoption of the Law on Factoring Companies Operations. Also, it is necessary to define the legal oversight of leasing companies, through amendments to the Law on Financial Leasing.

In order to encourage the growth and development of the insurance market, it is necessary to intensify educational and promotional activities with the aim of better positioning of the insurance activities at the financial services market. Also, it is necessary to stimulate the education of actuaries and implement standards for their licensing.

In order to improve the efficiency and effectiveness of the regulatory and supervisory capacities of the financial market regulator, it is necessary to work intensively on harmonization of existing and/or drafting new legislation harmonized with the EU directives and international standards.

One of the basic prerequisites for making timely and effective measures of economic policy makers is the quality of the statistical base. Therefore, it is

necessary to work intensively on the harmonization of the existing regulations in the area of statistics with the EU regulations. In this regard, coordination and communication between all regulators in the financial markets is necessary in order to define legal solutions that will provide data harmonized with the EU legislation in the area of statistics.

## 2. Capital market

<i>Key recommendations</i>	<i>Implementation deadline</i>
Adopt Capital Market Law	Short
Continue activities to intensify links with regional and European markets	Ongoing
Improve the protection of minority shareholders' rights and respect the basic principles of corporate governance	Ongoing
Implementation and compliance with international financial reporting standards	Ongoing
Request from companies listed on the stock exchange to timely submit financial statements in order to provide accurate and reliable information, which will be available to investors. Implement efficient control of financial statements of companies	Ongoing
Intensify educational activities of the population	Ongoing
<i>Main risks</i>	<i>Risk trend</i>
Inadequate level of market liquidity	Stabile
Shallow market with the view of market material available for trade	Stabile
Inadequate protection of proprietary rights of minority shareholders	Stabile
Inadequate levels of transparency and quality of financial statements of companies whose shares are quoted on the stock exchange	Stabile
High sensitivity to risk and shaken investor confidence	Stabile
Inadequate asset management funds	Stabile
The slowdown in the privatization of the remaining large companies	Stabile

### *Background*

In the first half of 2014, Montenegro stock exchange recorded turnover of 65 million euros, which is six times more than in the same period of the previous year. A significant increase in turnover at Montenegro stock exchange mostly resulted from the issue of government bonds in March 2014, government bonds sold in a total value of 43.2 million euros. The average monthly turnover amounted to 10.8 million euros during the first six months of 2014, which is significantly more than the average monthly turnover in 2013 (2.6 million euros).

However, if we exclude sold government bonds, the average turnover in this period amounted to 3.6 million euros. Of the total turnover in the first half of 2014, 66.4% was achieved through primary sale, primarily as a result of the issue of government bonds, while the remaining 33.6% referred to secondary trading. In the structure of turnover, turnover with various types of bonds (71.7%) had dominant share, followed by trading in shares of companies (19.5%) and shares of joint investment funds (8.8%). Total market capitalization of shares as at 30 June 2014 amounted to 2.9 billion euros. At end-June 2014, MONEX20 index was lower by 125.3 index points (1.3%), and Monex PIF index by 581.3 index points (17%) compared to end-2013.

These figures show that the capital market is in a deep crisis that was triggered by the global financial crisis. Unlike previous years, most of turnover was realized through primary sale. However, as to the sale of government bonds, it can be concluded that there is still no interest of investors for the primary issue of shares. High degree of uncertainty of recovery of the international economy has a negative impact on the propensity of investors for placement in Montenegro, which means that its recovery will be long.

Draft Law on Capital Market has been prepared. It is highly compliant with EU regulations in this area.

### ***Operational measures***

Continuous work on the harmonization of legislation with the EU acquis is compulsory, especially in the part relating to the investment funds' operations.

In order to improve operations in the capital market, regain investors' confidence and ensure adequate protection of investors, on the one hand, and achieve higher level of harmonization of Montenegrin legislation with EU regulations, it is essential that as soon as possible adopt a new law on capital market, and starts with its efficient implementation.

In order to improve operations in the capital market, regain investors' confidence and ensure adequate protection of investors, on the one hand, and achieve higher level of harmonization of Montenegrin legislation with the EU regulations, it is essential to adopt, as soon as possible, a new Law on Capital Market, and start with its efficient implementation.

It is necessary to continuously improve trading oversight system through the establishment of a proactive system that uses statistical tests and can identify irregularities in trading at an early stage. Education of the participants at the capital market should be encouraged in order to improve trade, deepen the market, increase the flow of information, reduce risk when investing, etc.

Insist on full implementation of IFRS in order to eliminate speculative activities arising from asymmetric information flows. It is necessary to require the companies listed on the stock exchange to timely submit financial statements in order to provide accurate and reliable information to investors and other users.

Continuous improvement the quality of reporting exchanges should be implemented, particularly in the part relating to indicators of actions' risk level, in order to adequately inform market participants about the risk/yield ratio of individual trading instruments.

Stimulate implementation of the Corporate Governance Code, with a view to further improving the quality of corporate governance of companies listed on the stock exchange.

## IX. RECOMMENDATIONS CONCERNING INTERNATIONAL ECONOMIC RELATIONS AND INTEGRATION

### 1. Balance of payments and competitiveness of Montenegro's economy

<i>Key recommendations</i>	<i>Implementation deadline</i>
Increase and diversification of export	Ongoing
Increasing competitiveness and productivity	Ongoing
Stimulate higher final processing	Ongoing
Increased promotion of exports and export potential	Ongoing
Implementation of the policy of import substitution and production increase	Ongoing
Strengthening the financial and non-financial support to small and medium enterprises and exporters	Ongoing
Stimulate association of enterprises in clusters and business zone valorisation	Ongoing
Reduction in food import and stimulation of domestic agricultural-food industry	Ongoing
Ensure full implementation of CEFTA agreement and increase cooperation in the region	Ongoing
Adoption of international quality standards	Medium
<i>Main risks</i>	<i>Risk trend</i>
Low exports and poor differentiation	Increasing
High import and unfavourable structure of import (import of consumer goods)	Increasing
Insufficient focus on export-oriented production	Increasing
Volatility of revenues from tourism	Increasing
The high dependence of economy on the inflow of foreign capital	Increasing
Lack of competitiveness and productivity	Increasing
Financing the current account deficit by borrowing	Increasing
Slow adoption of international quality standards	Stabile

#### *Background*

Balance of payment data for the first six months of 2014 show that the current account deficit amounted to 441.8 million euros, which showed an increase of 5.6% compared to the same period in 2013. These developments are largely the

result of an increase at the deficit on goods account, as well as the surplus decline at the accounts of primary and secondary revenues. The deficit at goods account was recognized as the main and often the only cause of the current account deficit. The goods account recorded a deficit in the amount of 643.6 million euros or 3.5% more than in 2013. Account surpluses of primary and secondary revenues decreased by 33.3% or 5.1%. At the services account, there was an increase in surplus, but it was not enough to compensate negative developments at other sub-accounts. Services account surplus amounted to 121.4 million euros achieving a growth of 11.6%.

The decreasing trend in the current account deficit has been present since 2009, as a result of the crisis adaptation of the Montenegrin economy and reduced opportunities for financing import. The exception was 2012, the year in which the deficit slightly increased. In 2013, the current account deficit again declined, and in the first half of 2014 the external situation again deteriorated slightly. Despite the reduction of external imbalances in recent years, the fact is that the deficit is high over years. In terms of slower economic recovery, vulnerable and underdeveloped export sector, sustainability of the current account deficit becomes the most important issue to be solved. Domestic economy is dealing successfully with the current account deficit, thanks to a sufficient inflow of FDI. However, the existence of long-term deficit indicates a deep external imbalance for which funding is only a temporary solution. After the adaptation to the crisis conditions and deficit contraction caused by reduced possibility of financing, it is necessary to implement a set of measures in order to make deep reforms in Montenegrin economy and improve external position in a long-term.

The global crisis has highlighted the vulnerability of the Montenegrin economy and undermined the sustainability of current growth model. The growth generated by the aggregate demand with high FDI inflow was related to the rapid increase in imports at the expense of worsening external situation. Low export base, poor differentiation of export and high dependence on import indicators are weak competitive position of Montenegro and indicate the necessity to correct the current situation. Strengthening and diversification of export along with increasing productivity and competitiveness are set as the imperatives of development of the Montenegrin economy in the future. With the adequate state involvement, and greater private sector initiative, enhanced financial and non-financial assistance, the Montenegrin economy has to go through structural changes necessary for further accelerated growth and development

## *Operational measures*

The model of economic growth, based on the expansion and diversification of exports can be a powerful growth generator of the Montenegrin economy in the future and it should be set as a priority objective of economic policy. Multiannual deficit foreign visible trade is a result of high dependence on import and weak export performance. It takes a strong commitment of the Government and the private sector in strengthening export potential. Export expansion involves the expansion of the branches that have not traditionally been present in exports. Strengthening exports, except the increase of its value and volume, implies improving its structure towards greater diversification. In our export, metal industry and electricity products are dominant. This concentration of export on few products makes our export sector vulnerable, with high volatility over years. Operating of the largest goods exporter – KAP is an open issue to be solved.

Increasing the competitiveness and productivity represent imperatives of development in the future. Emphasis should be put on small and medium enterprises, as well as new export-oriented companies. Quality implementation of the Strategy for stimulating competitiveness at the micro level (2011-2015) should be ensured, thus defining measures and activities to improve the competitiveness of companies. Lack of private sector participation in European research programs is evident, and there is a need to continue education of the private sector and SMEs about the possibilities offered by European projects. It is necessary to adopt a new strategy for boosting export, since the existing strategy was adopted in terms of global economic expansion, while a new strategy needs to be harmonized with demands of the Montenegrin economy and the new growth model.

It is necessary to change the structure of export in a way to increase export of products with higher level of processing, based on new technologies and innovations. The increase of product finalization affects substantially higher prices of export products, higher wages, greater competitiveness, and a number of other positive effects on the economy. In order to change the export structure, it is necessary to provide additional funds in the form of soft loans or "grants" for the purchase of equipment for the development of new products and processes and the implementation of modern technology. Private investments in the modernization of business and innovation should be stimulated with the aim of raising the general level of competitiveness of products. Financial and non-financial support to new businesses should be continued, and the development of special programs such as franchising, technology parks, and business incubators should be supported.

Companies need support for the inclusion in foreign production lines in order to become a part of a larger and organized production chain.

In order to strengthen export and export potential it is necessary to continue with current promotion of Montenegro and Montenegrin entrepreneurs at international markets, participation at specialized fairs, economic meetings and the like. Emphasis should be placed on increasing the participation of diplomatic-consular offices and Montenegrin missions abroad in promotion and export of Montenegrin products and services.

External trade deficit is largely a result of high import. It is necessary to study and perform an analysis of the goods to be imported in order to obtain information that is really necessary to import goods, and that could be compensated by the substitution. Policy of import substitution reduces the country's dependence on imports and encourages domestic production and competitiveness. Domestic economy requires rapid recovery of production. Enterprises engaged in the production should be stimulated and as many entrepreneurs as possible should be included in manufacturing activity. In order to improve the monitoring of domestic producers there is a need to complete the work on forming the base of existing and potential producers. This database would provide a good basis for a number of analyses and would be in the service of improving business activities.

Tourism, agriculture and energy were identified as strategic sectors in which Montenegro has huge potential for development. In view of their successful development it is necessary to increase the quality of infrastructure, improve accommodation capacities, and implement planned major investments in tourism (Ada Bojana, Velika Plaža, Luštica, Kumbor, and the like). It is necessary to improve the energy and transport links. We should not forget the potential of tourism in terms of strengthening ties with agriculture, transport and logistics. In the area of agriculture we should take advantage of significant potential, with increased assistance and support of the state. Investments in renewable energy sources should be stimulated.

It is necessary to provide sufficient financial resources in order to implement all projects planned by the SMEs Development strategy 2011-2015. System of credit guarantees issue for SMEs should be improved by the Investment Development Fund. Credit and factoring IRF support to SMEs, agricultural producers and entrepreneurs should be considered. Possibilities for continuation of existing and introduction of new financial instruments for SMEs (new guarantees, instruments to support export, risk capital funds) should be considered. Special emphasis is

placed on financial support to new businesses, especially those that focus on export. Take advantage of the possibilities of using funds from the European financial institutions. Encourage use of available financial instruments within COSME-HORIZON 2020<sup>25</sup> program. Also, it is necessary to improve the quality and availability of non-financial support. Improvement of the existing and establishing new business incubators should be continued by improving information availability, education and training for potential entrepreneurs, promotional activities, counselling for existing and new businesses by encouraging the development of women's entrepreneurship. In this sense, operation of the Market information service is of a great importance, and it is necessary to further improve its activities.

Cluster development can significantly contribute to increasing the competitiveness and productivity of the Montenegrin economy. It is necessary to ensure further implementation of the Strategy for sustainable economic growth through the introduction of clusters 2012- 2016. For SMEs, create clusters would facilitate access to new markets, transfer of knowledge, new technologies and reduce operating costs. Establishment and functioning of clusters should be accelerated. Establishment of regional clusters should be promoted more efficiently. Clusters in the area of agriculture, wood industry, tourism offers have a potential for development. Activities on setting up Innovative entrepreneurship centre "Tehnopolis" in Nikšić should be continued as well as activities on completion of the first Science-Technology Park. A Program of strengthening the competitiveness of small and medium enterprises through the formation of clusters should be continued as well as work on the development of the Plan for the business areas.

Montenegrin agriculture is not competitive enough, it is characterized by a low productivity, inadequate technical and technological equipment and fragmented plots. Strengthening of domestic agricultural production could significantly reduce food import, which far exceeded its export. It is necessary to increase funds available through the Agriculture budget for subsidizing agricultural production and entrepreneurship in agriculture. Continue with the project Institutional strengthening and the development of agriculture in Montenegro - MIDAS project. Use the EU "grants" which are implemented through IPA funds. A consistent

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<sup>25</sup>COSME (Programme for the Competitiveness of enterprises and SMEs) is a new program of the European Union for the financial period 2014-2020, which will encourage the competitiveness of SMEs. Together with the existing program HORIZON 2020, SMEs will be able to access financial instruments through investments in start-up, early stage and SMEs growth phase.

implementation of the Plan for promotion of investment potentials of Montenegro and attract investors in the agricultural sector has to be enabled.

Stronger regional cooperation represents a solid preparation for the EU accession, when we expect a stronger competition. Improved implementation of CEFTA agreement should be ensured, especially when it comes to the elimination of non-tariff barriers. The competitive position of Montenegro in the region should be improved. Export to the region and the EU could be improved. Trade liberalization (facilitating export and import through reduction of customs procedures) and bilateral cooperation with neighbouring countries should be continued.

Expenditures for research and development in Montenegro are very small, especially in the private sector. Further effort is required to support the private sector in order to increase the amount of funds allocated for research and development. There is a room for innovations development, especially in SMEs. The project "Voucher scheme" for innovative SMEs should be continued. The budget for this purpose should be increased as well as the amount of funds allocated to innovators. Financial support and tax incentives to SMEs investing in research and development should be continued and they should be encouraged to participate in international programs for research and innovation (Horizon 2020, Cosme and Eureka). Work on establishing centres of excellence should be continued. Cooperation of scientific-research community with the corporate sector should be enhanced and the implementation of the Strategy for scientific research in Montenegro 2012-2016 should be ensured. Development of a national system of innovation should be supported.

For more competitiveness and secure placement of domestic products on the EU market and other markets, it is necessary to adopt a number of quality standards. In this regard, it is necessary to raise funds to subsidize the introduction of standards. Informing companies and citizens about the certificates, technical standards, and rules on goods origin should be continued and producers at the EU market should be protected, given the importance of this market for Montenegro and future integration processes. Database on SMEs that possess quality standards should be improved. A national strategy for standardization should be adopted. The improvement of existing and development of new brands should be supported with the intention to obtain regional and international character. Branding of Montenegrin products and promoting trademark "Made in Montenegro" should be continued.

## 2. Foreign direct investments (FDI)

<i>Key recommendations</i>	<i>Deadline</i>
Increase inflow of FDI in competitive and export oriented production branches with a view to fostering economic growth	Ongoing
Increase the share of greenfield investments in total investments	Ongoing
Improvement of investment and business environment	Ongoing
<i>Main risks</i>	<i>Risk direction</i>
Great competition in attracting FDI	Increasing
Continuation of the crisis in the euro area countries and lower investment appetite	Increasing
Red tape preventing successful investments	Stable
Delays in privatisation of strategic enterprises	Stable
Unsuccessful privatisations – failure to meet contractual investment and social programmes by strategic investors	Increasing
Administrative barriers – poor coordination between the national and municipal administrations	Stable
Unfavourable investment structure (concentration of investments in the service sector)	Stable
Absence of greenfield investments in high-tech and export-oriented sectors	Stable
Problem of unresolved land property disputes	Stable
Underdeveloped infrastructure	Stable

### *Background*

In the past few years, foreign direct investments have been a stable source of capital in Montenegro and they have significantly contributed to the financing of the current account deficit. These were primarily investments in the service sector, while investments in the production sector fell short. Despite the crisis, our country has managed to maintain a relatively steady inflow of FDIs and be the leader in the region in FDI per capita.

Early 2014 were marked by a slight uptrend in FDI inflow that suggested a potential recovery after a decline in the previous year. There was an increase in equity and debt investments. As per the results of the World Bank's "Doing Business 2014" report, Montenegro significantly improved its position with regard

to the improvement of business environment, “ease of doing business”, and is ranked 44<sup>th</sup> of 189 countries. However, this progress was recorded only in some segments (dealing with construction permits, registering property, real estate development), whereas in other areas it remained stagnant or deteriorated its position.

The economic crisis has further emphasized the importance of investments and competitiveness of the business environment. According to the Global Competitiveness Report 2014-2015 of the World Economic Forum, Montenegro is ranked 67<sup>th</sup> on the global competitiveness rankings, which is the same position as in 2013. Inefficiency of bureaucracy, poor infrastructure and inadequate level of innovation and education of workforce were, among others, recognized as the major obstacles to business development. Therefore, it is necessary to make additional efforts in order to increase the competitiveness and attractiveness of the country for investments.

Considering the existing macroeconomic environment, the challenge in the following years will be the creation of favourable conditions for attracting foreign investments. The privatisation process, as the strategic determinant of Montenegro’s development, as well as the promotion of investment potential, should be continued as they are of key importance for the strengthening of competitiveness of the country’s economy. The promotion of investment potential of Montenegro in emerging markets is a positive step considering the recession in the EU countries and lowered interest for foreign investments in general. So the challenge will also be the attracting of foreign investments in export-oriented production sectors that could contribute to a change in the economic structure and the acceleration of economic growth and development.

### ***Operational measures***

Channel foreign investments to sectors where Montenegro holds comparative advantage. Considering that tourism, energy sector and agriculture are seen as the pillars of the future economic growth of the country, continue promoting and attracting FDIs to these sectors with a view to strengthening competitiveness of Montenegro’s economy. Intensify promotion of agriculture and tourism as complementary activities with a view to achieving better utilisation of their potential. Encourage investments in export-oriented sectors in order to change the export structure from the labour-intensive to intermediate products.

Montenegro has a great potential for attracting foreign investments in the energy sector. Taking into consideration the competitive advantages of the energy sector (hydro energy potential, renewable energy resources, favourable geographic position); it is necessary to intensify its promotion in order to attract high quality investors. The share of electric energy export in the total export of 2013 amounted to 25.4%, while in the first six months of 2014 this number was 16%, which is a significant increase in relation to 2010 when it amounted to mere 5.2%, and a reflection of the export potential of this sector. It is necessary to continue the improvement of the regulatory framework in the area of energetics, and to create the conditions for the strengthening of competitiveness, through the improvement of the energy sector and gradual increase of production capacities.

The previous years were marked by the lack of Greenfield investments, which may more significantly influence the structural changes in the Montenegrin economy and the increase of its competitiveness. Montenegro must intensify the promotion of Greenfield investments and create incentives with a view to increasing employment and transferring new technologies. Considering the increased competitiveness in attracting foreign investments in the countries of the region, the quality and the efficiency of the promotion of Montenegro's investment potentials will be of immense significance, therefore, the further strengthening of institutions promoting and attracting foreign investments need to be prioritized.

In 2015, it will be necessary to pursue a policy of targeting foreign investors and to take a proactive approach in fostering and attracting foreign investments. The quality of the promotion of investment potential and the establishing of a transparent and stable regulatory framework will be of high importance. The main challenge will be to attract new foreign investments, especially in export oriented production sectors, which are key to increasing export and achieving sustainable economic growth and development.

The improvement of the investment environment represents one of the prerequisites for attracting FDIs and ensuring successful realisation of investments. It is necessary to continue the regulatory framework reform in order to simplify the procedures and create an efficient bureaucracy. Continue structural reforms referring to labour legislation and the removal of business barriers. Successful FDIs attraction implies an efficient legal system and a stable business environment. Unstable business environment and changes in the business conditions induce the lack of confidence among investors and the increase in the business expenses. In addition to efficient legal system and stable macroeconomic policy, it is important to create favourable investment climate and increase the competitiveness of

investment locations by investing in the infrastructure and creating incentive measures.

Regardless of Montenegro's competitive regulatory framework, foreign investors pointed out the issue of poor coordination between local and state institutions. Better coordination of institutions at local and state level is essential, since the successful realisation of investments is possible only with the cooperation of all the institutions included in the realisation of investment projects. Lengthy bureaucratic procedures often represent a problem slowing down the realisation of major investment projects. It is necessary to shorten and simplify the procedures for the realisation of domestic and foreign investments. Accelerate the realisation of privatised or planned projects by eliminating the red tape at the local level.

It is necessary to create the environment for the successful valorisation of tourist potentials of Montenegro. This primarily implies the development of detailed urban and space plans and enhancing of the rule of law in the area of real estate development. Restitution often acts as a limiting factor in the realisation of major projects. Montenegro needs to improve the restitution resolution mechanisms. The resolution of the issue of the return of property (restitution) and land ownership represents a crucial precondition for increasing the FDI inflow.

Underdeveloped infrastructure still represents a limiting factor for the development and realisation of Greenfield investments. Putting in further efforts in steering the investments toward the infrastructure is essential, especially in the area of transport and energy, in order to improve the competitiveness and attractiveness of Montenegro regarding FDIs.

## X. RECOMMENDATIONS CONCERNING ECOLOGY AND SUSTAINABLE DEVELOPMENT

<i>Key recommendations</i>	<i>Deadline</i>
Foster the development of the ecological awareness of citizens	Ongoing
Improve the protection of the environment from devastation, pollution, poaching, degradation of maritime zone, adverse effects of climate changes, fires	Ongoing
Ensure the implementation of the “polluter pays” principle	Short
Ensure the rational usage of natural resources	Ongoing
Direct more attention towards the renewable sources of energy, such as the energy of the sun, wind, biomass, etc.	Ongoing
Improve the water management system	Ongoing
Protect the sea bed from devastation	Short
Increase the efficiency of the application of laws and regulations in the area of environment protection, and improve the ecologic security system	Short
Improve the fire protection	Medium
Enhancing human capacities in the sectors in charge of environment protection and sustainable development	Ongoing
Prevent illegal construction, especially in the protected locations	Medium
Establish a sustainable system of environment protection financing at both, local and state levels	Medium
<i>Main risk</i>	<i>Risk direction</i>
Devastation of the environment	Increasing
Production of food in the locations with too high level of pollution	Stable
Soil pollution due to excessive use of agro-chemical agents in agriculture	Stable
Increased air pollution due to the use of outdated vehicles and vehicles lacking the adequate protection systems	Stable
Insufficient energy efficiency, insufficient use of renewable sources of energy	Stable
Pollution of locations rich in springs	Stable
Devastation of the sea and coastal area	Increasing
Loss of a part of biological diversity of the maritime zone due to the extensive illegal fishing	Increasing
Frequent bushfires	Stable
Migration as a result of imbalanced regional development, depopulation of rural settlements, decline in agricultural production, pressure on the urban infrastructure, further social layering, etc.	Increasing

## ***Background***

Significant part of the Montenegrin territory has been included in the international conventions or protected by international agreements.

However, only 9.05% of the territory is currently under protection of national legislation. In addition, Montenegro is the only country of the Mediterranean without protected maritime areas. Considering the fact that Montenegro is an ecological state<sup>26</sup>, the percentage of territory protected by national laws is regarded insufficient. The urgency for enhancing the protection is becoming a pressing issue, especially over the past few years when the pressure to the environment has increased and parts of our natural wealth became seriously endangered.

Among the increasing pressures the country's natural wealth has been exposed to, the following are the most prominent: poor waste management (inadequate disposal of municipal, medical and industrial waste, increasing number of illegal waste dumps), poor wastewater management (the discharge of untreated wastewater into the surface or underground waters or into the sea), the intensive development of certain sectors (especially tourism, construction), followed by illegal and unscheduled construction, and conversion of natural habitats into semi-natural and artificial ones. In addition, water management in Montenegro is inadequate, and it may lead to changes and losses in water resources and have adverse effects on the environment as well as on the country's economic and social situation. Due to the increased urbanisation and illegal construction in the narrow coastline zone, illegal and excessive felling, uncontrolled and illegal poaching and fishing, uncontrolled collection of edible and medical herbs, fungi and forest fruits, as well as the illegal and excessive exploitation of gravel from the riverbeds, the biodiversity in this country is severely endangered. Another major issue is the inadequate protection from bushfires, which destroy habitats of certain species every year. Major polluters and waste generators using outdated technologies in their production processes are situated near protected areas<sup>27</sup>. Transport vehicles in use and the enormous increase in the number of cars stand out as major environment pollutants. The analysis conducted by the Environment Protection Agency of Montenegro show the concentration of extremely dangerous powder

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<sup>26</sup>Declaration on the Ecological State of Montenegro "OGRM" no. 39/91

<sup>27</sup>Montenegro's territory holds four environmental black spots recognised as key ecological issues. These are the Aluminium plant KAP, Adriatic Shipyard "Bijela", TE "Pljevlja" and the flotation lead and zinc waste dump "Gradac". In addition, there are other waste generators, such as the electrode factory in Plužine, coal mine "Pljevlja", plants for the maintenance of mining, construction and other machines, etc.

substances above the prescribed minimum in the large number of measurement areas.

Due to effect of all the above-mentioned pressures, the available room for ecologic valorisation of the country's natural wealth is constantly diminishing, and considering the lack of adequate systems for its protection, occurrences of direct endangerment of the protected area and the loss of natural wealth are rather frequent.

Health of the population is directly and indirectly connected to the environment. This is supported by the fact that the environmental factors are the cause of disease in one quarter to one third of cases.

With the adoption of the Declaration on the Ecological State, Montenegro strategically decided to take the path of adopting and applying the highest standards in the area of environment protection, and strive to preserve the environment and provide economic development by complying with the principles of ecologically sustainable system. Nevertheless, higher degree of commitment in terms of environment protection stems from the obligations related to the EU accession process. Therefore, over the past few years, Montenegro is continuously working on the improvement of the institutional and legislative framework in the area of ecology and sustainable development, with the harmonisation of national legislation with the *Acquis Communautaire* as a main goal.

Regarding the improvement of the legislative and institutional framework, our county has achieved certain results over the past year. This includes the adoption of Coastal Zone Law, Law on National Parks, and the Environmental Liability Law along with the "polluter pays" principle, and the principle of compulsory insurance, etc. Corporate Social Responsibility Policy in Montenegro and the Regional Development Strategy for the period 2014-2020 were also adopted. In addition, as at 1st January 2014, Centre for Sustainable Development began its work. The founding of this Centre created the prerequisites for the exchange of experiences, knowledge and practices with the global network of sustainable development centres. The activities performed within the GEF/UNDP PAS project, are aimed at the protection of regional parks Piva and Komovi by the end of 2014.

Montenegro advanced its policymaking on climate through the founding of the National Council for Sustainable Development and Climate Change. This Council's main objective is monitoring the development and the implementation of the national policy in the area of climate change, and Montenegro's development policy in terms of its consistency with the country's policy on climate change.

Montenegro is also taking activities aimed at raising public awareness and knowledge of environmental issues. Montenegro has also continued the implementation of the project “Green Economy Initiative”, which is aimed at building the capacity of local civil society organisations to participate in decision-making and formulation of public policies, and promoting the concept of green economy and its importance in community development through civil society initiatives. Implementation of the project CLEAN – Citizens Learning Environmental Actions Needed, aimed at the improvement of waste management in the cross border area, building the capacity of public utility companies through the procurement of necessary equipment and employee training, as well as raising public awareness on proper waste management, ended in June 2014.

With a view to resolving the issue of the disposal and treatment of all types of solid waste, Montenegro completed the project “Preparation and Implementation of the National and Local Waste Management Plans”. The program was carried out between October 2012 and April 2014, and it yielded three key documents - National Waste Management Strategy 2014 – 2020, National Waste Management Plan 2014 – 2020, and local/regional waste management plans. Out of eight planned sanitary landfills, two were constructed – in Podgorica and in Bar. Currently, activities are being conducted on the closing and rehabilitation of the landfills in Bar and in Cetinje. However, the possibilities for material recycling are limited, while the separate waste collection system in its initial phase. Primary recycling centres exist in Podgorica and Herceg Novi, in which certain types of waste are selected and prepared for transportation, in order to be further processed. In addition, there is a smaller recycling line in Kotor.

In cooperation with the World Bank, Montenegro is realising the Industrial Waste Management and Clean-up Project. The purpose of the project is the reduction of natural resources pollution and lowering the risk that the exposure to industrial waste landfills has to public health. The project plans rehabilitation of three black environmental spots<sup>28</sup>.

The project also includes plans for the construction of national hazardous waste disposal facility.

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<sup>28</sup>Aluminium Plant Podgorica (solid waste disposal area and red-mud basins on the KAP sites), (poisonous waste landfill), Bijela shipyard (industrial waste disposal - grit), Thermo power plant Pljevlja (disposal of ash and cinder “Maljevac”) and Mine “Šuplja stijena” Pljevlja (flotation waste rock Gradac)

Certain progress has been made regarding the wastewater management. In 2014, wastewater treatment plant in Budva started operation, while the wastewater treatment plants are under construction in Nikšić and Herceg Novi along with the construction of the joint wastewater treatment plant for Kotor and Tivat.

In the area of air quality, Montenegro adopted air quality management plans for the municipalities of Pljevlja and Nikšić. These plans include measures aimed at minimising and eventually eliminating the overstepping of prescribed thresholds. In 2013, thermal power plant “Pljevlja” repaired its electro filter system, while the ironworks in Nikšić was modernised by installing the dust collection system on the new electric arc furnace. With a view to raising public awareness on the adverse effects of the use of fuels with high content of pollutants for household heating Montenegro organised the “Chimney Sweeping Week” campaign within the “European Green Week” programme.

In addition to the above, numerous activities and projects are being carried out in the area of environment protection. However, regardless of the progress recorded in legislative and institutional framework, the key risks and factors threatening the natural wealth of the country are still largely present. The key issue in the area of environment protection is the lack of efficiency in the application of adopted laws and regulations, the failure to implement the sanction measures for polluters, along with the extremely low level of public awareness of the importance of environment protection.

### *Operational measures*

Montenegro should increase surfaces under national protection to 10%, as well as protect at least 10% of its maritime zone. It is necessary to establish a network of protected areas, and include them in the urban and space planning documentation. Since it is possible that certain locations have lost, partially or completely, the specific features, which were the cause for their protection in the first place, our country should conduct a comprehensive analysis of the protected areas not categorised as national parks. In addition, Montenegro needs to carry out activities directed towards increasing the economic use of protected areas’ potentials. Drafting a strategy for the development of tourism in protected areas would be of high importance. Establishment and development of the environmental information system in Montenegro is also necessary in order to provide reliable and timely information on the state of the environment, which are required for the efficient pursuit of the environment protection policy.

In order to protect the environment from devastation, it is necessary to draft plans for the use of natural resources (forests, rivers, the sea, land, etc.), as well as plans/programmes for the protection of wildlife. Montenegro should be efficient in the implementation of the “polluter pays” principle, pursuant to the Environment Liability Law.

With a view to ensuring the appropriate protection of soil from degradation and pollution, Montenegro should adopt a National Plan for Combating Desertification and Soil Pollution with the action plan, pursuant to the Environment Law. All (real and potential) soil polluters should be more closely monitored, and severe sanctions should be implemented pursuant to the provisions of the Environment Law, including the halting of a production process until the ecologic demands are met. Sites with excessive level of soil pollution should be mapped, and the pollutants should be required to detoxify the said sites. The polluted sites should be banned for food production, while the pollutants should pay the indemnification for farmers. The efficient measure would be the introduction of tax reliefs in the development of production processes which comply with the ecological standards, as well as tax discouragement of consumption of products harmful to the environment and human health. Strict control of the import and use of plant protection products and monitoring of the application of mineral fertilizers and pesticides is also required. Long-term harmonisation with the EU Directives is necessary in this field. It is also necessary to adopt regulations on the application of good agricultural practice, promotion of the use of organic fertilizers and biological plant protection products. Montenegro should foster better understanding of ecological processes that influence the production, and the earmarking of agricultural land through organizing practical trainings for producers.

Water is expected to be one of the key resources in the following decades. This is supported by forecasts showing that by 2030, the lack of water will amount to 30%. Therefore, it is necessary to pay more attention to ecological protection of areas rich in water resources, in order to create comparative advantages in the future. Registry of springs as well as real and potential sources of water pollution should be made. It is necessary to establish zones of sanitary protection as prescribed by law. Montenegro also needs to develop and implement comprehensive and long-term water planning, focusing in particular to the development of policies aimed at increasing the productivity and efficiency in the use of water resources in all sectors, especially in agriculture. It would be useful to draft water protection strategies, or strategies for improving water monitoring, with

the proposal for the long-term development of capacities. Montenegro should work intensively on raising the awareness of the necessity for saving and protection of water. An adequate solution for the issue of water protection in Montenegro would be to found the Water Management Agency, which would be in charge of protecting health and property of population from harmful effects of water, monitoring and protection of surface, underground, and coastal water, and ensuring the earmarked and rational use of water, etc. Montenegro should adopt the National Strategy for Integrated Coastal Area Management, which shall ensure coordination and the integration of policies referring to the coastal zone. The Strategy should also enhance the strategic framework of coastal ecosystems protection, the process of monitoring and gathering data on the coastal processes, as well as the process of application of operational instruments for sustainable development of the coastal zone. Systems of ecological protection in ports and marinas need improvement and so do the systems for protection from oil derivatives spills in the aquatory, and systems for protection from explosions and fires in the oil derivatives warehouses in Boka Kotorska and in the port of Bar.

Activities aimed at more efficient resolving of the waste management issues need to be intensified, primarily through the implementation of the Waste Management Plan 2014 – 2020. Montenegro needs to continue working on the rehabilitation and re-cultivation of unsanitary landfills (“Ćafe” landfill in the municipality of Bar, and “Vrtijeljka” in Cetinje), as well as to carry out intensive activities in the aim of rehabilitation of unregulated landfills. As per the Environmental Protection Agency’s information for 2013, there are 273 unregulated landfills in Montenegro. It is necessary to build regional sanitary landfills, which comply with the European standards, as well as to construct a national plant for safe disposal and treatment of hazardous waste, and intensify the activities aimed at the construction of planned recycling centres. Particular emphasis should be placed on the need for the enhancing collaboration between the state and local government, and on investing in the area of waste management.

Primarily, it is necessary to establish a functional recycling system, intensify efforts in organising selective waste gathering, and form a network of recycling plants. Training public utility officers to react appropriately in cases of waste mismanagement is of high importance. Continuously raising public awareness and knowledge on the appropriate waste management, repurposing, and recycling is required. Media should take a more significant role in promoting adequate disposal and repurposing of waste.

Montenegro should foster the production and use of biodegradable and eco-friendly packaging. Therefore, Montenegro should adopt the Law on packaging and packaging waste management. The use of light thin plastic bags, particularly the ones used in supermarkets, represents a major ecological issue. These bags are disposable, and most of them end up in the sea. Their effects are very harmful, and leading to the loss of biodiversity. Therefore, Montenegro needs to develop a policy and define objectives with a view to limiting the use of light plastic bags, with the possibility of banning them for use.

In order to preserve and improve water quality and meet the EU standards, it is necessary to continue the realisation of projects of building the wastewater treatment plant. Simultaneously, Montenegro should focus on resolving the issue of the wastewater treatment by-products (sludge). This underlines the necessity of adopting the National Strategy for Wastewater Treatment Products and harmonising the existing legislation with the adopted strategy.

The air quality analysis showed that the stationary sources, i.e. major industrial plants, are the biggest air polluters. This refers primarily to the thermal power plant “Pljevlja” where the ash and slag landfill requires rehabilitation, and the aluminium plant “KAP” and the rehabilitation of its red mud pond, which is waiting to be finally resolved. In addition, there is the issue of “Željezara Nikšić” ironworks- where the quality of fuel used in the industrial boiler rooms needs improvement. Significant source of air pollution is also the household heating with the use of fuels containing a high level of pollutants; therefore, it is necessary to continue to raise public awareness of its harmful effects. In order to increase the coverage of territory under air quality monitoring, it is necessary to increase the number of monitoring stations in the country. Montenegro needs to draft an air quality plan for the municipality of Podgorica, where the air quality does not comply with the prescribed standards, and to define strategic approaches to resolving this issue.

Montenegro must continuously promote and develop transportation methods acceptable to the environment, prioritizing the promotion of the use of public transportation, especially in the urban environment. As a prerequisite, it is necessary to improve the public transportation system, and increase its availability in a greater number of municipalities in the country. Montenegro should introduce the application of stricter regulations on the import of new and the registration of old vehicles, and promote purchase of vehicles with lower toxic mater emission and hybrid vehicles (e.g. by lowering registration prices). Introduction of special tax on vehicles is recommended, with the amount paid depending on the vehicle’s

emission of CO<sub>2</sub> (“CO<sub>2</sub> tax”). Montenegro should establish an appropriate legal framework that would ensure production, trade, control, and use of biofuels and other renewable fuels for transportation purposes. Montenegro should establish gas emission standards for transportation vehicles, as well as standards for greenhouse gas inventory. In addition, Montenegro should focus more on promoting healthy lifestyles through concrete activities, such as construction of cycling infrastructure and introduction of pedestrian zones within the urban zones.

Investing continuous efforts in increasing the level of integration of the climate change issues in the sector strategies is of the essence. Pursuant to the Environment Law, our country needs to define its policy on climate, through adopting the National Plan for Climate Change Mitigation and the National Climate Change Strategy by 2030.

With a view to improving the protection of the environment from fires, it is necessary to create an adequate legal framework in the area of fire protection, provide funds for establishing a more efficient fire protection system. It is especially important to strengthen its preventive aspect, in order to prevent intentional starting of fires, and the occurrence of fires resulting from gross negligence. Possibility of founding a regional firefighting centre and joint procurement of firefighting aeroplanes and helicopters should be taken into consideration. Urgent measures must be taken on rehabilitation of degraded forests, and, to this end, afforestation and forest recovery plans must be drafted. It is necessary to strengthen the monitoring of building, prevent illegal and unplanned building in the protected areas, and take measures needed for the recovery.

Another significant issue of biodiversity protection is high rate of poaching. In order to resolve this issue, Montenegro has to intensify control and to ensure the implementation of sanctions and other measures prescribed by law, at the same time working on the development of stimulation measures aimed at changing the structure of catch. Capacity building is necessary in fishing inspection. Montenegro needs to adopt the Fisheries Development Strategy and the National Fishery management Plan.

In order to achieve better protection of national parks and other protected areas, Montenegro is recommended to establish an association of park rangers and wardens (Ranger Association). Ranger Association would be in charge of the direct supervision of the implementation of the Environment Law, and filing charges for offences and misdemeanours committed in the national parks under

their competence. This association would afterwards become a member of the International Ranger Federation, enabling thus the training for Montenegro's park rangers, exchange of experience at the international level, and transfer of best practices and models of supervision applicable in our country.

Activities referring to the adoption of environment protection plans at the local self-governments' level should be continued. Montenegro should apply standards of the ISO 14000 series, which refer to different aspects of environment management and apply to companies and organisations striving to control their impact on the environment.

Montenegro should put more focus on, and give incentives for the use of EU and other institutions' funds aimed at renewable energy sources. In this area, the stress should be on the importance of fostering research, development, and application of ecologically sustainable new technologies in the energy sector. In order to create a sustainable environment protection financing system, Montenegro needs to establish an Environment Protection Fund – Eco Fund, including eco funds at the local self-government level. Eco funds should be committed to financing and realising of programmes and projects in the field of preservation, sustainable use, protection, and promotion of the renewable energy resources, as well as to the efficient implementation of the “polluter pays” principle.

The adequate implementation of the said measures requires investment of public and private sectors' funds. In the background of the global financial crisis, the advanced countries saw the chance in the fact that the need for economic reforms and reduction of public debt in the member countries provides an opportunity that these countries should use to start forming low-carbon economies, which are more efficient in terms of resources.

Continuous launching of different types of campaigns by the government and non-government sector is required, along with organizing public debates in the aim of informing the public on the environmental issues. Introduction of education programmes should continue, targeting the educational institutions and curricula at all levels of education (kindergartens, primary schools, secondary schools, and universities), the business sector, non-governmental organisations, media, and local communities. Focus should also be on country's business sector, through the promotion of waging campaigns in a socially responsible manner. In that regard, tax and other types of reliefs should be used to stimulate companies to invest in technologies which do not produce adverse effects on the environment, also,

creation of products which promote adhering to the sustainability principles should be fostered.

With a view to maintaining the balance between economic development, social justice, and the need for the protection of the environment, economy's financial infrastructure should be reoriented to the goals of sustainability. To achieve this, it is important to recognise the role of financial institutions and investors in initiating sustainable development. In the effort to allocate capital to companies operating on the principles of sustainability, financial institutions can significantly influence their clients, encouraging them to adjust their activities with long-term sustainability goals. The role of the stock exchange can also be significant in the process of transition to markets that integrate ecological issues by promoting transparency in terms of ecologic performances of listed companies, encouraging thus the responsible and long-term approach to investing. In that regard, the stock exchange should be encouraged to promote responsible investment and corporate sustainability with the Montenegrin companies.

With a view to improving the efficiency regarding the application of regulation, it is necessary to increase institutional and staff potential for the implementation of obligations required by the legislation and strategic frameworks, while improving coordination of institutions in charge of the preservation of the environment and implementation of relevant laws. Montenegro must put in more effort in training and connecting municipal services in order to answer any challenge in all the areas of environment protection. In addition, since the Ministry of Sustainable Development and Tourism is not in charge of all the elements of the environment, providing an integrated approach to the system of environment management is required. In order to mitigate the damage of the activities negatively influencing the environment, ecological inspection oversight must be intensified. Establishing the institution of Environment Protection Ombudsman would be a useful step forward in strengthening the overall environment protection system.

Montenegro cannot achieve sustainable socio-economic development without a uniform development on the local and regional levels. To achieve a more uniform development of all three regions (continental, central, and coastal), our country needs to focus more on the measures directed towards the balancing of regional development. Primarily, greater efforts should be invested in the development of human resources and infrastructure in less developed local self-governments units. Montenegro needs to continue drafting secondary legislation aimed at ensuring consistency between the local communities' interests and general development framework, thus ensuring the appropriate direction of funds to all parts of the

country, as well as equal allocation of priority investments. Montenegro should focus on the use of EU funds directed towards the uniform regional development, and to that respect, increase its efforts invested in building programme and project capacities for application for international funds. With a view to the efficient pursuing of regional policy and monitoring the development of individual regions, it is important that the statistical system start producing key indicators on a regional principle.

Population represents a major factor in development. Projections results indicate that the demographic development of Montenegro by 2050 will be characterised by the aging process. Results of the 2011 Census support this projection. In relation to 2003 Census results, population under 24 years declined, while population older than 24 increased. These results urge for the initiation of population policy, and the drafting of National Demographic Strategy.

## XI. RECOMMENDATIONS CONCERNING OTHER AREAS

### 1. Statistics

<i>Key recommendations</i>	<i>Deadline</i>
Strengthening administration capacities by means of continuous employment, education and motivation	Medium
Use all types of support and technical assistance programmes	Ongoing
Provide adequate spatial and financial conditions for better functioning of Monstat	Short
Compilation and publishing of quality macro indicators such as calculation of quarterly GDP with value added by sectors, on the production side, quarterly GDP by consumption categories, calculation of annual GDP under income approach, of certain indicators of agriculture, tourism, etc.	Short
Work on the revision of GDP data using the ESA 2010 methodology	Short
<i>Main risks</i>	<i>Risk direction</i>
Lack of sufficient number of experienced and motivated statisticians in Monstat and other institutions producing statistics.	Stable
Unsatisfactory general working conditions of non-executive officers, lack of working space, inadequate salary, which may lead to brain drain and slowing of the process of development of statistics and statistical system.	Stable
Non-existence of multi-annual time series of quarterly GDP data, and quarterly GVA series by individual sectors, which may result in passing low-quality recommendations for economic policy in some sectors.	Declining
Insufficient reliability of some data collected by interviewers	Declining

### *Background*

The Statistical Office of Montenegro (Monstat) continuously works on improving statistical areas and surveys under its competence pursuant to the Law of official statistics and official statistical system<sup>29</sup>. Development activities in the field of statistics are related to requirements of EUROSTAT to ensure full compliance with the Acquis Communautaire, which represents an extensive and demanding task.

<sup>29</sup> OGM 18/12.

During the previous period, MONSTAT, as the user of pre-accession programmes, successfully implemented (and continuously implements) a number of projects aimed at improving different statistical areas. Improvement and development of statistical areas includes updating existing surveys as well as creation of new ones in order to fully comply with all requests of the *Acquis Communautaire* in the field of statistics.

During the previous period, three key strategic acts have been prepared for the area of statistics: Development Strategy of Official Statistics 2014-2018, Programme of Official Statistics 2014 – 2018 and Annual Plan of Official Statistics for 2014. All three acts are equally important. On one hand, the Programme of Official Statistics represents a document that defines general objectives while the Development Strategy of Official Statistics complements the Programme by defining strategic directions for future development of Montenegrin statistics. At the same time, both the Strategy and the Programme of Official Statistics represent a detailed harmonisation plan for negotiation Chapter 18. Development of official statistics through the Strategy is necessary and the implementation of development will depend on provision of necessary human and financial resources, as well as on development assistance from international institutions.

In 2013, the Statistical Office conducted 184 regular surveys out of total 194, issued 3 publications, published 334 press realises, 3 analyses, 1 newsletter, 9 statistical methodologies, participated in 87 international conferences, meetings, workshops, trainings or study visits outside Montenegro aimed at improving official statistical system of Montenegro, as well in the work of 19 inter-institutional working groups.<sup>30</sup>

The Annual Plan of Official Statistics for 2014 envisages 211 statistical surveys, covering six areas: Demographic and social statistics, Macroeconomic statistics, Business statistics, Statistics on agriculture, forestry and fishery, Multi-domain statistics as well as Area referring to support for statistical results.

There has been a progress in most statistical surveys from different areas such as national accounts, labour market, prices, transport, tourism statistics and the like. Bearing in mind the challenges ahead and the complexity of Chapter 18, all available resources need to be improved in order to perform the tasks deriving from comprehensive implementation of the EU acquis, i.e. in order to fulfil the main strategic objective of official statistics which is to comply with the legal

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<sup>30</sup> Taken from the Report on Work for 2013, Statistical office of Montenegro, January 2014

system concerning official statistics. The fact that this Chapter is regulated by the EU acquis consisting of about 350 regulations, directives and recommendations best demonstrates the complexity of work referring to official statistics.

### *Operational measures*

One of the main activities should be hiring new staff, as defined by the Montenegro's EU Accession Programme for the period 2014 – 2018<sup>31</sup>. At the same time, the Rulebook on Internal Organisation and Systematisation, no. 01-621/2 as of 02, April 2008 envisages that the number of employees should be 203, which is almost double compared to 104 people employed in MONSTAT at end-2013. Professional training and education of employees along with additional stimulation (increased salaries or some type of compensations) would in the long term provide Statistical Office with quality staff that would be motivated to deal with the challenges from the Chapter 18.

Despite continuous professional training through various technical assistance programmes, it is necessary to keep skilled workers. The fact that 129 persons were employed in Monstat at end-2009 while 104 persons<sup>32</sup> were employed at end-2013 speaks volumes about the lack of employees needed for successful operation of all statistical areas, as well as to successfully meet all future obligations concerning implementation of the EU acquis during the accession process.

In order to increase working space capacities, the Government of Montenegro allocated additional space to the Statistical Office in 2014. However, what remains is the problem of lacking and adequate spatial solution for creating suitable working conditions, especially since MONSTAT needs to employ much larger number of statisticians, as envisaged by the Montenegro's EU Accession Programme.

In its operation and production of final data, for certain statistical areas, Statistical Office also uses information from other institutions in the system, i.e. official producers of specific statistical data. Therefore, it is of utmost importance to strengthen the role of MONSTAT when it comes to creating new and improving existing administrative sources of data in order to increase the use of data for statistical purposes, reduce the overload of reporting units, reduce the cost of data

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<sup>31</sup> Table 3.2, Administrative capacities – page 355 shows the number of employed persons per year for the period 2014 – 2018.

<sup>32</sup> Report on Work for 2013, Table 4.

collection and the like. Data control and regular updating of registers require particular attention in order to achieve good and internationally comparable indicators of official statistics through implementation of European legislation.

MONSTAT continuously works on harmonisation of all statistical areas with the EU legislation. Programme of Official Statistics for the period 2014 – 2018<sup>33</sup> provides an overview of expected results of official statistics by areas as well as information on their periodicity and the degree of compliance with international standards. Even though each of the mentioned statistical areas, which are grouped into five main areas<sup>34</sup>, has its own specificity and importance, the focus should be placed on national accounts within macroeconomic statistics. Since the system of national accounts, i.e. GDP calculation, represents a part of a very complex and comprehensive statistics, there should be a continuous effort aimed at improving all statistical surveys which are conducted monthly, quarterly and annually. This will contribute to improving calculation of annual and quarterly GDP, both in current and constant prices, by activities in the production side and consumption categories in the expenditure side of the GDP. Income approach is still not used when calculating GDP, which is contrary to the EU acquis.

Implementation of activities in the area of macroeconomic statistics, particularly national accounts is conditioned by an increase of staff capacities and professional training of employees. Statistics of the agricultural sector as well tourism sector represents a special challenge in the process of harmonisation because they represent important segments in the total GDP. Even though there have been significant efforts in these areas, there is still no sufficient information in the area of agro-monetary statistics, accounts in agriculture, information on revenues in individual accommodation capacities, and the like. This would facilitate calculation of GVA of these sectors in the total GDP of Montenegro. There is a project that aims to improve statistical information system in Montenegro. It started in May 2013 and will last until May 2015, and it also includes agriculture statistics (component 1 from the Project), national accounts statistics (component 2) and business statistics (component 3, which includes tourism statistics). Through planned activities, the project will influence further harmonisation of the mentioned statistical areas with the EU standards, as well as production of quality internationally comparable indicators:

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<sup>33</sup> Published in OGM, 13/14, as of 14 March 2014

<sup>34</sup> Given in the Montenegro's EU Accession Programme for the period 2014 – 2018, December 2013, page 320. Chapter 18: Statistics

- Gross domestic product, which indicates the “strength” of Montenegrin economy,
- Agriculture, which represents a sector with several segments and can use the EU funds, and
- Tourism, which represents a sector that is best known for attracting FDI.

In September 2014, Methodological framework for producing national accounts data (ESA 1995) is replaced by the new European System of Accounts (ESA 2010). Compared to ESA 95, ESA 2010 holds 44 improvements. In Europe, national accounts have a key role and represent a basis for numerous indicators that make a backbone of the European fiscal policy. When it comes to the area of macroeconomic statistics, one of the most important priorities of the Statistical Office of Montenegro is harmonization of national accounts with the methodology ESA 2010. Due to comparability of data with other countries that will publish basic indicators in line with ESA 2010 starting from October 2014, MONSTAT’s statisticians face a huge challenge, especially national accounts statisticians. Therefore, it is necessary to provide support in the form of human and financial resources in order to create adequate conditions for performing one of the most complex tasks when it comes to adopting EU legislation, which is compilation of national accounts.

## 2. Accounting and auditing standards and their application in Montenegro

<i>Key recommendations</i>	<i>Deadline</i>
Work on further professional strengthening of accounting-auditing expertise and practice in order to accomplish satisfactory quality, application of ethical standards and codes as well as even and coherent reporting quality using the IAS.	Short
Intensify application of adopted amendments to the Law on Accounting and Auditing, particularly in the part referring to meeting deadlines and reporting format for submitting annual financial statements to the Tax Administration of Montenegro.	Short
Develop mechanisms for supervising the quality of accounting and auditing practice and the institutional framework for external control of the quality of annual financial statements.	Short
Intensify cooperation with the IFAC and the World Bank in realisation of technical assistance, translation of IAS and inclusion into the work of relevant bodies and institutions dealing with accounting-auditing practice.	Short
<i>Main risks</i>	<i>Risk direction</i>
Inconsistent application of passed amendments to the 2011 Law on Accounting and Auditing referring to implementation of the IAS and their translation, as well as the IFRS and the ISA.	Stable
Insufficient institutional cooperation and insufficient volume of control mechanisms for quality in the work of accountants and auditors.	Stable
Untimely submission of annual financial statements to the Tax Administration.	Declining
Disrespecting requests for financial reporting pursuant to the IFRS, which would meet the obligation that all shareholding companies at the stock exchange's listing should timely submit financial statements with adequate quality, pursuant to the <i>acquis</i> .	Declining
Lack of audit independence.	Stable
Inadequate attention paid to financial reporting by small and medium enterprises.	Stable
Insufficient attention paid to quality in filling the forms submitted to the Tax Administration.	Declining

## ***Background***

Despite improvements made in 2014, application of international accounting, auditing and financial reporting standards (IAS, IFS, ISA<sup>35</sup>) in Montenegrin companies remains insufficient. Tax Administration of Montenegro improved submission of annual financial statements of Montenegrin companies by making significant financial investments in terms of electrification of control.

During 2014, amendments to the existing accounting and auditing regulation were supposed to provide a higher level of harmonisation of national legislation with directives and *acquis communautaire* of the EU and to increase the quality of data, especially in the domain of comparability, continuity and consistency criteria in (fair) presentation of accounting situations and policies. However, the implementation itself is still in progress. The implementation of these standards represents a practical guide for regulating accounting practices that can be applied to countries with different economic features and on the other hand, it supports the goal of Montenegro to meet the criteria necessary in the process of accession to the EU in this domain.

The World Bank's team visited Montenegro in 2006 and prepared the Report on the Observance of Standards and Codes (ROSC) on accounting and auditing in Montenegro. The ROSC sets out recommendations aimed at increasing the quality of financial reporting in Montenegro. The Ministry of Finance of Montenegro and stakeholders competent for improving the financial reporting quality in Montenegro (Ministry of Economy, Monstat, Central Bank of Montenegro, Securities and Exchange Commission, Tax Administration of Montenegro, Commercial Court of Podgorica, Institute of Certified Accountants and Auditors of Montenegro) accepted the World Bank's recommendations. Moreover, the Ministry of Finance of Montenegro established the National Council for Accounting and Auditing with the aim of strategic improving the accounting-auditing practice, management and accounting organisation of companies in Montenegro according to IAS, ISA, and IFRS. The strategy and Action plan of operational and step-by-step reforms have been prepared, including the stakeholders' activities on improving the legislative framework, institutions and accounting business and improving business and ethical culture with a unique accounting objective: raising the quality of micro and macro financial reporting to lead to the harmonisation of the Montenegrin regulatory framework of account and

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<sup>35</sup> IAS- International Accounting Standards; IFRS – International Financial Reporting Standards; ISA – International Standards on Auditing

other financial reporting with the *acquis*. This included working on preparation of consolidated financial statements and legislation for regulating the operations of auditing firms, centralisation of annual statements database, publishing of financial statements and improving their quality, electronic accounting practice, working on financial classification of companies to small, medium and large companies, and the like.

There was a noticeable delay in implementation of the Action plan pillars referring to the establishing of a public body for oversight of auditors' work in 2014. At the same time, the adopted amendments to the 2011 Law on accounting and Auditing set out the obligation of submitting annual financial statements to the Tax Administration. The existing legal provisions enable submitting annual financial statements both in hard copy and electronic format, which includes the possibility of electronic submitting of financial statements into a single database. This manner of submitting financial statements is still not fully implemented in practice despite the fact that about 15% of annual financial statements were submitted electronically to competent institutions during 2014.

In 2014, there was also a significant progress in terms of educating accountants and auditors by the Institute of Accountants and Auditors through seminars, courses, publications, and the like, thus strongly contributing to the higher quality of accounting and auditing practice in applying IAS, ISA, and IFRS in Montenegro. Additional education on computerising the accounting should be directed to companies in municipalities that still do not practice it.

### ***Operational measures***

It is necessary to continue implementing the *Strategy and the Action plan for improving quality of financial reporting in Montenegro*. Moreover, it is necessary to invite ROSC delegation to perform the „follow up“ of the implementation of Recommendations from May 2007 and thus assess the progress in accounting and auditing practices in Montenegro.

Continue reporting on the corporate governance progress in joint stock companies in Montenegro and on managers dealing with accounting practice, so that relevant authorities could create necessary measures to improve this area.

International standards should be fully implemented. Currently, the audit reports are contained in the ISA framework but the ISA are not fully translated (the IFAC Manual) and adopted in Montenegro.

Activities started under the REPARIS projects aimed at improving standards for education and certification of accountants and auditors under relevant national bodies should be continued.

Accelerate expansion and development of the database for annual electronic financial reporting, primarily on the websites of the Tax Administration, the Ministry of Finance and the Securities and Exchange Commission.

Continue and accelerate work in relation to “FIRST” initiative, with two main objectives: (1) providing technical assistance to the Government of Montenegro in determining priorities within the National plan for improving financial reporting for the period until the end of 2015 and (2) providing the Council for Accounting and Audit with the extension of the national action plan in the medium and long term.

Regional cooperation, and institutional and supervision connections in accounting and auditing should be strengthened, particularly in translating and interpreting the IAS and the IFRS. Relevant institutions should establish an institution for supervising auditing and accounting firms. Relevant bodies should strengthen organisational units to work on the compliance of financial reports with the legislation.

Provide a higher level of operational transparency and reporting of economic entities, especially by the insurance and reinsurance companies, investment funds, NGOs, stock exchanges and stockbrokers as well as and information on board of directors’ members, particularly in their participation in ownership structure, and compensations to management. Moreover, the publishing of (semi)annual financial reports of joint stock companies quoted at the market SEC’s website should be initiated.

A special body – Agency should be formed to supervise and evaluate work of auditors, especially operations of (re)insurance companies.

The state should impose a stricter control and sanctions to companies that do not submit annual financial statements within set deadlines.