

**RECOMMENDATIONS TO THE GOVERNMENT OF  
MONTENEGRO  
FOR  
2016 ECONOMIC POLICY**

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## **I. INTRODUCTION**

Real GDP growth rate up to 4% is expected in 2015. The growth is higher than the projected which largely resulted from stronger tourism growth and the related activities in this year. In addition, other sectors recorded growing activities, which is partly explained by real increase and partly low base from the last year. Favourable weather conditions and also external circumstances during 2015 resulted in a substantial growth in tourism sector. However, an issue of draughts and vulnerabilities that they may have in agriculture and electricity sectors in the following period opened.

Fiscal deficit will be high due to a substantial increase in expenditures for the purpose of highway construction. However, low structural fiscal deficit is mitigating factor. Current account deficit in the first six months of 2015 recorded a y-o-y increase, and it is an indicator, partially, of the economic recovery but low competitiveness of export products and services. Public debt reached the 60% level, but it is expected that its development component will create new value in the future.

Montenegro's economy is on its upward trend, but it will face large number of risks in the following period. This primarily refers to the preservation of fiscal stability, high level of real sector illiquidity, low level in competitiveness, high share of NPLs and consequently high interest rates, non-diversified export, high current account deficit, and the like.

Economic policy in 2016 should be focused on fiscal policy, i.e. prudent public spending, which would be at the level of current budget revenues. Although fiscal deficit will be high in 2016 due to the highway construction, structural deficit should not exceed 1%. Fiscal stability would be preserved and we would not enter the zone of increased risk of public finances. In addition, structural reforms should be prioritised, which will promote growth and development, competitiveness of the economy and create stability. The most important economic policy measures should relate to the continuation of fiscal consolidation, gradual change in development model, enhancement of Montenegro's economy competition, more dynamic negotiations with the EU, continuation of structural reforms and privatisation, passing of systemic laws in accordance with the best international practices, continuation of deregulation, removal of business barriers, and the like.

In the fiscal policy area, significant efforts have been made in fiscal consolidation, which was shown through the increase in public revenues, reduction of shadow economy and decrease in structural fiscal deficit. Still, the key risks in the upcoming period will remain concentrated in the fiscal sphere due to the level of public debt and planned infrastructural activities. In addition, a potential risk may result from excessive borrowing at the local level. 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 benefit of capital expenditures.

The banking sector is stable. Yet highly liquid and solvent, it is burdened with a high share of non-performing loans, and consequently prudent lending policy of banks and high interest rates. Enhancing of the recovery, implementing legal model of voluntary financial restructuring, positive international environment might contribute to further increase in the financial sector stability increasing simultaneously the effectiveness and productivity of the real sector.

Passing of the Economic Reform Programme 2015-2018 in accordance with the new requirements of the EC in economic dialogue with the candidate countries, the Government of Montenegro focused its economic policy on the structural reforms striving to achieve sustainable economic growth. One of the priorities in the forthcoming period should be the implementation of the solutions recognised in this strategy paper.

It is also important to change growth model from the one driven by the domestic demand to the one to be driven by export expansion of products and services. This would also be an incentive for higher productivity and competitiveness of the economy that would guarantee long-term and sustainable growth. Moreover, in order to promote further this growth model, it is necessary to maintain stable and competitive tax environment underlying such growth.

An important set of measures refers also to the labour market where growth both in employees and unemployed persons was recorded. The policy of substituting foreign workforce with domestic workforce should be implemented, wherever possible, thus paying attention to gradual substitutions as rapid substitution could jeopardise the functioning of the tourist sector.

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 2016 Economic Policy. Analyses of the selected areas contain key recommendations, the deadline for their implementation, the analysis of the most important possible risks in the upcoming period and their direction, 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 energy;
- 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;	Ongoing
Initiate with all local self-government units the creation of incentive programmes to attract investors	Short
Improve the implementation of anti-monopolistic policy	Ongoing
Continue the implementation of RIA methodology in passing new legislation	Ongoing
Continue combating shadow economy by strengthening institutional capacities involved in these activities	Ongoing
Strengthen the mechanism of restitution and expropriation	Short
Introduce automated bankruptcy	Medium
Sanction all investors breaching privatisation process contractual obligations	Ongoing
Strengthen the financial support for creating new and developing the existing SMEs through the Investment and Development Fund	Ongoing
Increase transparency of the public procurement process and simplify the conditions for participating in the procurement process	Short
Implement fully e-administration system	Short
Increase efficiency of the Real Estate Administration and improve the work of its subsidiaries	Short
Consistently implement Law on Deadlines for Settlement of Monetary Obligations	Ongoing
<i>Main risks</i>	<i>Risk direction</i>
Further deepening of real sector illiquidity	Increasing
Difficult collection of receivables	Stable
Inefficiency and slow administration in implementing legislation	Stable
Sluggishness of courts in resolving commercial disputes	Stable
Unresolved property and legal relationships	Stable
Highly monopolised market	Stable
Inexistence of qualitative planning documents, lack of 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 and winter tourist seasons	Stable
Unstable legal framework, frequent amendments to systemic laws	Stable
Still present shadow economy, disloyal competition and corruption	Stable

## ***Background***

The development of sound and favourable business environment is the key for new investments, which are very important for the growth and development of a country, in particular Montenegro as a small and open economy. The activities on the improvement of efficiency of financial and legal institutions and the development of sound policy climate are of utmost importance for improving investment and business environment.

Montenegro's membership to the EU and NATO bears strengthening of the institutions and legal state, which contributes to more stable business environment and increase of the investors' confidence, thereby opening higher possibilities for the operations of the existing and opening of new small and medium enterprises. Fulfilling the conditions required by the EU and NATO will strengthen the confidence into the economic and legal systems of the State, which creates conditions for the investors to invest foreign capital and support the development of local companies, which will substantially contribute to the economic development in its entirety.

The Council for Improving the Business Environment, Regulatory and Structural Reforms continued with the implementation of activities in 2014 and 2015 which contributed to the increase in efficient administration (shorter procedures and more transparent deadlines for resolving applications) and creating more favourable climate for domestic and foreign investors. Previously prepared "*Analysis of local fiscal adjustments*", contains the recommendation of the Council to abolish utility fee for the construction land starting from 2016, which is the main barrier for the realisation of investments. This fee is one of the highest in the world and represents a great obstacle for the investors.

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 Ministry of Finance's Department for Business Environment Improvement gave opinion on 1.057 proposals of the regulations since formal introduction of the RIA<sup>1</sup> methodology into the Montenegrin regulatory system in 2012. In addition, the Government adopted a report "*Analysis of the effects of regulations in Montenegro*" on the proposal of the Council for the improvement of business environment, regulatory and structural reforms<sup>2</sup>, together

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<sup>1</sup>*Regulatory Impact Assessment*

<sup>2</sup> The report prepared by the OECD in cooperation with the SIGMA.

with the proposal of recommendations aimed at eliminating business barriers and improving the quality of regulatory framework. The purpose of this report was to evaluate actual implementation of the RIA methodology relative to formal request and identify areas with potential improvements.

The implementation of the recommendations of the “Guillotine of Regulations” continued also in 2014 and 2015. The level of the implementation of recommendations since the first adopted Action Plan until May 2015 was 74.62%. The implementation of 237 recommendations is expected by the end of 2015, whereby the implementation of some recommendations planned for 2014 is postponed for 2015. During 2016, some 99 recommendations should be implemented, while seven recommendations should be implemented in 2017.

Law on Deadlines for Settlement of Monetary Obligations entered into force and Law on Enforcement and Securing of Claims was amended<sup>3</sup> in 2014 in order to strengthen the financial discipline and liquidity of legal entities and public sector. The Law on Deadlines for Settlement of Monetary Obligations prescribed that the deadline for settling monetary obligations between legal entities and between public sector and legal entities is 30 days, whereas the agreement may envisage other deadline that cannot exceed 60 or 90 days following the day of the occurrence of the debtor and creditor relationship<sup>4</sup>. This law also prescribed sanctions in case of failure to meet contractual obligations.

Moreover, it is expected that the implementation of the Law on Voluntary Debt Financial Restructuring, which entered into force in May 2015, will contribute to the decline in illiquidity of the economy.

With a view to strengthening the competitiveness of small and medium-sized entrepreneurship, a grant for the project “Establishment of Regional Business Centre and Incubator for North-East Montenegro” was provided within the IPA Programme 2011<sup>5</sup>. The project covers the opening of the office of Regional business centre for the municipalities in the north of Montenegro (Berane, Rožaje, Plav, Andrijevica and Bijelo Polje) and incubators in Berane.

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<sup>3</sup> Another amendment was made in April 2015.

<sup>4</sup> Full compliance with the Directive 2011/7/EU on combating late payment in commercial transaction will be reached through the adjustment of the level of default interest rate as anticipated in the draft Law on interest rate ceiling.

<sup>5</sup> IPA Programme 2011 “*Inter-municipal development grant programme*”. Eng. „*Establishment of Regional Business Center and Incubator for North-East Montenegro*“.

Since 2014, the implementation of the IPA project “Enhancing the Competitiveness of Local SMEs in Montenegro through Cluster Development” started. Technical support was provided within this project for four clusters (Trout Breeding Cluster, Olive Oil Cluster, Metal Production and Processing Cluster, and Wine Production Cluster), and the following studies have been prepared: Study on Funding Possibilities for Cluster-Based Initiatives in Montenegro, and Study on Legal Framework for Clusters Development in Montenegro.

The implementation of the project “Internet portal for companies in the municipality of „Bijelo Polje” was completed in 2014. The project was initiated in July 2013 within the cooperation of the Directorate for SME Development and the Ministry for Economic Development of the Republic of Italy. The Portal became operational in February 2015 and contains all information on the municipality, manufacturing companies, documentation required for the registration of business, funding possibilities, and the like.

During Q1 2015, the Investment and Development Fund and the European Investment Bank signed the Agreement on disbursement of the first tranche of loan of 40 million euros for SME development in Montenegro. Total amount of loan is 70 million euros and it will be disbursed through two tranches. The purpose of the agreement is to support the development of entrepreneurship and business ideas as basis for resources valorisation of Montenegro.

At the beginning of 2015, the Government passed a Decree on direct investment incentives in order to enhance business environment, attract foreign investors and increase employment. According to the Decree, potential subsidy per job position amounts to three to ten thousand euros. Funds will be allocated based on the public announcement<sup>6</sup>, the minimum value of investment for investment projects applying for the subsidy will amount to 500 thousand euros, and at least 20 job positions should be provided within three years following signing of the agreement on funds utilisation. The funds needed for the realisation of this decree are envisaged in the 2015 Budget and they amount to 2.25 million euros.

In September 2015, the Government also adopted a Decree on business zones that regulates the conditions for establishing business zones in Montenegro and their

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<sup>6</sup> There are predefined criteria for the selection of the investment project, that relate to investors' references, the effect of investment project on the productivity of suppliers and other companies in Montenegro operating in the same industry, sustainability of the investment project, and the like. In addition, the criteria cover the environment impact assessment, international turnover volume, the effects of the project on the development of less developed municipalities, and the like.

classification based on strategic importance, and the establishment, organization, management and enhancement of infrastructure in the business zones.

The amended Public Procurement Law will contribute to the improvement of business environment and increase of the competitiveness of the companies in Montenegro, which has been applied since end-April 2015. These amendments improved substantially public procurement area, and the increase in the efficiency of the enforcement of procedures, decrease in costs for offering preparation and removal of legal and technical uncertainties is expected.

New Accounting Law is in the Parliamentary procedure, i.e. it is included in the Plan of the legislative work of the Parliament of Montenegro for 2015. This law will introduce international standards for the valuation of properties. The introduction of these standards will contribute to significant protection against potential fraud in the construction and real estate sectors, and it will be easier for the investors to obtain banking loans, which will contribute significantly to the improvement of real estate activities.

The implementation of the project “Public Administration Tailored to the Needs of Businesses and Citizens” started at the beginning of 2015, which is conducted by the Ministry of Finance in cooperation with the UNDP and support of CDT and SEECOM. The main objective of the project is to initiate public dialogue by which citizens and business community will point to the local problems with regard to the business barriers and propose manners for improving the quality, efficiency and availability of public services and creating more encouraged business environment. The main tool of the project is online platform, [www.prijavibarijeru.me](http://www.prijavibarijeru.me), which enables citizens and entrepreneurs in pilot municipalities (Budva, Žabljak and Danilovgrad) to report problems that refer to over-regulation and necessary complicated and other procedures in public administration at local level. Based on the reports and proposals obtained, a report for the Council for Improving the Business Environment, Regulatory and Structural Reforms will be prepared, which will serve for providing more specific proposals to institutions for the removal of the barriers.

In April 2015, the implementation of the new Foreigners Law started, which brought significant facilities in the foreigners' employment area, but also certain restrictions if unemployed persons are registered in the Employment Agency of Montenegro that meet the conditions prescribed for the employment. This will provide for gradual substitution of foreign labour force with the domestic one, in particular, in the area of seasonal employment. However, as a significant number

of foreign labour force has been already employed before the implementation of the new law, particularly at seasonal jobs, the Law amending the Foreigners Law was passed in May which postponed the implementation of the law until November 2015, in order to create, in a timely manner, the conditions for more qualitative implementation of the law and for decreasing risks that could threaten the successfulness of tourist season.

The Law on Arbitration was passed in July 2015 and it is expected that its implementation will contribute to the improvement of business environment and both legal and economic stability. Namely, this law governs out-of-court settlement of disputes, which has significant advantages compared to court proceedings. The expertise of arbitrators for certain type of dispute, as well as the velocity of proceedings and first instance in decision making are key advantages for this way of dispute resolution.

The results of numerous activities conducted for the improvement of business environment are also recognised in the World Bank Doing Business Report 2015, according to which Montenegro improved its position by six places (36<sup>th</sup> out of 189 countries included in the report). The report noted successful reforms in Montenegro in the area of granting construction permits – fee for providing utility services was reduced and fee for obtaining urban technical conditions from relevant municipalities was eliminated. On the other hand, a decline was recorded in the following six indicators: starting a business (-8), getting electricity (-4), resolving insolvency (-2), getting credit, paying taxes and trading across borders (decline by 1 position). These findings clearly indicated that further reforms have to be taken in order to create more favourable business environment.

According to the Heritage Foundation Index of Economic Freedom, Montenegro ranked 66<sup>th</sup> of 178 countries included in this index, with 64.7 scores (1.1 more than in the previous year).

Montenegrin Foreign Investors Council published sixth edition of the White Book for Montenegro in June 2015. Even besides significant progress made in the previous several years, Montenegro still suffers certain critiques by foreign investors. Numerous business barriers are still present in the form of slow and long-term procedures, particularly at the local level. The MFIC Index was published also in the White Book. It is a perception-based evaluation of the ease of doing business in Montenegro. Overall rating is 6.3 – the same as the last year, which means that the foreign investors believe that the investment climate and business environment have not changed much.

Business barriers are still present in Montenegro, such as complicated and expensive administrative procedures, infrastructural issues and funding. In addition to many activities conducted to improve the business environment, there are certain deficiencies and problems that should be eliminated in the following period.

### *Operational measures*

Sound and clear regulations, together with efficient, rational and professional public administration are the main prerequisites for creating new companies and attracting foreign investors. The creation of better legal and regulatory framework will enable the reduction of operating expenses, simplification of procedures, higher level of legal security and predictability will reduce possibilities for corruption and ultimately create better and more stable business environment. More efficient court proceedings and efficient implementation of the legislation will encourage foreign investors to invest their capital to Montenegro.

With a view to improving business environment and removing business barriers, the relevant authorities have to provide efficient application of the enacted laws. The representatives of real sector should also be included in the process of passing laws and creating public policies that refer to the improvement of business environment.

With a view to improving the efficiency of the public administration, civil servants education system should be improved, and acquiring new knowledge, skills, and competences should be enabled through ongoing training. Moreover, administrative procedures should be improved, simplified and more transparent, implying shorter deadlines for acting, collecting documents *ex officio*, and determining actual fees in accordance with the administration costs.

There are many instances in which new owners do not adhere to all provisions of privatisation contracts, sometimes generating additional costs to companies and the State Budget. The authorities should control and keep systematised records of contracts' implementation, conduct inspections, and timely respond by taking appropriate actions.

The application of the RIA methodology should be continued. Recommendations given under the “Guillotine of Regulations” project should be also 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 financial incentives for new investments, establishing of business zones, 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 for the 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. 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. With a view to increasing the number of entrepreneurs and other legal entities in the municipalities in the North in particular, the cooperation between private, public and financial sectors should be intensified.

Utility fees for the construction land differ significantly at the local level, which creates difficulties for potential investors. Therefore, these fees should be balanced (price list) and the procedure for utility.

The one-stop shop system should be further improved for obtaining the construction permits in all local self-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.

The restitution and expropriation mechanisms should be improved in the following period for the purpose of creating legal security as basis for encouraging investments as unresolved property relations often represent big problem for the investors.

The problems are evident with regard to the operations of the Real Estate Administration in the area of unreliable data the Administration has, which resulted from irregularly updated information in the cadastre records at the local level. In addition, time period needed for the local self-government units to apply detail spatial plans and other documents important for the realisation of investments is rather long. Therefore, the work of the Real Estate Administration should be enhanced (particularly in local units) and increase administration capacities. Moreover, the level of data update in cadastre records should be increased to be accurate and reliable and as such would not create uncertainties and problems to foreign investors.

In the process of the registration of the companies, the officer responsible for registration checks submitted documents and notary authentications, which substantially extends the registration process. Law on Business Organisations should be amended in the following period, which would prescribe that the applicant should be responsible for the accuracy of data instead of the current provision of verification of documents. These amendments would shorten the procedure of company's registration, while simultaneously the responsibility for the data accuracy would be transferred to the future founder of the company.

The consistent implementation of the Law on General Administrative Procedure should be enabled in the following period, so that persons do not have to submit documents already in the possession of state bodies and local self-government bodies, which would significantly simplify administrative procedures.

Rights of the consumers and training of consumers on their rights should be promoted in order to use legal possibilities in this area and strengthen the competitiveness of the economy. The consumers should be protected and ensure that dominant position (monopoly) of the companies is not misused. Full opening of the market is needed in all segments where the competition is restricted by encouraging investments in this area and creating favourable conditions for investments. In addition, the activities on reducing the shadow economy and disloyal competition should be continued. Professional and non-selective actions of the administration should be ensured both at the state and local level, particularly the inspection services. Penalty policy for operating in the shadow zone should be strengthened and implement activities to transfer legal entities working in the shadow zone into legal zone as well as strengthen public campaign on negative shadow economy effects.

Illegal employment is a significant problem, mostly during the summer and winter tourist seasons. Therefore, it would be necessary to improve inspection oversight in order to prevent this problem. In addition, the coordination and connectivity of various inspection services should be increased in order to act faster and address issues present in the economy (shadow economy, corruption, intertwining of the responsibility of inspection services, and the like).

With a view to mitigating the illiquidity problem, the Central Bank remains with the recommendation to introduce the principle of automated bankruptcy. Thus, the real sector would be cleared, which would affect positively the financial sector's stability. In order to give companies sufficient time to potentially unfreeze their accounts 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 the 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, products with designation of origin, geographic indication and promotion of Montenegrin food production specificities and improvement of competition.	Ongoing
Support investments in rural infrastructure improvement, and connectivity with towns	Medium term
Encourage the production of high quality products and strengthen the production in the protected areas (greenhouses)	Ongoing
Encourage the connectivity of the tourism with agriculture through the cooperation with the agricultural holdings in creating tourist offer – development of culinary tourism	Ongoing
Encourage production and investments in the cattle breeding	Ongoing
Reach EU standards in the area of food safety	Ongoing
Encourage the appearance of small and local producers in the form of a consortium with recognizable products in the market	Ongoing
Increase the level of forest wealth usage, adhering to the sustainable development concept	Ongoing
Use the forestry sector potential for strengthening wood production and increasing the share of this industry in the manufacturing industry	Ongoing
Promote possibilities of products and increase their awareness	Ongoing
<i>Main risks</i>	<i>Risk direction</i>
Migration of rural population and de-agrarization resulting in depopulation of villages	Growing
Lack of professional labour force and unfavourable aging structure	Growing
Undeveloped infrastructure in rural areas	Stable
Insufficient technical and technological equipment of producers and low productivity	Stable
Breeding of inadequate assortment	Stable
Inadequate forest management and fire danger	Stable
Low information level of population on opportunities in agriculture	Stable

## ***Background***

Agricultural area accounts for 38% of total territory of Montenegro (about 0.8 ha per capita), which is a significant resource to be used more. Agriculture sector (agriculture, forestry and fishing) has significant but unsatisfactory place in the overall economy of the country. 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 holdings<sup>7</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 8% in 2013. Montenegrin agriculture is characterized by traditional production, poor infrastructure in rural areas, price non-competitiveness of domestic products (partially also as a result of high input prices), fragmented farms with low level of mechanisation in production and processing, which makes Montenegro a large importer of food. The main activities in the agriculture will be focused in medium and long term on the increasing of the volume of agricultural production, strengthening of competitiveness, creating incentives for revitalisation of rural areas, decline in migrations from rural areas and improvement of the quality of domestic products aimed at their better recognisability and competitiveness.

Due to their complexity, the negotiating Chapter 11 - Agriculture and Rural Development is 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*. In order 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 and enabling regulations, which will be aimed at preparing clear guidelines for the development of certain areas of agriculture, as well as securing funds for further development. Thus, the Law amending the Law on Agriculture and Rural Development was passed (OGM 56/09, 18/11, 40/11, 34/14, 01/15) in order to improve position of an old-age holder of a family agriculture holding. It defines better conditions for obtaining financial support and old-age allowance for holders of family agriculture holdings, which is another measure for supporting development of agriculture. The following documents were adopted: Rulebook on the Content of Requirements and Manner of Keeping Registry of Olive Growers and Olive Oil Producers (OGM 10/15), Rulebook on Manner of Declaring and Labelling Olive Oil (OGM 14/15), and Rulebook for Determining the Characteristics and Quality of, Manner of Sampling and Methods of Olive Oil Analysis (OGM 33/15). The proposal of the

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<sup>7</sup> Source: Monstat, Agricultural Census 2010 data.

Law amending the Law on Olive Growing and Olive Oil was determined in order to develop olive growing in Montenegro in accordance with the European standards. Passing of the new law on wine is also in the procedure. This law will create conditions for increasing the quality in wine production in Montenegro and its international recognition. In order to strengthen viticulture and wine production area, the implementation of the IPA 2011 funding project “Technical Support to Renewal of viticulture zoning of Montenegro” has started.

The use of pre-accession funds for rural development is of particular importance for Montenegro, which represents a substantial support to both agriculture producers and strengthening of the administrative capacities. The process of withdrawing funds from EU Funds for investing in domestic agriculture started at end-2014. It is possible to withdraw, through *IPARD-like* programme whose value is 4.5 million euros<sup>8</sup>, EU grants for the development of rural areas and modernisation of production and increase in productivity of agricultural holdings. This programme is intended to support agriculture producers in Montenegro and relevant institutions in the process of establishing system for future successful implementation of the pre-accession EU funds. Simultaneously, it represents also the preparation for the *IPARD II* implementation for Montenegro which is adopted in July 2015 by the European Commission. In period 2016-2020, domestic agriculture producers will have at their disposal 39 million euros through *IPARD II* (50% of grants for the projects).

The largest challenge in the following period will be investing of funds in real projects and their management. Therefore, in June 2015 *Strategy for the Agriculture and Rural Development of Montenegro 2015-2020* was adopted. The strategy is harmonised with core elements of joint European policy and contains guidelines for further development of agriculture in Montenegro. *ADMAS*<sup>9</sup> project support to the development of agriculture will contribute to further development of agriculture and strengthening of competitiveness in this sector. Agreement on long-term lending of Montenegrin agriculture in the amount of 50 million U.S. dollars was signed in June. The implementation of this agreement will ensure the application of new technologies, modernisation of the production, opening of new job positions, and strengthening, primarily, the processing area, and increasing competitiveness of domestic agriculture products.

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<sup>8</sup> Source: Ministry of Agriculture and Rural Development, “Information on priority development projects in agriculture“, September 2015.

<sup>9</sup> Abu Dhabi to Montenegro Agricultural Support

*Framework Programme Document* for the cooperation of Montenegro with the UN food and Agriculture Organisation (FAO) is also important for the increase in the competitiveness of Montenegrin agriculture and support to sustainable use of available natural resource. This document was signed in April 2015. This document defined the priority areas where future cooperation will take place: competitiveness of agriculture through the increase in standard and creation of policies for reaching EU standards, sustainable management of natural resources respecting climate changes and rural development through the increase in revenues of rural area citizens.

Forestry, together with the agriculture, is an integral part of rural economy and rural development. Forests are basis for creating value added for the area of wood processing, renewable sources of energy, food production and tourism. With its quality, functions and products, forests are recognizable symbol of ecologic state and they also play an important role in combating climate changes. The *Strategy with the forest development plan and forestry 2014-2023* was adopted in 2014 which would resolve the issue of sustainable management of this resource. In July 2015, Law amending the Law on Forests was adopted which removed certain barriers in order to improve operation of legal entities from the forestry and wood industry area and strengthen the control of the State in the area of the improvement of the system of forest protection and reduction of illegal activities in this area.

### ***Operational measures***

Incentives for agriculture development are important for poverty reduction and for the containing of migrations, therefore, the State should continue in the following period with the programmes of support to agriculture production modelled according to the most developed countries' models. It is obvious that Montenegro must not leave agriculture only to the market, but whole programme of support is needed that would be based on: the promotion of the competitiveness of the producers, sustainable resource management and improvement of the rural quality of life. The sustainable development and adequate resource management would establish the balance between economic growth, environment protection, and social aspect. The promotion of specific, indigenous products with expressed quality both locally and internationally.

The Policy of Agriculture Development of Montenegro must be harmonised with the *Common Agricultural Policy*<sup>10</sup>. New agriculture policy of the European Union particularly recognises “small agricultural producers” and provides greater freedom of creating rural development measures. Montenegrin agriculture producers should seek their chance here and they will be able to rely on greater financial support after Montenegro joining to the EU. Implementing and adopting EU legislation, agriculture of Montenegro may substantially increase the level of quality and become ready for all challenges in the future period.

One of the key reasons of low level of development of Montenegro compared to the EU is uneven regional<sup>11</sup> development in Montenegro. The northern region, which occupies 52.8% territory of Montenegro, with about one third of total population, is the least developed region in the country. 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. Therefore, higher amount of funds from the EU pre-accession funds should be invested in the development of agriculture in this region, which would enable making revenues, increase of employment in less developed municipalities and would also affect the revitalization and reduction of migration of population.

One of important challenges of overall development of Montenegro is accomplishment of sustainable development of rural areas. Adequate living standards for rural population should be ensured through measures of recovery and development of villages and building of infrastructure. Poor rural infrastructure is characteristic of many rural areas in Montenegro, in particular for inaccessible remote areas. This has a negative impact on the 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 production of agricultural products.

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<sup>10</sup> European Parliament adopted four of the *acquis* from the reforms (CAP – Common Agricultural Policy) in November 2013.

<sup>11</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.

During the next period it is necessary to redirect the production of agricultural products to the products that carry potentially higher profit, such as early cultivation of fruits and vegetables, and increase the production in greenhouses, which has a low level of participation in the total production.

Organic food production is also a chance for the development of agriculture in Montenegro, but small potential is currently used for the area. The support for the development of organic production will contribute to the strengthening of the competitiveness of Montenegrin products and creating a recognizable brand, which consistently applies the concept of ecological state. What needs to be determined is what is going to be produced, i.e. which organic food can bring profit to farmers, but for which there will be a certain demand. Therefore, it is necessary to continue to encourage the organic producers in financial and promotional terms by organising activity, such the one that was organised in Podgorica, "Days of Montenegrin Organic Food". This activity was organised in the form of market of organic local products.

Revenues would be increased by connecting the agriculture with tourism, and cooperation with agricultural holdings when creating tourist offer, and by developing culinary tourism. Therefore, tourist - gastronomic offer would be improved by specific Montenegrin products of national cuisine, which will contribute to better results in both sectors.

Meadows and pastures accounted for the main share in the structure of agricultural land in Montenegro<sup>12</sup>, representing less productive areas. The best way to make use of this potential is encouraging the development of cattle breeding, as one of the most important branches of agriculture. Since this branch is not sufficiently developed, larger investments are needed, which would contribute to the development of rural areas, especially in the north where the configuration of the terrain allows it. This will result in an increase in the production of milk and meat, and thus reduce their imports. In addition, large meadows and pastures offer good conditions for the development of beekeeping. Honey production has increased in recent years, but the work is needed on the modernization and improvement process in order to increase of production of honey.

It is necessary to implement activities to improve food safety, reaching EU standards in that area. In doing so, the domestic products would keep the quality

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<sup>12</sup> To wit, 2013 Monstat data showed that meadows and pastures occupied 210.618 ha in 2013. (*Statistical Yearbook 2014. MONSTAT*)

that is required for obtaining a license for export to the European Union. In particular, this applies to products that have the greatest potential for export.

Ongoing work is needed to increase the level of agricultural production at family agricultural holdings. FADN system, an instrument used for the evaluation of family agricultural holdings (network of accounting data on agricultural holdings), has not been established in Montenegro yet<sup>13</sup>. The Law on Agriculture and Rural Development prescribes the establishment of a system of accounting data on agricultural holdings, and the 2010 Agricultural Census provides a good basis for the establishment of FADN system. According to the Agricultural Census, of total of 48,870 agricultural holdings, only 5,448 of them keep records of income and expenditure, which is an additional reason to establish the FADN system.

It is necessary to continuously work on raising awareness of small, local farmers about the benefits of association and joint presence at the market. To this end, the strengthening of the advisory services should be continued, and local governments should be supported to encourage and stimulate the consortium appearances, to make products more competitive.

The increase in the GDP<sup>14</sup> of forestry sector, wood industry and other industries depending on forests should be needed. It is possible to increase economic by increasing the volume of woodcutting (with the necessary investments) and by increasing the value added in the wood processing chain. The potential of the forestry sector should be used in order to stimulate the connectivity of manufacturer of timber with wood processors, which is aimed at exporting products of higher level of processing. Due to the fact that about 60% of Montenegrin territory is covered by forests, it is necessary to strengthen the wood processing in the coming period, because there is still a large unused potential. In 2014, the area of production of wood and cork and furniture products accounted for only 2.3% in the total industry.

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 portion of EU funds - IPA for rural development and other purposes is focused also on the development of forestry. Therefore, it is necessary to attract funds for

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<sup>13</sup> Source: Ministry of Agriculture and Rural Development “*Strategy of Development of Agriculture and Rural Areas 2015-2020*”, June 2015.

<sup>14</sup> One of the main objectives of the *Strategy with the Development Plan for Forests and Forestry 2014-2023* is the increase in GDP of the forestry sector and the dependant industries from 2% to 4% of total GDP.

the development of underdeveloped segment by corresponding measures and plans.

#### IV. RECOMMENDATIONS CONCERNING ENERGY

<i>Key recommendations</i>	<i>Implementation deadline</i>
Construction of new capacities in cooperation with leading strategic partners	Long-term
Engagement of overall energy potential of Montenegro, which meets the principles of sustainable development and have no negative impact on the environment	Long-term
Increasing energy efficiency in all sector	Ongoing
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	Ongoing
Modernization and revitalization of the existing and the construction of new infrastructure for the transmission and distribution of energy on the principles of international technical standards in order to minimize losses and facilitate sustainable development	Medium-term
Higher the level of use of alternative energy sources (solar energy, wind energy, biomass, and the like)	Ongoing
Implementation of project of strategic stocks of petroleum products in accordance with EU energy policy	Medium-term
Transparent pricing of electricity and the continuation of the programme 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	Ongoing
<i>Main risks</i>	<i>Risk direction</i>
The delay in the implementation of new capital investments and revitalization of the 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	Stable
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	Stable

## ***Background***

Great progress has been made with a view to harmonising the national legislation in the area of energy industry with the EU legislation. *Acquis Communautaire* was largely implemented through these regulations.

Energy Policy of Montenegro by 2030 distinguishes the following three priorities: (i) security of energy supply (ii) 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 adding up to about 4.2 billion euros or 10% of GDP per year, clearly indicating that the energy sector is one of the strategically important areas of Montenegro's economy. New projects could be among the main drivers of the new development cycle of country's economy. This would provide an additional diversification of the economy, making it more export-oriented. A new wave of investments would have a multiplier effect on the other activities development, new jobs creation, higher income generation, and a living standard improvement. This would induce the reduction of the current account deficit, which was rather high in the previous years. Additional contribution to potential development of the energy sector prompts the integration of Montenegro into the regional and European energy market. By pursuing the announced projects for connecting electricity systems, Montenegro could take a strong strategic position in the region.

In early 2009, electric energy market was open to all consumers except households, and as of 2015, it opened for households as well, in line with the provisions of the Treaty establishing the Energy Community<sup>15</sup>. In 2010, Electricity Market Operator of Montenegro (COTEE d.o.o.) was founded in line with a decision of the Government of Montenegro. COTEE d.o.o. was established with a view to separating the activity of electric energy market management from CGES. Montenegro signed the Protocol on the United Nations Framework Convention on Climate Change and the Kyoto Protocol in 2007. The Government, in cooperation with UNDP, created the first National Report on Climate Changes, which identified the main polluters. Draft National Strategy on Climate Change until 2030 was put under public discussion.

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<sup>15</sup> Montenegro signed the 2005 Treaty establishing the Energy Community

The importance of energy independence can be observed through the stability of electricity prices. The stability of electricity prices affects the competitiveness of Montenegrin products and services. The share of electricity in the consumer price index is the largest after basic food products and it represents a major expense for households.

Current production capacities of electricity in Montenegro fail to meet the overall domestic market demands<sup>16</sup>, which surpass the EPCG's production abilities in terms of energy as well as in terms of capacity. Announced normalizing of production in KAP, could again challenge regular electricity supply. In addition, the uncertainty regarding the future electricity consumption of KAP and ironworks in Nikšić significantly restricts reliable planning of consumption, and consequently, a reliable assessment of the lacking amount of energy and petroleum products. Dependence on imports was very high in the previous years; therefore, the evident congestions of transmission capacities in the region may pose a risk for Montenegro. In the area of imports, Montenegro terminated a long-term agreement on business and technical cooperation with EPS (Electric Power Industry of Serbia), which was supposed to be in effect until 1 January 2016; therefore in 2015, the only long-term agreement in effect is the one with ERS (Power Utility of the Republic of Srpska).

The increase in electricity production capacities represents a necessity, not only from the viewpoint of economy, but also in terms of preservation of energetic independence minimum, given the significance of this issue in the full swing of current geopolitical trends.

In addition to the lacking quantities of electric energy, there are also high losses in the transmission and distribution grid. The entire energy chain - starting 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, production increase and energy balance improvement became a strategic goal of development.

Low energy efficiency is evident especially in big industrial companies and transport sector. Regardless of their reduction of consumption or capacities, big industrial companies and transport sector still took the main share in final consumption of electricity in the previous years.

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<sup>16</sup> The exception occurred in 2013, as a result of reduced production of KAP, as well as in 2010, for the same reason and due to the record production in TP Pljevlja, which resulted in almost zero net import.

Excessive and irrational use of electricity, i.e. low energy efficiency is also present in the household sector, which accounts for about 30% of total electricity consumption. In the period 2005-2013, household sector electricity consumption grew at an average rate of 1.9%.

Energy industry development in Montenegro is based mostly on the development of the electric energy sector, including revitalization of the existing large hydropower plants and thermal power plants, or the construction of new hydropower plants and expansion of the thermal power plant capacity. The analyses of this area 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 can be put into operation relatively quickly and have no harmful effects on the environment. This includes revitalization of existing and the construction of new ones. Wind farms also have the potential, and their possible sites have been specified. Implementation of the project on landfill gas cogeneration in Podgorica is in progress. Bearing in mind the various types of waste and the possibility of its "recycling", as well as the impact it has on the ecology and tourism, this form of generating energy is of strategic importance.

The main portion 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, the utilization of these resources could be a development chance of the northern region. Projects valorisation could induce the slowing down of negative demographic trends in this part of Montenegro.

Montenegro has no access to international resources of natural gas, has small coal reserves and it has to import oil products. Retail sale 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 further development.

### *Operational measures*

The key priority will be the construction of new capacities. Montenegro has a substantial hydro potential as well as the possibility to build a new thermal power plant facility.

- Invest efforts in employing the domestic financial sector in project financing, through various modalities – primarily engaging the banks in the construction of small hydro-power plants – which would allow the banks to expand their saturated and rather small market, get higher and more secured profits and, thereby potentially easier and cheaper financing of the other parts of the economy;
- Upon the building of new capacities, it will be essential to meet Montenegro’s energy requirements in line with the EU standards. This should be taken into consideration upon the construction of new capacities, primarily in laying the high voltage interconnectivity undersea cable between Montenegro and Italy. Large number of thermal power plants in the country and in the region use dated technologies, therefore, expectations in the middle and long term are that some plants will be shut down, and the country should prepare for such outcomes;
- Anticipation of Montenegro’s obligations which will rise upon and following the EU accession is of extreme importance, bearing in mind the Directive 2009/28/EC, aimed at promoting the use of renewable energy sources. Energy policy should be harmonised with the future Energy Development Strategy of Montenegro by 2030. Climate changes increase the risk of draughts, which may affect the hydro potential of the country and the region, which in combination with the possible reduction of production capacities may induce the price growth;
- Attract renowned investors for projects such as construction of large hydro or thermal power plants.

More attention should be paid to the diversity of electric energy sources, primarily to the utilisation of the wind and solar energy, both of which have great potential to be used in large plants as well as in households in Montenegro. Continue subsidizing the household energy efficiency loans.

With regard to energy efficiency issues, the following measures should be implemented:

- Continue the revitalisation programme of HPP “Piva”, the revitalisation programme of HPP “Perućica”, as well as revitalisation of TPP “Pljevlja”;
- Continue modernization and development of the distribution network;
- Continue the project of developing a transmission network at the regional level;

- Protect the state and the consumers from potential concessionaire misconduct. Include mandatory provisions in concession agreements, thus obliging the concessionaires to repair and maintain the facilities on a regular basis;
- 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;
- Improve regulations in the area of construction;
- 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;
- Find adequate investors upon giving the concessions for the use of aquifers for the construction of small hydropower plants on Bukovica and Štitarička aquifers. Continue further activities related to giving concessions for Sjevernica, Bistrica, Lještanica and Bjelojevička aquifers; continue developing the plans for the aquifers: Zlorečica, Peročica and Trnovička River; continue the cooperation in research for the HPP Komarnica project; invest efforts in achieving an agreement with neighbouring countries on the utilisation of common hydro potential (e.g. the aquifer of Bilečko Lake) – conduct necessary research for HPP Boka and/or HPP Kruševo;
- 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 substations, overhead transmission lines) and road infrastructure.
- 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;

- Prepare project for the hydro power plants maintenance after the expiration of concessions;
- 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;
- Promote broader utilization of solar energy and biomass;
- Promote the introduction of biofuels in transport.

Bearing in mind the small market and the lack of interest, consider the possibility of encouraging competition in the market for the distribution of electricity to the household sector.

Montenegro has no production of liquid and gas fuels, and in that area it is completely import-dependent. Efforts should be invested in meeting the conditions for the creation of the strategic 90-day oil stock, as provided by the energy policy of the EU. Continuation of offshore oil and gas exploration on the coast is necessary, however, with full regard of the environmental standards.

Consider the option of gasification by connecting to the Adriatic-Ionic gas pipeline in accordance with the EP priorities for 2011.

## V. RECOMMENDATIONS CONCERNING SERVICE SECTOR

### 1. Tourism

<i>Key recommendations</i>	<i>Implementation deadline</i>
Stimulate investments in the construction of high-end hotel facilities and upgrade the existing accommodation capacities, including small 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
Encourage mechanisms for the inclusion of the informal sector in the official offer flows (e.g. renting unregistered accommodation capacities/ apartments)	Short
Make arrangements with airliners and airports in the country and the region in order to increase the accessibility of Montenegro as a tourist destination	Medium
Find a balance between mass and high-end tourism valorisation, as well as price and offer;	Medium
Revitalise rural areas (develop rural, eco and other forms of tourism)	Ongoing
Invest efforts in the improvement of road and auxiliary infrastructure (water supply, electricity, waste water, solid waste, parking space).	Ongoing
Invest efforts in the improvement of tourist infrastructure (development and creation of new beaches, ski lifts, funiculars, etc.)	Ongoing
Continuously raise the quality of Montenegrin tourism through education of new and professional development of the existing human resources	Ongoing
<i>Main risks</i>	<i>Risk trend</i>
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
Lack of competitiveness	Stable
Season still not sufficiently long	Stable
Too high reliance on a small number of markets	Stable
Inadequate utility and local infrastructure	Stable
Insufficient number of highly qualified domestic human resources particularly management in the tourism sector	Stable

## ***Background***

Tourism is the fastest growing economic field and it represents a key for development, well-being and prosperity of the state. This sector is recognised as one of the priorities of Montenegro's development, and due to its direct and indirect impact, one of the key sources of its economic growth. Tourism has a direct impact on the social and economic progress of the state, revenue generation, investment activity, creation of new jobs, and the development of the infrastructure. Nowadays, every state invests effort in the development of some form of tourism.

Regardless of the results achieved, the uptrend in tourist arrivals and overnights in Montenegro is expected to continue in the near future. In order to keep the existing and attract new tourists, continuous efforts are needed in improving the quality of the promotion of tourism offer in the new source markets. In doing so, the state must secure the position of tourism as a main driver of growth in all the regions with specific tourism potential. Consequently, the even development of the north and the south would bring direct and long-term benefits from tourism, which would be felt throughout all the regions, with an equal share in the increase in tourism revenues.

To achieve adequate management of tourism trends 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.

Over the past five years, Montenegro has shown an evident uptrend in the number of tourist arrivals and overnights recorded. In 2014, the number of tourist visiting Montenegro was 1.5 million, while the number of overnights added up to 9.6 million. Compared to 2013, these figures increase by 1.7% and 1.5%, respectively. Moderate growth in the number of overnights in 2014 was due to a decline in the visits rate in the unusually rainy summer months, during which over 70% of annual

turnover is recorded<sup>17</sup>. Monstat data shows that in the first six months of 2015, 390,174 tourists visited Montenegro, which is y-o-y increase of 13.8%, while 2 million overnights recorded over the same period indicate the y-o-y increase of 13.7%. Hospitality industry services also improve in quality on a yearly basis. In 2014 and 2015, 20 new hotels with the bed capacity of 900 places were classified. In 2012, beds in 4\* and 5\* rated hotels accounted for 27% of total bed capacity, while in 2015, this share increased to 36%. The number of beds in 4\* and 5\* rated hotels increased by 30% in relation to 2012.<sup>18</sup>

At a meeting held in July 2015, the Parliament of Montenegro adopted amendments to the Law on Residence Tax, which significantly simplifies its collection, provides better compliance with laws on local self-government, misdemeanours, on foreigners, on registers of temporary and permanent residence, and on yachts. This will improve the supervision of the number of guests in the accommodation capacities, and ultimately help reduce shadow economy.

Numerous investment projects in the northern and southern regions are also essential to the further development of tourism, given that their implementation will significantly widen the overall tourist offer of Montenegro, and result in considerable budget revenues.

Founding of the Health Tourism Cluster of Montenegro represents a solid basis for the future development of this form of tourism. Health tourism is the fastest growing branch of tourism in the world, and Montenegro holds all the necessary prerequisites for becoming the future health destination.

Montenegro's image of a unique tourist destination, attractive regardless of the season due to its diversified offer, is continuously being built following the basic guidelines defined in the Master Plan. Creation of tourist products, which would meet the needs of tourists throughout the year, was continued through the adequate employment of the country's natural resources in combination with continuous organisation of numerous tourist amenities and events.

Problems recorded over the previous period still persist, affecting the development of this sector to a rather high extent. With this regard, there is the issue of incomplete offer, followed by underdeveloped road infrastructure, insufficient number of parking spaces, common traffic jams during the summer season, the

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<sup>17</sup> Source: Ministry of Finance, Spring analysis of macro-economic trend and structural reforms – 2015, June 2015

<sup>18</sup> Source: Ministry of Sustainable Development and Tourism, August 2015

issue of city sanitation and waste disposal, noise, overcrowded beaches, too short season, water supply issues in certain municipalities, etc. In addition, the overpricing of ancillary services (beach equipment, parking, restaurant services, etc.) significantly jeopardizes price competitiveness of Montenegro's tourism.

### *Operational measures*

Regardless of the progress recorded in the previous period, Montenegro must continue activities aimed at attracting foreign investments in the construction of new high-end hotels, as well as in the adaptation and expansion of the existing hotel capacities. After the valorisation, these capacities would attract the high purchasing power tourists. Building and expanding the high-end hotel capacities should be implemented equally in all regions of Montenegro, with a view to creating a tourist offer which would attract guests all year round. Creating a diversified tourist offer should not be focused solely on higher purchasing power tourists, but also provide offer suitable for lower purchasing power guests.

Global tourism market analysis reveals that tourists opt mainly for high-end hotels because of the vast array of possibilities they offer. Hotels and similar accommodation capacities still account for the minor share in total accommodation capacity of the country, as compared to private accommodation. In future, Montenegro should continue the development of new high-quality accommodation capacities, focussing on big hotel chains, with already well established hotel network, which would attract the high purchasing power tourists. Improvement of the structure and quality of accommodation would result in the enhancement of tourist offer and attraction of tourists from source markets which currently take rather small shares in total arrivals structure.

Montenegro should continue controlling the quality of services and keeping records of accommodation and hospitality facilities with a view to combating shadow economy and its transfer into legal cash flows.

Montenegro's natural potential provides the best foundation for creating a tourist offer which would meet the tourists' needs throughout the year. Presenting our natural wealth through differently designed tourist product can make a significant contribution to generating new revenues from tourism sector. Prolongation of the season and an even participation of all regions in tourism could be achieved by renovating the existing hotel facilities, especially in the northern part of the country, and re-engaging those capacities through new investments or public-

private partnerships, and through the inclusion of additional services, thematic conferences and events in the offer.

The issue of short season persists. Additional activities are required to continue the promotion of cultural, religious, sports, and health tourism. Improvement of offer through numerous sports events, revitalisation of cultural facilities, and development of adventure parks and other amenities in preseason and postseason requires investing efforts in meeting the needs of target tourist groups (tourists interested in hiking, alpinism, cycling, sailing, paragliding, water skiing, rafting, canyoning, etc.). Health tourism can also help Montenegro become a destination attractive regardless of the season. This would require creation of a special strategy determining future directions of development of this type of tourism. Adjusting the tourism product and widening the offer in preseason and postseason with a view to meeting the needs and expectations of guests would significantly reduce the effects of seasonality on this sector, while generating additional revenues.

Developing high quality tourist offer in preseason and postseason will largely depend on the development of MICE tourism. In the upcoming period, Montenegro should invest significant funds in equipping the existing and building new higher category hotels with the supporting infrastructure which would enable organising specific types of meetings, conferences and events. Apart from hotels, this type of tourism could be introduced in ships which would be adapted for these purposes. Accordingly, Montenegro should continue the adequate promotion of this type of tourism, in order to position itself as one of the leading congress destination in the future.

Activities aimed at developing healthy lifestyle (low-carbon tourism) would enable sustainable development of the tourism sector, ultimately resulting in better quality of services, creation of new jobs, and improvement of tourism facilities energy efficiency and generation of revenues with far lower GHG emissions, which would strengthen international position of Montenegro as a green destination.

Tourist products which could be offered by agro, eco and rural tourism in Montenegro could be of high importance for the future development of tourism sector, diversification of tourist offer, and prolongation of the season. In addition to significantly increasing agricultural production and enabling better placement of our traditional products, the synergy of agriculture and tourism would also enable continuity the revitalisation of the rural areas. Investing in infrastructure, with the appropriate utilisation of natural resources and stimulation of locals to engage in tourism in addition to agriculture, would create an opportunity for further

development of the rural areas, especially in the central and northern parts of the country. The progress in the development of these types of tourism would generate significant economic and social benefits, resulting in considerable decline in migration and improvement of the age and work structure of the population in rural areas.

Professional and educated human resources represent an important element of the development of tourism. Special attention should be paid to building qualified and professional human resources, given that the presentation of total tourist offer and the tourists' motivation to return to our country depends mainly on them. Human resources development should be in line with the trend of increase in tourism capacities and tourist offer diversification. Adoption of the Law on Foreigners brought progress in terms of employment of domestic labour force for seasonal jobs. To this regard, cooperation between tourism and education system institutions must continue, through additional education and organisation of professional schools, practices and trainings, with a view to creating qualified human resources, which will meet all the specific requirements of this industry in terms of quality and quantity.

Relying on a small number of markets remains a problem for Montenegro's tourism sector. Addressing this issue requires continuous efforts in achieving market diversification, with significant involvement of diplomatic and consular offices in the aim of promoting the tourist offer in new source markets.

Highly important element of future development of tourist market is well-developed traffic network. Issues occurring in traffic relate to insufficiency and poor quality of traffic and transport infrastructure, large congestions during the season, long queues on the border crossings, etc. Addressing these problems would include continuous investing in traffic and municipal infrastructure, resolving the issue of waste waters and solid waste disposal, as well as the issues of water and electricity supplies, especially during the tourist season. Introducing more low cost flights is required in order to make Montenegro more accessible and well-connected to specific source markets.

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

## 2. Transport

<i>Key recommendations</i>	<i>Implementation deadline</i>
Continue the improvement of the transport infrastructure primarily by using the available financing sources through EU arrangements	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 the activities on high-way construction	Long
Continue the development of maritime transport capacities	Long
Work on the implementation of standards concerning environment protection and minimising the negative impact of the implementation of infrastructure projects in this industry	Ongoing
Continue development and promotion of bicycle traffic	Ongoing
Continue the strengthening of institutional and legislation framework and its harmonisation with the EU requirements and Acquis Communautaire	Short
<i>Main risks</i>	<i>Risk trend</i>
High costs of transport infrastructure construction and long timeframes for investment implementation	Growing
High number of road accidents as a result of inadequate level of road network safety in Montenegro	Growing
Insufficient technical and technological equipment of the infrastructure and the deficit of domestic labour force in this industry	Stable
Risk of a significant deficit and public debt increase due to investing in road infrastructure	Growing
Slower development of tourism due to the inadequate transport infrastructure	Stable
Adverse effects of transport on environment	Stable
Poor connectivity of specific types of transport with the region	Stable

## ***Background***

Transport plays a major part in the overall economic development of Montenegro. It makes an impact on the level of country's integration in the region and wider international environment; therefore the development, modernisation and reconstruction of the transport system is essential in connecting our country with the rest of the world. Contemporary transport includes very expensive infrastructure and technology, with high fixed costs and long repayment periods of investments. Development of an efficient transport system is recognised as one of key areas for ensuring sustainable growth, due to its linkage with the development of other sectors contributing to GDP growth (tourism, trade, agriculture, forestry, etc.).

Since Montenegro is in the process of pre-accession negotiations with the EU, it is necessary to comply with the main objectives of the EU transport policy, reflected primarily in the improvement of the functioning of cost-effective, safe, sound and competitive transport, which is acceptable in terms of environment protection.

Regardless of the progress it made in the area of transport infrastructure improvement, Montenegro still fails to meet the requirements of a dynamic economy. Recognising the weaknesses is very important for the future economic development as well as for the regional integration of Montenegro. With regard to international services, the share of transport revenues takes second place (after tourism revenues). The latest available data shows that in the first six months of 2015, the share of transport revenues (passenger and cargo transport) amounted to 30.1% of total service revenues in Montenegro. Of that, the main share (55.7% of total revenues) referred to maritime and air transport.

Economic crisis has had an adverse effect on the utilisation of transport capacities. Nevertheless, in the previous two years and in the first six months of 2015, indicators of the majority of transport segments showed favourable trends. As per latest available data, in the first six months of 2015, passenger and cargo transport increased in road and railway transport, total turnover in ports also increased, whereas in air transport, cargo transport increased, but passenger transport declined.

With regard to railway transport, in the first quarter of 2015, the Government adopted the *Programme of construction, maintenance, reconstruction and modernisation of the railway infrastructure for 2015*. The programme defines current and investment maintenance of railways and supporting facilities, power

grid and equipment, plants as well as the regulation of transport on the railways in Montenegro. It also determines the activities aimed at reconstruction and modernisation of railway infrastructure. In June 2015, the government adopted the Decree on categorisation, classification and signalisation of railways which defines the categorisation, classification and signalisation of railways with regard to their purpose, economic importance, importance in international and national railway transport, management and utilisation of railway infrastructure, and their development plans.

One of the most important infrastructure projects was launched in the area of road transport. By adopting the Law on the Bar-Boljare Highway in December 2014, the legal prerequisite was met to commence the construction of the priority highway section (Smokovac-Uvač-Mateševo), in line with the Agreement on the Project Design, Construction, And Procurement and Installation of Equipment and Materials for the Construction of the Bar-Boljare Highway signed between the government and Chinese company CRBC. Works commenced as at 11 May 2015, and the project design and construction deadline for the priority section is 48 months. Out of the total contracted value, 85% will be financed on the basis of the Agreement on the preferential loan between the Government of Montenegro - and the Chinese Exim Bank, while the remaining 15% is to be provided from the Budget of Montenegro. The project is significant for connecting the Montenegrin coast with the northern region of the country, Serbian border and thereby with Central Europe. The project will also induce a more even development of all regions, development of tourism, trade, better use of natural resources, etc.

In the area of maritime transport, the Law on Amendments to the Law on Safety of Maritime Navigation was adopted in July 2015. The Law harmonised the provisions referring to certification and issuing licences which ensure seafarers meet new international objective standards of competence<sup>19</sup>. This created the preconditions for the adoption of secondary legislation document, necessary for regulating the status of Montenegrin seafarers. With a view to improving the maritime navigation controls, single electronic database containing information on licence stickers (vessels' safety certificate) and records on training and certification of seafarers has been in use as of July. Creation of this database was one of the most important recommendations of the European Maritime Safety Agency (EMSA). Establishing the single electronic registry of ships, boats and yachts, i.e. all vessels registered in Montenegro is planned in the forthcoming period. Montenegro submitted its application for full membership in "Paris MoU- the Paris

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<sup>19</sup> The International Convention on Standards of Training, Certification and Watchkeeping for Seafarers STCW 78/95/2010.

Memorandum of Understanding on Port State Control”, in April. This will allow the reduction of entry of ships which fail to meet safety standards, increase the level of navigation safety and the level of environmental protection. To that end Law on the Ratification of Paris Memorandum of Understanding on Port State Control was passed in July this year.

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. To achieve the implementation of a part of those plans, the government rendered the Information on negotiation aimed harmonising the mandate letter between the Airports of Montenegro and European Bank for Reconstruction and Development. The mandate letter was subsequently signed by the representatives of Airports of Montenegro an EBRD. The document refers to the continuation of negotiations regarding the loan arrangement (20 million euros) for the construction of new airport terminal and the reconstruction and expansion of the platform and manoeuvring area at Tivat Airport.

In regards to safety, it is necessary to stress out the constantly alarming situation in the Montenegrin roads, with a large number of traffic accidents, dead and injured persons in road transport. In 2014, the number of traffic accidents increased by 5.1% in relation to 2013, while the number of injuries and deaths increased by 0.7%. As per preliminary Monstat data, in the first six months of 2015, the number of traffic accidents declined by 16.3%; however, the number of deaths and injuries increased by 3.8% in relation to the same period of 2014. A *2015 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 hot spots, construction of third lanes, removal of bottlenecks, reconstruction of crossroads, rehabilitation of bridges, landslides and slopes on public roads, construction of tunnels, which would create conditions for safe transport, and result in the reduction of traffic accidents and risks for passengers.

Although the results achieved in virtually all areas of transport were positive, further investments are still needed, given that the latest available data shows the decline of the gross value added of this activity (transport and storage) in the total

GDP - from 4.7 percent in 2010 down to 3.8% in 2013. It is necessary to improve transport safety, ensure a more efficient use of the existing capacities, enhance transport services quality, develop transport infrastructure in line with the economic development needs, continue the implementation of investment projects, and upgrade the connection of Montenegro's transport system into the Trans-European Transport Network.

### *Operational measures*

With a view to improving transport infrastructure, it is necessary to invest continuous efforts in eliminating transport deficiencies, namely: complete the initiated reconstruction of sections of motorways and regional roads, modernize traffic signalisation in order to raise the level of traffic discipline, eliminate hot spots in the affected areas, as well as address the problem of bottlenecks.

Maintenance of the busiest roads in the country needs improvement. 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 recently affected by floods serves as an additional warning about problems that bad weather conditions may cause for the transport infrastructure.

Reforms are needed in the area of infrastructure, particularly road infrastructure, in all municipalities. Construction of the highway will have multiple benefits, such as the faster transport of passengers, assistance in cargo transport, increase of the sea ports' and airports' importance and value. In addition, improvement of motorways, regional and local roads in Montenegro is needed for better connection with the countries of the region. Therefore, particular precautionary measures should be implemented in the form of timely rehabilitation of identified risks and provision of adequate transport equipment in the case of natural disasters.

Montenegro should take advantage of the EU programme for financing the extension of the so called core network in the Western Balkans. To wit, following the signing of the agreement the core transport network for the Western Balkans at the WB6 Ministerial meetings in Brussels in April, at end-August, a programme through which the EU gives grants amounting to 600 million euros for energy and transport projects in the Western Balkans countries. Within this programme, this year, Montenegro was granted 45 million euros as assistance for the implementation of two projects in the area of electrical transmission and railway transport. The granted railway transport project refers to the reconstruction of the Bar-Vrbnica railway section. The programme will continue in the next several

years, with the total funds provided by the EU amounting to 7.7 billion euros. Therefore, it is necessary to speed up the process of forming expert teams and drafting feasibility studies and project documentation in order to attract as much of the funds from future programmes (grants) to Montenegro. Enhancing the inter-connections of Western Balkans countries and their connections with the EU countries remains one of the key prerequisites for increasing competitiveness of the region and encouraging growth and development.

In order to eliminate traffic congestions, it is necessary to find the best way of financing the already recognised projects for the construction of bypasses in large coastal towns as well as passenger bridges at the places with the highest tourist frequency. Construction of bypasses near Golubovci and Nikšić has already shown good results, in terms of reduction of road congestions. This gives grounds to finding the best way to resolve this issue in the coastal region, since it escalates during the summer tourist season. In addition, achieving better connection among all the regions of the country is regarded as an asset of the tourist offer, and it can be done by introducing bus lines from Podgorica and Tivat airports to all the municipalities.

Railway infrastructure should be improved and ongoing projects completed through investments. Average speed should be increased and delays in transport (particularly in extreme winter conditions) reduced by investing in railway connections. In addition to the reconstruction of the Bar-Vrbnica railway section, more funds should be provided for the construction of new regional railways with a view to promoting railway transport and improving connections with neighbouring countries.

In the upcoming period, Montenegro needs to render a Railway Development Strategy containing the current railway transport analysis and goals and guidelines for the future development of railway (infrastructure and transport). The strategy must be harmonised with the single transport policy of the EU. The obligation of rendering the ten year strategy is provided in the Railway Law adopted in 2013.

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

Continue the implementation of the *Master Plan for the development of the state-owned company Airports of Montenegro* by investing in the modernisation of our

airports. Provide all the necessary conditions for the unhindered functioning of air transport during bad weather (heavy snows, ample precipitations, fog). Implement priority Master Plan projects, focussing primarily on the actualisation of loan arrangement for the new airport terminal and the reconstruction and expansion of the platform and manoeuvring area at Tivat Airport. In addition, it is also necessary to make the most cost-effective concept for the implementation of the project of new terminal and platform construction at Podgorica Airport. This project was a part of the first Master Plan development phase but it was delayed due to excessive investment costs.

The sale of the Container Terminal and General Cargo Bar revealed common interests with the new owner on positioning the Port of Bar as a cruising destination. Since the port's location gives it preference for the development of cruise tourism, it is necessary to invest in adequate infrastructure for the reception of passengers, increase in the number of berths, waste and waste water disposal infrastructure, etc.

Luka Bar is equipped with the floating platform and the infrastructure necessary for hydro air plane landing. This gives grounds for considering upgrading the air transport with this form of transport. Connecting Montenegro with other maritime countries by introducing regular airlines for this type of flights would enrich Montenegro's tourist offer.

Since there is no regular internal ship transportation in Montenegro, the introduction of greater capacity hydrofoils should be considered given that they could link coastal towns without causing congestions characteristic of the summer season. Construction of pier within the Tivat Airport would provide faster transfer of tourists as well as the locals.

Montenegro must uphold the development of combined transport since it has all the prerequisites in terms of infrastructure and legislation necessary for its usage. Constructing new and reconstructing the existing terminals for combined transport at the railway stations is necessary in order to 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. An agreement on the donation of the People's Republic of China embassy in Montenegro to the Podgorica capital for

the construction of bike paths on the corridor III was signed in August. Nonetheless, Montenegro must further the development of bike paths in other municipalities as well, since this would reduce traffic congestions, as well as the household budget expenditures.

Montenegro must 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. To achieve this, 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>
Engaging all institutional and individual stakeholders from the educational system in activities defined under the educational strategies to achieve the goals of the reform	Short
Keeping enrolment policy that allows a reduction of the structural imbalance at the labour market	Ongoing
Developing education standards in accordance with the principles of the National Qualifications Framework and on the basis of information on the labour market needs	Short
Developing cooperation between educational and labour market institutions	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
Involving organizations dealing with social inclusion in the education reform activities	Short
Involvement of local governments, employers' representatives, business associations and other NGOs in activities of the education reform	Short
Developing and promoting the concept of lifelong learning	Ongoing
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
Training and motivation of 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, sole traders, NGOs)	Stable
Significant differences in the relations rural-urban areas and north-south in Montenegro and their effect on implementing reform	Increasing
Extensive approach in transferring knowledge to education system	Stable

participants (the traditional method of presenting the subject, without building skills and inelastic with respect to changes and labour market demands), learning by reproducing the content	
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***

During the previous period, legal framework significantly improved including the establishing of necessary institutions, which contributed to system strengthening and tracing path towards the objective – reformed education.

The content of the reform is defined in the key documents/strategies: from preschool through elementary and vocational to tertiary education, covering also inclusive education and education of adults. All documents mean strategic development directions realised through action plans in the defined period. Their development results from the support through active participation and contribution of EU experts, and financial support provided through different programmes: from IPA funds, the EU funds allocated to candidate countries, and other sources.

The following important strategies are important due to their direct connection to the labour market:

- Strategy on the Development and Financing of Higher Education in Montenegro (2011-2020),
- Strategy for Development of General Secondary Education in Montenegro (2015-2020),
- Strategy for Development of Vocational Education of Montenegro (2015-2020),
- Strategy of Adult Education (2015-2015),
- Strategy of Inclusive Education,
- National Lifelong Career Guidance Strategy (2011-2015).

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

Significant improvements have been made despite complex demands of the educational reform in the initial phase. The most of implemented activities referred to: improving tertiary education quality, improved connectivity between vocational and tertiary education, and creating staff that would respond to labour market needs.

The analysis of recorded objectives and results, determined deficiencies and needs for improvement, and the assessment of future trends served as the basis for new strategic documents. They represent framework for acting of factors in a complex system such as education, containing priorities and objectives, measures and activities of the future development.

As regards the tertiary education reform, the implementation of the Strategy on Development and Financing of Higher Education (2011-2020) is ongoing.

Bearing in mind the significant problem of structural mismatch between the labour market offer and demand, the research titled “Perception of Higher Education in Montenegro” was done at the sample of 600 employers from public, private and NGO sectors in Montenegro. The implementation of the Programme of Vocational Education of Persons with Acquired Higher education, performed for the third consecutive year at the duration of nine months, collected and analysed information on actual market needs for specific qualifications. The synthesis of the results of these activities resulted in the Study on Labour Market Needs in Higher Education. The Results will be used for improving the Higher Education quality, and adjusting contents of offer and demand.

The Visibility Study for the implementation of monitoring the career of graduate students was made, with the view of establishing the administrative register of all graduate students in Montenegro, starting from the first generation in 2008.

During the observed period, the activities included developing National Qualification Framework, and its comparability with the European Qualification Framework. Montenegro is one of 23 European Countries and the first EU Membership candidate country who performed the referencing process. The Advisory Group for European Qualification Framework of the EU made a decision on full compliance of National Qualification Framework with the European Qualification Framework. This has opened the possibility to Montenegro citizens to continue education or be employed in the EU.

Under the INVO project, six academic and one science-research institution for assigning were selected during this year for allocation of 2.6 million euros. Moreover, the activities were initiated on assigning national scholarships for excellence in master, doctoral and post-doctoral studies. A half of the total amount (1.26 million euros) will be allocated for financing scholarships for master studies, while the remaining half will be used for financing doctoral and post-doctoral studies abroad.

With a view to fostering lifelong learning, the Action Plan for Implementing the National Lifelong Career Guidance Strategy for 2015.

The procedure of external evaluation of tertiary education institutions in Montenegro ended in late 2014. The independent service of the European University Association published the Evaluations of ten higher education institutions in Montenegro report, i.e. the Institutional Evaluation Report (IEP). With a view to raising the quality of educational and other processes, higher education institutions are obliged to make corrections according to the Report.

The Analysis on situation in recognising educational certificates issued abroad was made. The “quality” issue of diplomas has become a current topic bearing in mind that Montenegro, and other countries in the region, are facing with many owners of diplomas issued abroad which quality and manner of recognition have to be issued.

Since 2001, Montenegro has been using Tempus Programme, the most significant EU programme supporting the tertiary education reform following Bologna and Lisbon Principles through which more than 50 projects were implemented. The financed project referred to different reforms focusing on the development of tertiary education in Montenegro, like modernisation of study programmes in many faculties, introducing European credit transfer and accumulation system (ECTS), and introducing lifelong learning concept on tertiary education institutions at the University of Montenegro.

The implementation of the educations reform also used the possibilities of participating in other EU projects. In May 2013, Montenegro signed the Memorandum of Understanding for the Participation in Centralised Actions of the Lifelong Learning Programme.

Since January 2014, the EU has introduced the new programme for education, youth and sport – Erasmus+ (inheriting three programmes for education in which Montenegro participated – Tempus, Erasmus Mundus, and Lifelong Learning

programme, and Youth in Action and Jean Monnet). The main objective of the Programme aims at developing knowledge and boosting skills and employability, as well as modernising education and training. The Erasmus+ projects finances projects at all education levels. The objective is improving formal, informal and non-formal learning, including the development of inclusive education, and connecting education with labour market. The total budget of the programme for the period 2014-2020 amounts to 14,774 billion euros. Tertiary education level Institutions in Montenegro submitted applications for the implementation of 23 projects, seven of which were shortlisted.

These programmes resulted in increased interest of academia in Montenegro for cooperation with foreign educational institutions. The implementation of projects with the tertiary education institutions from the EU resulted in improved capacities of academic and administrative staff in some institutions of tertiary education.

The working conditions also significantly improved by purchasing contemporary equipment and the new teaching equipment.

The *Analysis with possible models for financing higher education in Montenegro* was made with a view to determining the adequate mode for its financing.

Positive trends were also recorded in lower level institutions in Montenegro. The traditional concept and contents of teaching is changing: lectures – exams – marks, table and chalk are being gradually changed with new forms of teaching methods and IT. Complex tasks require the preparation and improving of teaching staff through continuous trainings.

During the reform implementation, new schools and regional 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, and increased the number of books in libraries significantly.

Many activities on inclusive education were also performed. The Agency for Teaching Books and Facilities prepared books for children with disabilities and improved 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. The work with children with special needs improved. Regular schools with special classes (seven) perform joint teaching in some subjects with pupils of the same age in regular classes. First-class children of

Egyptian and Roma population were enrolled, while education for older pupils continued in six primary schools in Podgorica. As in the previous year, pupils were provided with books and transport to school. Regular contact with parents was established with a view to regularity in attending and preventing the results of abandoning the education process.

The concept of lifelong learning becomes permanently important in tertiary level institutions.

Educational programs of institutions lower than the university level pay due attention to professional orientation emphasising its importance, with entrepreneurship as obligatory course.

In addition to positive trends, the current situation is facing the following deficiencies:

- The number of students in Montenegro has constantly been increasing. As the result non-matching enrolment and labour market policies, the increased number of students strongly affects the structural imbalance between the offer and demand at the labour market. This resulted in hyper-production of some professions.
- On the other hand, there are high shortfalls for some lacking personal due to low interest for some crafts, compensated by engaging foreign labour force. This shortfall is present in strategic development branches like tourism, construction and agriculture.
- Generally, the biggest problem is non-utilisation of labour force lays in tertiary education enrolment policies not being in line with the labour market needs.
- Since this mostly refers to the new established (private) tertiary institutions, the 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 sufficient critical appraisal of the possibilities of their sustainability over the long term, both in staffing 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 prepared to respond to the more demanding reforms.
- The results on PISA tests pointed to specific deficiencies of the education system in Montenegro. The Action Plan for improving pupils' results at the PISA tests 2014-2018 was passed.
- Information system in education is insufficiently developed.
- There is 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.
- The cooperation of educational institutions with local administration is insufficient.
- With a view to adjusting education process to labour market needs, educational institutions insufficiently cooperate with employers.

### *Operational measures*

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, achieving these objectives requires:

- Working permanently primarily on securing and improving the quality of the higher education and of other educational levels.
- Connecting different education levels vertically and horizontally, and/or enabling mobility and advancement of knowledge through a compatible connection between the education levels.
- Developing education standards enabling the accurate comparison of educational qualifications and verifying education acquired in a formal and informal way.
- Striving to link higher education and the labour market and increase entrepreneurial-innovative characteristics of education.
- Continuously adjusting enrolment policy to the labour market needs to avoid hyper-production of hard-to-employ population and reduce structural imbalances at the labour market.
- Creating realistic assumptions for increasing the participation of the population with the higher education, respecting real labour market needs.
- Developing a lifelong learning model.
- Developing a research-oriented higher education.

- Participating to the maximum extent possible in the research projects of foreign educational institutions to gain knowledge and experience.
- Permanently materialising theoretical and practical knowledge of the teaching staff at all educational levels.
- Contributing to the promotion and encouragement of mobility and interests of teachers and students to use training opportunities and professional development abroad.
- Developing 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.
- Developing cooperation with all institutions dealing with social inclusion and creating 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. Moreover, the requirements for establishing faculties should be tighter, as well as the control of their operations. Thereby, tertiary education institutions should be supervised in order to determine whether the obligations from the External Evaluation Report of ten university units were met.

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

## 2. Labour market

<i>Key recommendations</i>	<i>Implementation deadline</i>
Aligning educational system enrolment policy with the labour market needs	Ongoing
Amending existing legislation in order to improve labour market flexibility	Short
Substitution of foreign labour force with the domestic one	Medium
Increasing the funds for the realisation of active employment measures performed by the EAM at the labour market	Short
Developing cooperation with employers and intensifying their involvement in the active employment measures programmes	Ongoing
Developing specific active employment policy programmes for employing youth, particularly university graduates	Short
Developing specific active employment policy programmes for the oldest categories of unemployed persons	Short
Developing specific active employment policy programmes for employees under risk to lose employment	Short
Developing training programmes, retraining and additional qualification of unemployed workers	Short
Continuation of stimulating the employment through employment financing programmes provided by the Investment-Development Fund of Montenegro and the EAM	Ongoing
Developing programmes and active employment policy measures to favour employment in the northern region	Short
Raising employers' awareness on opportunities of hard-to-employ population at the labour market	Ongoing
Providing inclusion and socialisation of hard-to-employ population	Medium
Developing specific active employment policy programmes for fostering increased activity of social welfare beneficiaries at the labour market	Short
<i>Main risks</i>	<i>Risk trend</i>
Structural mismatch of the labour force supply and demand	Stabile
Problem with the evident shortage of staff with a high school degree	Stabile
Unresolved status of a large number of business entities in Montenegro whose accounts are frozen	Increasing
Limited resources for active labour market measures	Stabile
Reduced potential for the creation of new jobs as a result of slower economic growth	Stabile
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	Stabile
Large volume of unregistered employment	Declining

## ***Background***

The labour market is affected by different multiple factors, with economic ones being directly or indirectly the most important ones. The effects of changes reflected as mild economic recovery and boosted activity had positive effect on labour market, although slower reaction to effects is one of its main characteristics. The current condition was also the strong result of measures and activities defined by the National Employment & Human Resources Development Strategy 2012-2015, implemented using the reduced financial assets volume.

Basic labour market trends and conditions include: structural incompliance of offer and demand resulting from tertiary education enrolment policies not being sufficiently in line with employment and labour market policies; high long-term unemployment; high inactivity and youth unemployment rates, particularly among the graduates; insufficient activity and unemployment of older workers and women; seasonal employment (with more fluctuations by employing graduates and without years of service, and youth in general); large regional sizes in employment and employment; low labour force mobility; insufficient cooperation of employers when creating employment programmes; insufficient level of knowledge and skills for individual running of business; employing relatively high number of foreigners; insufficient inclusion on persons with disabilities, marginalised and vulnerable groups at the labour market; large volume of non-reported work – illicit operations; long-term practice of twofold manner of paying salaries to employees in the private sector, to their detriment and the detriment of the Budget of Montenegro.

Due to the incomparability of official MONSTAT and EAM data in 2015 in corresponding period, we presented situation at the labour market in Q4 2011, when the implementation of the National Employment & Human Resources Development Strategy 2012-2015 started, and in Q4 2014, based on the MONSTAT data-indicators from the Labour Force Survey (LFS).

According to the labour force indicators during the observed comparable period, basic developments and conditions at the labour market during the implementation of the strategy are reflected in the following:

- Activity rate of the population aged from 15 to 64 years boosted from 55.8% to 61.5%. The rate for men grew up from 60.9% to 66.9%, as well as for women from 50.7% to 56.2%.
- During the same period, the employment rate ranged from 45.6% to 50.3%. For men, this rate increased from 49.5% to 56.4%, whereas for women it declined from 41.7% to 40.6%.
- The unemployment rate remained unchanged (18.3%) at the beginning and the end of the analysed period. The number of unemployed persons changed: it increased from 42.9 thousand to 47.4 thousand. The rate for men decreased from 18.7% to 18.3%, whereas it increased for women from 17.7% to 18.2%.
- Activity, employment, and unemployment rates of young people (aged 15-24) in this period best illustrate the negative situation in terms of their position and participation at the labour market. Namely, the activity rates were ranging from 19% (estimate) to 25.8%. Employment rate is very low – from 11.5% (estimate) to 14.1%, while unemployment rate is extremely high: at the beginning of the period, it amounted to 39.4%, while at the end of the period it amounted to 45.3% referring to 10.1 thousand unemployed persons of the mentioned age. Thereby, we should point to extremely high unemployment rate of men of 47.7% (estimate) in late 2014.

On the other hand, according to the Employment Agency of Montenegro data:

- the total number of registered unemployed persons at early-2015 (as at 31 December 2014) amounted to 34,687, or 4,166 or 13.6% more compared to 30,521 unemployed persons registered in early 2012 (as at 31 December 2011).
- The highest number of unemployed persons in administrative-territorial sense (observed by EAM regional offices) was recorded in Podgorica, Podgorica, Danilovgrad, Kolašin and Cetinje – 11,294 unemployed persons (32.56% of total number), while Pljevlja and Žabljak registered the lowest number – 2,745 unemployed persons (7.91% of total number).
- The difference between the estimated (Labour Force Survey - Monstat) and the number of registered unemployed persons (the Employment Agency of Montenegro) amounted to 8.2 thousand persons or 23.6% of the registered number.

- The share of women in overall unemployment increased from 46.9% to 47.8% (due to the increase in their number, from 14,317 to 16,575).
- Unemployment rate was 14.95 as at 31 December 2014, and it was by 3.4 percentage points higher than the rate at the beginning of the analysed period (11.55%), whereby we should also note that this increase also resulted from the change in the number of labour active population (decrease from 264,276 to 232,010 in 2012). The largest unemployment rates (up to 34.11%) were recorded in the municipalities of the Northern Region, while the lowest rates (of 9.11%) were recorded in the Coastal Region and the Municipality of Plužine (with the rate of 8.07%).
- During the reporting period, unemployment of young persons increased, namely: for persons aged up to 25 years by 31% (from 5,529 to 7,241), the age group from 25 to 30 years recorded significant increase in unemployment by 54.2% (from 4,247 to 6,549), while the number of unemployed persons aged over 50 years decreased by 12% (from 10,238 to 9,140).
- The number of persons registered as unemployed over one year increased by 2,070 (from 17,693 to 19,763, i.e. by 11.7%). The share of this category in total unemployment amounts to some 57%, or 1 percent point less than that share in the beginning of the period..

The economic crisis has caused a minor drop in demand at the labour market. During 2014, the EAM announced 43,227 vacancies in total, which was by 1,731 or 3.85% less in relation to the number of announced vacancies in end-2011. However, the structure of reported needs changed significantly. Observed by education degrees, demand for non-qualified labour force (education degrees I and II) increased by 21.1%, which was approximately the same decrease in demand (20.6%) for persons with completed tertiary education (education degrees VI, VII and VIII). The number of announced vacancies for employment of qualified labour force (education degrees III, IV and V) decreased by 30.7% at the end of reporting period.

During the reporting period, the number of employed persons through EAM amounted to 20,909, 14,646 and 14,318 in 2012, 2013 and 2014, respectively. The fact is that the numbers of announced and realised employments are incomparable, since some vacancies are announced several times during the year. However, the difference is the result of the crisis and large mismatch between offer and demand which confirms significant structural misbalance, enabling the continuation of

long-term practice of seasonal labour force employment, and the non-reported (illicit) employment of labour force.

The number of employed foreigners is growing over years. In 2014, the Employment Agency of Montenegro issued 23,061 work and employment permits for foreigners, which is by 11.3% more in relation to the 2012 (20,712). The application of the recently adopted Foreigners Law aims at substituting significant number of foreigners with the local labour force.

According to MONSTAT, total number of employees increased from 162,450 to 171,158 persons, i.e. by 8,708 persons (5.4%) during the period January 2012 - December 2014.

Observed in sectors, the number of employees increased in 14 out of 19 sectors from 101,165 to 114,308, i.e. by 13,143 persons or 13%. Simultaneously, five sectors of recorded the decrease in number of employees. Instead of the starting number (61,285), the number of employed persons at the end of the period amounted to 56.850, or by 4,435 or 7.2% less than in the beginning of the reporting period.

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%).

During the reporting period, the employment observed by sectors increased in the Central and Coastal areas by 5,858 or 6.4% and 2,852 or 6,4%), respectively, while the number of employed persons in the Northern region was at the same level (decreasing by 2).

The Labour market in Montenegro is characterised also by the problem of illicit and non-reported labour (scaling from 25% to 29% of GDP), with multiple adverse direct and indirect results. A large problem at the labour market is also insufficient inclusion of persons with disabilities, and of marginalised and vulnerable groups, mostly resulting from prejudice and other reasons, employers avoiding to engage these persons and settle this legal obligation in monetary terms. On the other side, there is insufficient connection of relevant institutions that would largely encourage members of these groups to be included in labour market flows, and foster increased activity of beneficiaries of unemployment benefits.

Labour market in Montenegro is also facing the problem of insufficient flexibility of the market and the need of improving business environment.

It should also be noted that multiple beneficiaries of self-employment loans were either insufficiently educated to conduct business or their business ideas were insufficiently economically viable. The EAM, that implements the Government's Programme for self-employment crediting, organises programmes and specialised training for these purposes.

Compared to 2012, average gross and net nominal wages declined in 2014. Gross salary amounted to 723 euros (727 in 2012), while net salary amounted to 477 euros (487 in 2012), which is a change of -0.55% and -2.05%, respectively. Due attention should be paid to long-term negative practice in private sector – twofold manner of paying salaries to employees - that is to the detriment of both employees and the Budget of Montenegro. This means officially registered and reported pay out of a portion of salary at the minimum amount, and non-reported pay out of the remaining amount (“under the table” pay out).

The state authorities that implemented multiple planned measures and activities under their competence and pursuant to their financial position strongly affected the situation at the labour market. Moreover, the required legislation was adopted within the determined deadlines, while strategic documents that will be the framework for future development were completed or ongoing. This and some other aspects should be used for improving the labour market statistics.

### *Operational measures*

The objectives to be achieved in this segment of economic policy include: increasing general activity and employment rates, reducing regional differences in employment and unemployment levels, increasing domestic labour force employment, particularly on seasonal jobs, fostering the development of entrepreneurship; reducing the illicit work; decreasing the youth unemployment (especially focusing on completed tertiary education level), and including social-vulnerable groups at the labour market.

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.

Several strategies referring to education and preparation for the employment are being implemented. They will have a long-term direct or indirect impact on labour market trends. The most important strategies include 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, and the Strategy for the Development of Small and Medium Enterprises 2011-2015.

National Strategy for Employment and Human Resource Development 2012-2015 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. Since the deadline for the implementation of the strategy expires, and that planned activities on drafting the next one are ongoing, it would be necessary to adopt the new strategy (covering the period 2016-2020) by the end of this year.

The changes in the education system should influence the situation at the labour market, primarily through the planned activities: higher compliance of the education system with the labour market needs, higher connection of educational institutions and the labour market, improving the quality of education at all levels and establishing the system of practical education in educational and/or study programmes.

Due to high degree of labour force inactivity and high number of unemployed persons, the cooperation of education institutions and labour market should be intensified. Only in that manner, by adjusting the enrolment policy with the labour market needs, the working potential of the labour market should be engaged in a more quality manner, with multiple positive effects.

Wherever it is possible, domestic labour force should substitute the foreign labour force. Still, it should be borne in mind that abrupt substitution does not aggravate the tourism development.

Special programmes should cover the population of unemployed persons who, in perspective, may mostly contribute to faster economic growth and development. This population includes young and specially educated staff. Significant room for their employment refers to seasonal employment in tourism, construction,

agriculture and trade. Their successful employment requires changes in the education system that refers to establishing the system of practical education and education of staff that may be directly engaged “from desk”. This would increase employer’s interest in domestic labour force.

Specific active employment policy programmes should, also cover the oldest category of unemployed persons as the most frequent beneficiaries of unemployment benefits.

It is necessary to continue the implementation of training retraining and additional qualification programmes aimed at unemployed persons from the EAM records. In order to define the programme properly, it would be necessary to include as many employers as possible. The priority should be given to those programmes with the existing significant employment of foreign labour force, since these jobs have demand and the highest likelihood of employment. Moreover, the labour market flexibility should be increased through relevant changes in legislation.

Simultaneously, the change in understanding and relation to employment of persons with disabilities and other of other unemployed persons from the category of vulnerable persons at the labour market should be affected. Changing the employers’ prejudices on possibilities of working engagement may increase employment and improve socio-economic position of these persons.

With a view to further fostering the employment, the employment programmes implemented by the EAM should be continued, particularly those for crediting sole traders by the IDF. When deciding, the priority should be given to regional component, i.e. allocating funds into the Northern region of Montenegro, with the most expressed unemployment.

Local administrations should have an important role, since their budgets should plan costs of stimulating and developing entrepreneurship at the local level.

Bearing in mind labour market condition and the need to follow gender equality in the implementation of these activities, due attention should be paid to employing of women and non-active users of unemployment benefits.

## VII. RECOMMENDATIONS CONCERNING FISCAL POLICY

<i>Key recommendations</i>	<i>Implementation deadline</i>
Define measures for rehabilitation of public sector	Short
Continue with public expenditure consolidation and restrictive fiscal policy	Ongoing
Intensify activities on decreasing taxation debt and on preventing the appearance of new taxation debts	Short
Use ultimate restrictive approach in issuing new state guarantees	Ongoing
Continue strengthening fiscal controls and further strengthening of mechanisms for internal and external audit of all budget expenditure units	Ongoing
Increase control and transparency of local government units' financial operations	Ongoing
Continue with public finance consolidation measures at local level	Short
Implement the Public Sector Internal Reorganisation Plan with a view to optimising the number of employees in public sector	Medium
Increase control over the operations of "state companies", in order to reduce negative outcomes and transfers of budget resources to these companies	Ongoing
Continue activities on combating shadow economy	Ongoing
Create sustainable taxation system model	Medium
Intensify activities on improving the taxpayers' tax culture, and on increasing fiscal discipline and reducing tax evasion	Short
<i>Main risks</i>	<i>Risk trend</i>
Continued public debt growth trends that may jeopardize fiscal sustainability	Increasing
Potential increase in price of constructing highway due to currency rate and contingent expenses	Stabile
Existing long-term fiscal deficit	Stabile
Public spending growth trends	Increasing
Insufficiently sustainable pension and health insurance systems	Increasing
Social pressures and negative demographic trends	Increasing
High share of mandatory spending in public spending structure	Increasing
Financing or co-financing of large infrastructure projects (additional burden on the fiscal position and fiscal sustainability jeopardizing)	Increasing
Calling of issued guarantees	Increasing
High indebtedness of local administration units	Increasing
Expensive and limited financial sources	Stabile
High illiquidity of the economy	Increasing
The emergence and spill over of new exogenous shocks due to the development of instability in the Euro area	Stabile

## ***Background***

Fiscal policy measures implemented in 2014 and 2015 aimed at providing public finance sustainability, limiting public debt growth, suppressing shadow economy, decreasing taxation burden, increasing budget revenues, and thereby reducing budget deficit and improving environment for new investments in order to establish long-term public finance sustainability. Moreover, the public finance quality was characterised by continued fiscal adjustments and budget spending rationalisation, as well as complying public finance with legislation and the EU practice.

Despite plentiful measures taken on fiscal consolidation, the Budget deficit is still high. It mostly resulted from financing the construction of highway and settling outstanding liabilities. The positive trait is low structural fiscal deficit.

In the upcoming period, the primary strategic fiscal policy objective is decreasing public debt and its share in GDP pursuant to the Law on Budget and Fiscal Accountability. Moreover, public finance consolidation prioritising budget deficit decrease, by increasing revenues and rational spending of allocated funds, still remains to be one of primary fiscal policy objectives.

In late 2014, the Ministry of Finance adopted the document “*Analysis of Specific Tax Policy Aspects – Reform Outlooks*”, which includes amending a set of laws aimed at increasing the level of public finance sustainability and restricting the public debt growth, distributing tax burden so as to largely support growth, and underpin and improve investment setting and competitiveness of Montenegrin economy.<sup>20</sup> By adopting the document, Montenegro initiated the taxation system reform, which foresees change in the taxation structure, i.e. transition to taxes bearing lower negative impact on economic growth.

In 2015, the Government continued pursuing the fiscal policy in line with the planned framework defined in the Guidelines of Macroeconomic and Fiscal Policy 2015-2018. Thus, the application of “crisis tax” on personal income (applied to the part of salary above the average) continued in 2015, whereby higher personal income tax rate decreased from 15% to 13%. Health insurance contribution rate paid by employer increase by 0.5 percentage points with continued application of the primary VAT rate of 19% in the upcoming three-year period, and retaining lower tax rates on specific products.

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<sup>20</sup> “Montenegro Economic Reform Programme 2015 - 2017”, Government of Montenegro, January 2015.

The Law Amending the Personal Income Tax Law introduced taxation of gains from games of chance stipulating that each individually paid gain from games of chance be subject to paying tax at the rate of 15%.

Moreover, with a view to providing public finance sustainability and limiting public debt growth, the supplement to the Decree on the Manner of Establishing Maximum Retail Prices of Oil Derivatives introduced the earmarked fee on retail price of fuels amounting to 7 euro-cents per litre. The funds gained from this tax are allocated for financing a portion of costs for constructing highway and representation sport. The Constitutional Court of Montenegro proclaimed the provisions of this Decree unconstitutional, and the prolongation of the validity of this earmarked tax would require its legal regulation.

The application of the tax on coffee started in 2015, and the Amendments to the Law on Excise Duties established the “excise duty calendar” for the five-year period, i.e. it established the increase dynamics of increasing the excise duty on cigarettes.

Activities on combating shadow economy focusing on labour market and excise duty products market significantly intensified during the last two years. To eliminate unfair competition and lower competitiveness of companies operating legally, the Commission for Suppressing Shadow Economy will continue to implement measures in combating shadow economy. In the upcoming period, the Commission’s primary determination will be zero tolerance, respecting the non-selectivity and full transparency principles with the application of stricter penal policy.

On the other hand, significant measures affecting the budget expenditure side were taken, primarily by cancelling “retirement under favourable conditions” practice, which would significantly decrease expenditures for social transfers. Moreover, pensions did not decrease in 2015 due to lower average salary compared to 2014, thus safeguarding the pensioners’ standard.

As a part of taxation policy reform, the fiscal incentives were introduced aimed at valuing significant resources and attracting foreign investors for new investments. These incentives refer to investments in high-end tourism (5+ stars-hotels), production of food products (except primary agricultural production), and capital investments in energy industry.<sup>21</sup>

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<sup>21</sup> Source: Document of the Ministry of Finance titled “*Montenegro’s Development Directions 2015-2018*”, June 2015.

The realisation of the largest and the most important infrastructural project in Montenegro (the construction of “Bar – Boljare” highway route “Smokovac-Matešev”) started, and it will be financed from capital budget with funds provided through loan from Chinese Exim Bank. The implementation of this project will undoubtedly result in temporary budget deficit and public debt increase. However, it will, through higher economic growth rates, result in public revenues increase in long-term perspective, thereby creating better conditions for public finance stabilisation. It should not be neglected that the conditions for financing the project are extremely favourable, with the six-year grace period and the four-year construction deadline.

Domestic/public debt has been in the focus of Montenegro’s fiscal policy. Public debt<sup>22</sup> continued its growing trend in 2015. According to Ministry of Finance data, public debt stood at the level of 60.3% of GDP as at end-H1 2015. This mostly resulted from the issuing 500 million euros of Eurobonds, and from withdrawal of Exim Bank loan funds amounting to 169.6 million euros. Further public debt increase is expected by end-2015 resulting from the need for additional funds necessary for construction of a highway route and financing budget deficit, as well as in the upcoming three-year period, primarily due to external debt growth for financing a highway route and the needs for refinancing existing liabilities. Still, it is encouraging that the public debt will trend down after the construction of the highway.

The abovementioned indicated that serious and comprehensive fiscal consolidation measures showing positive results were taken. They are primarily visible through decrease in budget deficit and shadow economy. Yet, maintaining fiscal stability being the anchor for total economy’ stability requires cooperation of all policy creators and regulators.

### *Operational measures*

To avoid risks accompanying fiscal sphere, it would be necessary to pursue economic policy contributing to attaining sustainable fiscal policy. The construction of highway will result in high fiscal deficit in the upcoming years, whereas structural fiscal deficit is targeted not to exceed 1%. Therefore, fiscal consolidation measures should continue in the upcoming period.

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<sup>22</sup> Excluding local administration units

Public debt is an important issue requiring priority in the upcoming period. It is expected to trend beyond limits set out by the Law on Budget and Fiscal Accountability (60% of GDP), thus the legal obligation of imposing measures and preparing resolution plans will be implemented. Thereby, it is important to make detailed debt management strategy containing concrete measures and steps to remove risk that may cause high share of public debt in the GDP.

Non-settling of obligations to the state is a significant problem. The amount of tax debt resulted from the economic crisis and economic decline shrinking. Since the Ministry of Finance data show that taxation debt amounts to 530 million euros<sup>23</sup>, it would be necessary to intensify activities on strengthening fiscal discipline and efficiency of state administration bodies, primarily the tax Administration, in the upcoming period, in order to establish taxation debt downtrend in the upcoming period, and thereby increase in budget revenues. It would be necessary to continue applying the Decree on the Proceeding of Collecting Taxation Receivables Using Taxpayer's Property and the Law on Writing-off of the Interest on Taxation and Customs Liabilities, aimed at decreasing the taxation debt amount. Pursuant to these legislation, it would be necessary to precise the uncollectable amount of debt that should be written off conditionally, i.e. transferred to separate records, used in the case of possible opening the possibility to collect a certain amount. The exclusion of uncollectable portion of taxation debt would give clearer overview on taxation debt of economic entities and, using the information, taking additional measures to collect the taxation debt.

Fiscal sustainability of the Pension and Disability Insurance Fund is an important fiscal consolidation factor. Unfavourable economic trends and the labour market condition, and the accelerated growth in level of pensions and number of pensioners, created gap in financing social welfare and produced risk of Montenegrin pension system's sustainability. It would be important to pursue the pension system reform in the upcoming period aimed at establishing long-term sustainable system that would provide better social and material safety and higher total level of pensions on one hand, while moderating demographic and economic turmoil and being less dependent on the state on the other hand.

Local government units represent another important segment of the overall fiscal system. The state and trends of public finances in local government units affect

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<sup>23</sup> Source: Document of the Ministry of Finance titled "Macroeconomic and Fiscal Policy Guidelines 2015-2018", March 2015.

fiscal sustainability and financial stability to a large extent. Some municipalities experience severe problems as a result of unrealistic planning and failure to harmonise spending with realistic tax capacity of the economy and population. Unsustainable public finances at the local level, reflected in negative indicators (high indebtedness, growing outstanding liabilities and overstaffing) pose risk both for public finances and economic growth. It is necessary to continue to pursue measures aimed at ensuring consolidation of public finances at the local level, and find mechanisms to reduce debt of local government units.

In order to reduce public spending, it is necessary to implement a detailed analysis of all budget expenditure positions within the current budget. In this regard, it is important to continue strengthening fiscal control of all spending units of the budget, as well as control of financial operations of “public” companies.

Expenditures for public administration employees remain to be high. Therefore, it is necessary to carry out control and ensure efficient implementation of Human Resource Plan, which defines restrictive employment.

Continue better implementation of the Law on Prevention of Illegal Business Operations, aimed at reducing the level of shadow economy, thus ensuring increased budget revenues. Also, it is necessary to continue efficient collection of public revenues, with increased control of taxpayers and implementation of all legal measures towards taxpayers who fail to meet their obligations in line with positive regulations. It is necessary to improve tax discipline of taxpayers and define penalties for those who repeatedly violate regulations.

It is necessary to form a transparent database of budget related projects, thus achieving a quality analysis of fiscal risks, which would primary be of great assistance in the process of efficient decision-making in terms of priority investment project. In accordance with the annual budget law, monitoring of implementation of investment projects initiated in order to monitor expenditure of planned funds should be intensified. A detailed analysis of every big infrastructure project is necessary so they do not 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. It was recently announced that new guidelines in this area will be adopted. 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 havens and ensuring the efficient exchange of information, and the like.

## VIII. RECOMMENDATIONS CONCERNING FINANCIAL SYSTEM

<i>Key recommendations</i> <sup>24</sup>	<i>Implementation deadline</i>
Continue reforms aimed at improving business environment and strengthening investment climate with a view to enabling easier access to sources of funding to competitive, innovative and export oriented companies	Medium
Intensify activities with regard to implementation of the Law on Voluntary Financial Restructuring of Debts towards Financial Institutions, aimed at reducing the level of non-performing loans and their share in total loans, thus improving the offer of banks in terms of loans under favourable conditions. In this respect, it is necessary to legally regulate the maximum allowed level of contractual interest rate	Short
Intensify activities on the development of a new and single regulatory framework which would regulate the operation and control of leasing companies, factoring companies, micro-credit financial institutions and credit and guarantee funds, thus improving the transparency of the financial system	Short
Intensify activities towards harmonising and implementing regulatory framework in the insurance market and capital marked with the EU acquis and international standards	Short
Promote education in the area of insurance, securities market and investment services	Ongoing
Improve protection of minority shareholders' rights and respect the basic principles of corporate governance	Ongoing
Improve supervisory capacities of all financial market regulators by proposing appropriate legal regulations, aimed at faster implementation of the regulatory framework and fulfilling obligations on the road towards the EU accession	Ongoing
Strengthen and develop administrative capacities with a view to strengthening the resilience and independence of regulatory and supervisory institutions in the area of financial services	Ongoing
Intensify institutional cooperation in the area of harmonisation and implementation of regulations for financial accounts statistics, aimed at forming a quality statistical base so that creators of economic policy could make timely and efficient measures	Short
<i>Main risks</i>	<i>Risk trend</i>
High exposure and economic ties of Montenegro with the region and the EU countries, and the fact that foreign banks make the Montenegrin economy, including the financial sector, vulnerable and sensitive to negative developments in the region.	Stable

<sup>24</sup> Key recommendations do not comprise recommendations under the jurisdiction of the CBCG.

High real sector illiquidity	Increasing
Still present high percentage of non-performing loans	Declining
High lending interest rates of banks and MFIs	Declining
Inadequate level of liquidity and shallow capital market in terms of market material available for trade	Stable
Inadequate protection of proprietary rights of minority shareholders	Stable
Inadequate levels of transparency and quality of financial statements of companies whose shares are quoted on the stock exchange	Stable
Inadequate management of funds' assets	Stable

## ***Background***

### ***Banking sector***<sup>25</sup>

After the new banks entered the financial market of Montenegro, the banking system comprises 14 banks. Introduction of new banks to the Montenegrin market opens new possibilities for improving lending activity in the forthcoming period. Also, bigger competitiveness in the banking system can result in a more diversified and favourable offer of banking products both to natural and legal persons.

During the first three quarters of 2015, the banking system of Montenegro was liquid, solvent and relatively good capitalised. At end-June 2015, the solvency ratio was 15.83%, which is significantly above the statutory minimum of 10%.

Restrictive lending policy of banks is reflected in the increase in monetary assets in the banking sector and, generally, the overall level of liquidity. It is evident that during the first nine months of 2015, the banks placed part of the excess liquid funds, arising from lower lending activity during the previous years, in securities, as an alternative source of revenues. Namely, investments in securities amounted to 50.4 million euros or 20.8% more in relation to end-2014, i.e. 70 million euros or 31.3% more in relation to end-September 2014. However, the banks showed cautiousness in terms of this type of investment because they placed the largest amount of funds into government securities.

During the first nine months of the current year, the funds deposited in banks showed an upward trend, recording an average monthly growth rate of 1.4%. At end-September 2015, banks' deposits amounted to 2,623.9 million euros, which represents an increase of 315.7 million euros or 13.7% in relation to end-2014, i.e.

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<sup>25</sup> Preliminary data.

355.9 million euros or 15.7% more in relation to the corresponding period of the previous year. Constant deleveraging of banks abroad comes as a result of increase of cheap domestic deposits (extremely low deposit interest rate), high liquidity of the banking system and weaker lending activity during the previous period.

Even though it remains to be limited, the lending activity of banks shows signs of slight recovery, with oscillations of total loans which also recorded an upward trend during the first nine months of the current year. At-end September, banks' loans amounted to 2,543.5 million euros, which represents an increase of 176.3 million euros or 7.4% more in relation to end-2014, i.e. 100.2 million euros or 4.1% more in relation to end-September 2014. During this period, a total of 650.3 million euros of new loans were granted, which is 134.6 million euros or 26.1% more than in the same period of the previous year.

Even though bad loans still represent a significant part of loans of the banking system, the quality of the lending portfolio of banks improved during the reporting period. This improvement is reflected in the decrease of non-performing loans as well as in the y-o-y decrease of non-performing loans in total loans of banks. At end-September 2015, non-performing loans amounted to 351.5 million euros or 6.4% lower than at end-2014 or 12.2% lower in relation to the corresponding period of the previous year. As a result of lower non-performing loans and higher amount of total loans, the share of non-performing loans in total loans also declined during the reporting period, when this indicator amounted to 13.82% or 2.05 percentage points lower in relation to the end of the previous year, i.e. an annual decline of 2.56 percentage points.

High level of non-performing loans affects financial performance of banks, making them borrow at higher prices, resulting in a lower lending activity and higher interest rates. Therefore, despite obvious positive trends of non-performing loans, reduction of the volume of non-performing loans through the implementation of Law on Voluntary Financial Restructuring of Debts towards Financial Institutions will continue to represent a key challenge in 2016.

Past due loans amounted to 423.2 million euros and accounted for 16.6% of total banks' loans. Past due loans declined by 4.9% compared to end-2014, while in relation to the same period of the previous year they were 9.8% lower.

At end-September 2015, the average lending interest rate on total banks' loans amounted to 8.89% while the average lending interest rate on new loans amounted to 9.63%. The downward trend of weighted average nominal and effective interest

rates (WANIR and WAEIR) which started in Q4 2014 continued into the reporting period of the current year. At end-September 2015, the interest rate on total banks' loans declined by 0.33 percentage points in relation to December 2014, and it recorded an annual decline of 0.68 percentage points. On the other hand, at end-September 2015, WAEIR on new loans increased by 0.61 percentage points in relation to end-2014, while it declined by 1.14 percentage points in relation to June 2014.

Bearing in mind the fact that high interest rates represent one of the factors for NPL growth, thus causing possible negative effects to the financial stability of the country, the Central Bank established and forwarded to the Ministry of Finance for further procedure the Draft Law on Maximum Allowed Interest Rates. The aim of the proposed law is to eliminate extremely high interest rates without market justification, which weaken financial capabilities of debtors, have a negative effect on the financial stability and enable creditors to record profit exceeding the acceptable level of money cost. Key provisions refer to the setting of default interest rate paid by a borrower who fails to meet financial obligations and maximum allowed contractual interest rates pursuant to the loan agreements, financial lease agreements and agreement on borrowing of monetary assets. In the part referring to the statutory interest rate, it is proposed that the existing legal solution is amended and harmonised with the Directive 2011/7/EU on combating late payment in commercial transactions. The Law will be implemented in line with mandatory principle and penalty provisions in case of non-compliance.

### ***Micro-credit financial institutions (MFIs)<sup>26</sup>***

Balance sheet of MFIs at the end of September 2015 amounted to 46.6 million euros and it increased by 8.3 million euros or 21.7% compared to end-2014 and by 11.6 million euros or 33.1% in relation to the corresponding period of the previous year.

At end-September 2015, total MFI loans amounted to 46.8 million euros, which is 7.5 million euros or 19.1% more in relation to end-2014, and recorded an annual increase of 10 million euros or 27.3%. The majority of MFI loans (90.2%) referred to the household sector. Also, 5.7% referred to financial institutions, while the remaining 4.1% referred to non-financial institutions.

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<sup>26</sup> Preliminary data

During the first nine months of 2015, the MFIs granted a total of 29.5 million euros of new loans. The lending activity was intensified, and new loans recorded a y-o-y increase of 4.3 million euros or 17%. The majority of new MFI loans (98.5%) referred to the household sector, while the remaining amount referred to the corporate sector.

At end Q3-2015, MFIs capital amounted to 20.9 million euros, i.e. 1.1 million euros or 5.4% more in relation to end-2014, while it recoded an annual growth of 1.8 million euros or 9.4%. Of the total amount of capital, 84.6% related to capital from donations, 10.3% to retained earnings, and 5.1% to the profit from the current year. At the aggregate level, MFIs ended the first nine months of 2015 with a net profit of 1.1 million euros.

At end Q3-2015, MFIs borrowings amounted to 23.4 million euros and recoded an increase of 6.9 million euros or 41.6% in relation to end-2014, while there was an annual growth of 9.5 million euros or 68.6%. Most of MFIs borrowings (85.1%) came from foreign financial institutions, while 14.8% referred to borrowings from domestic banks.

Lending interest rates of MFIs are high and are subject to constant monitoring by the Central Bank. At end-September 2014, the average interest rate on total loans amounted to 24.88%, while the average interest rate on new loans amounted to 25.52%. MFI adjusted the interest rates, following the recommendation of the Central Bank to do so, but failed to reduce them to a significant amount. At end-September, WAEIR on total loans recorded an annual as well as a y-o-y decline of 0.78 percentage points and 1.19 percentage points, respectively. On the other hand, WAEIR on new loans increased by 0.90 percentage points in relation to December 2014, while it recorded an annual decline of 0.69 percentage points.

### *Insurance market<sup>27</sup>*

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

At end-June 2015, total balance sheet of insurance companies amounted to 173.7 million euros and recorded growth of 2.6% compared to end-2014. Solvency of

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<sup>27</sup> Last available preliminary data

companies, measured as the capital to solvency margin ratio was satisfactory (264.92%).

Gross insurance premium amounted to 6.1 million euros in August 2015. In the total gross premium, non-life insurance had a dominant share (83.3%), while life insurance accounted for the remaining 16.7%. In August 2015, in the structure of non-life insurance gross premiums, insurance premiums from liability due to the use of motor vehicles (60.2%) recorded a dominant share, followed by accident insurance (17.1%), motor vehicles insurance (5.9%) and property insurance against fire and other hazards (5.7%) and other property insurances (4.8%). In the structure of life insurance, the largest share was recorded by life insurance (89.9%).

At end-June 2015, insurance market generated a gross profit of 2.6 million euros.

### ***Lease market in Montenegro<sup>28</sup>***

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

In Q1 2015, the number of new contracts was 3.3% lower than in the same period of the previous year, and 35.8% lower than in Q4 of the previous year. The highest number of new contracts was concluded with legal entities (71.6%), while the contracts concluded with natural persons accounted for 28.4%. Of the total number of new contracts, 88.7% related to financial leasing, with a share of 96.9% in the value of signed contracts. The remaining number (11.3%) or the remaining value (3.1%) of new contracts related to operating leasing.

Looking at the value of new contracts in Q1 2015, 69.4% of the total value of concluded contracts related to the purchase of passenger vehicles, 26% to the purchase of commercial vehicles, while 4.6% related to the purchase of construction machinery and equipment.

The number of active contracts as of 31 March 2015 was 20.7% lower than at the end of the previous year. The largest number of active contracts was concluded with legal entities (51.8%), followed by natural persons (47.7%), while the contracts concluded with entrepreneurs accounted for only 0.5%

### ***Capital market***

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<sup>28</sup> Last available data

Montenegrin capital market is relatively small and without significant influence to the stability of the financial system. During the first nine months of 2015, Montenegro Stock Exchange recorded turnover of 26.5 million euros, which represents a y-o-y decrease of 63.7%.

In the aftermath of the crisis, the key shift in the Montenegro capital market is bond trading. This type of trading is very developed in the EU countries. Placement of bonds in the domestic capital market managed, to a certain degree, to reignite the interest of investors due to the fact that for a while yields exceeded corresponding interest rates for deposits in banks.

When comparing turnover, we should bear in mind the fact that in corresponding period of 2014, there was a significantly higher turnover as a result of sale of government bonds during March 2014, in the total amount of 43.2 million euros or 59.1% of total turnover during this period. If we exclude this sale, during the first nine months of 2015, turnover recorded a y-o-y decrease of 11.2%. The entire turnover came from secondary trade.

In the structure of turnover during the first nine months of 2015, turnover of shares of companies recorded dominant share (53.8%), which represents a y-o-y increase of 27.1 percentage points, followed by turnover of various type of bonds (41.2%) which recorded an annual decline of 23.2 percentage points. The remaining 5% of the total turnover referred to turnover of shares of investment funds, whose contribution declined by 3.9 percentage points.

At end-September 2015, total market capitalisation at Montenegro Stock Exchange amounted to 2,968.1 million euros. Market capitalisation increased by 0.3% in relation to end-2014, while it recorded an annual decline of 0.8%.

At end-September 2015, MONEX index was higher by 561.58 index points or 4.9% in relation to end-2014. On the other hand, MONEX PIF index declined by 37.96 index points or 1.2% in relation to the corresponding period. The newly formed MNSE10 index, which was introduced to Montenegrin capital market on 1 April 2015, declined by 53.22 index points, or 5.3% in relation to its initial value.

Such a small capital market that exists in Montenegro represents both an advantage and a disadvantage in terms of harmonisation of regulations with the EU principles and implementation thereof. The advantage is easier adaptation to new regulatory

requirements, given the market size, while the key disadvantage is its underdevelopment and small turnover, so it takes time to clearly examine this area.

### *Operational measures*

In order to stimulate lending activity of banks, it is necessary to work continuously to create a favourable investment climate and stimulating business environment. In this regard, it is necessary to continue to implement reforms that would increase competitiveness of Montenegrin economy, especially in terms of tax policy, corporate governance and the rule of law.

Even though there was a downward trend of NPLs during the previous three years, it is necessary to take a more active approach in solving this issue, which has been the most important problem of the banking sector. In May 2015, the Law on Voluntary Financial Restructuring of Debts towards Financial Institutions came into force, so what remains is the challenge of its adequate implementation in terms of resolving a large amount of NPLs which burden banks in terms of inflow (flows), while in terms of the level of NPLs, it is necessary to improve deadlines and efficiency of contract enforcement. These objectives have also been identified as a clear framework and joint conclusion of the Economic and Financial Dialogue between the EU and Western Balkans and Turkey, in the part referring to Montenegro.

In order to improve transparency of the financial system, it is necessary to regulate operations and supervision of leasing companies, factoring companies, micro-credit financial institutions and credit guarantee funds by adopting a single Law on financial leasing, factoring, micro-crediting, and credit and guarantee operations. The new Banking Law, which is planned to be adopted at end-2016, will only regulate banks as credit institutions, in line with the EU acquis. Thus, it is necessary to timely regulate the legal status of other financial institutions that are not credit institutions, and which are regulated by the current Banking Law (micro-credit financial institutions and credit-guarantee funds). In line with the recommendation of FSAP mission (carried out by experts of the IMF and the World Bank), the most reasonable solution would be for the Central Bank of Montenegro to also regulate this segment of the financial system.

It is necessary to continue with the activities towards improving regulatory framework for insurance, based on the EU directives and international standards, especially in the part referring to implementation of the Solvency II Directive.

Consider the possibility of receiving technical assistance for implementation of this regulation.

It is very important for financial institutions to take part in the process of financial education because they play an important role in the contact with final users of financial services.

With a view to increasing growth and developing insurance market, it is necessary to intensify educational and promotional activities in order to improve positioning of the insurance sector in the financial services market. In this respect, the National Bureau of Montenegro Insurers plays an important role when it comes to promoting and strengthening education activities, aimed at familiarising users with financial products on the insurance market.

It is necessary to encourage education of participants at the capital market in order to improve trade, deepen the market, increase the flow of information, reduce risk when investing, etc. Continuously improve the quality of reporting of the stock exchange, particularly in the part relating to the level of shares risk indicators, in order to adequately inform exchange participants about the risk/yield ratio of individual trading instruments.

In order to improve operations in the capital market, regain investors' confidence and ensure adequate protection of investors, as well as to achieve higher level of harmonization of Montenegrin legislation with the EU regulations, it is essential to ensure efficient implementation of the new Law on Capital Market, planned to be adopted in Q4 2015. This should be done by drafting secondary legislation framework which will ensure fair and organised securities trade.

When it comes to protection of minority shareholders, it is necessary to reach the European standards. 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.

Aimed at improving efficiency and effectiveness of regulatory and supervisory capacities of all financial market regulators, it is necessary to timely propose legislation so they would be adopted within the deadlines set in the Montenegro's EU Accession Programme for the period 2015 – 2018.

In order to enhance the strength and independence of regulatory and supervisory institutions it is necessary to strengthen and develop the overall administrative

capacities for implementation of the EU acquis in the area of financial services, having in mind the growing responsibility of all institutions that will be formed as a result of implementation of the EU acquis.

One of the basic prerequisites for making timely and effective measures by the makers of economic policy is a statistical base of good quality. Therefore, it is necessary to work intensively on further harmonization of the existing regulations in the area of financial accounts statistics with the EU regulations (ESA 2010) and implementation thereof. In this regard, it is necessary to establish a more intensive and quality coordination and communication between the Central Bank, MONSTAT and the Ministry of Finance in order to define legal solutions that will provide data that is harmonized with the EU legislation in the area of financial accounts statistics.

## IX. RECOMMENDATIONS CONCERNING INTERNATIONAL ECONOMIC RELATIONS

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

<i>Key recommendations</i>	<i>Implementation deadline</i>
Increase competitiveness and productivity in branches of strategic export importance by achieving higher level of specialisation and finalisation of the production cycle	Ongoing
Increase and diversify export	Ongoing
Increase export promotion with an active role of diplomatic missions	Ongoing
Increase and unify support to exporters	Ongoing
Implementation of the policy of import substitution and production stimulation	Ongoing
Stimulate clusters, development of products with geographical indication and development and protection of national brand products	Ongoing
Valorisation of business zones	Ongoing
Ensure implementation of CEFTA agreement and increase regional cooperation	Ongoing
Stimulate innovations as well as research and development investments	Ongoing
Improve business environment, remove administrative barriers, protect copyrights and other intellectual property rights	Ongoing
Adopt international quality standards	Medium
Stimulate use of information technologies	Ongoing
Stimulate even regional development	Ongoing
Harmonise national legislation with the EU acquis	Short
<i>Main risks</i>	<i>Risk trend</i>
Low export and poor diversification	Increasing
High import and unfavourable structure of import	Increasing
Low production and poor export orientation	Stable
Low finalisation and specialisation of products	Stable
Volatility of revenues from tourism	Stable
High dependence of the economy on the inflow of foreign capital	Stable
Financing the current account deficit through borrowing	Increasing
Slow adoption of international quality standards	Stable
Insufficient research and development investments	Stable
Poor implementation of information and communication technologies	Stable
Low level of internationalisation of Montenegrin companies	Stable

## ***Background***

In H1 2015, according to preliminary data, the current account deficit increased. The deficit amounted to 490.4<sup>29</sup> million euros, recording a y-o-y increase of 9.6%. The increase of the current account deficit comes as a result of higher imbalance in the goods account, lower export and higher import of goods, as well as lower surplus in the secondary income account. Visible trade was the main generator of the current account deficit. As a result of lower export of goods by 5.7%, as well as increased import by 3.5%, there was a foreign trade deficit in the amount of 686.7 million euros or 5.7% more in relation to the corresponding period of the previous year.

Services account surplus amounted to 121 million euros, which represents a y-o-y increase of 1%. Also, during the reporting period, there was an increase of primary (factor) income from abroad by 2.8%, which represents net inflow of 25.2 million euros. Secondary income account recorded a surplus in the amount of 50 million euros, which is 13.3% less in relation to H1 2014. This came as a result of higher outflow based on interest repayment and paid dividends. High dependence on import, as well as a downward trend of export influence further deepening of foreign trade imbalance. Coverage of foreign trade deficit by the surplus recorded in other accounts of the current account amounted to 28.6% which represents a y-o-y decrease of 2.5%.

The downward trend of the current account deficit has been present since 2009, as a result of the crisis adaptation of the Montenegrin economy and reduced abilities to finance import. Since the beginning of 2014, including the first six months of 2015, the current account deficit has been increasing again. There is a noticeable deterioration in the goods account – followed by a decline of export and slight increase of import. Given the above, the issue of 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 sufficient inflow of foreign accumulation through foreign direct investments and partly through portfolio investments. However, the existence of long-term deficits indicates external imbalance for which the abovementioned source of funding represents only a temporary solution. It is necessary to undertake a set of measures in order to implement comprehensive structural reforms in our economy and improve the external position in the long run.

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<sup>29</sup> The data on the balance of payments of Montenegro are published in line with the new methodology of the IMF (Balance of Payments and International Investment Position Manual, sixth edition – BPM6, 2009).

Low export base, poor differentiation of export and high dependence on import indicate weak competitive position of Montenegro. Strengthening and diversification of export along with increasing competitiveness are set as imperatives of development of the Montenegrin economy. Only with the adequate state involvement, as well as greater private sector initiative, enhanced financial and non-financial assistance, the domestic economy can go through structural changes necessary for further accelerated growth and development.

### ***Operational measures***

Increasing the competitiveness and productivity represents imperatives of the future development. Emphasis should be put on small and medium enterprises, as well as new production-oriented companies, with a special emphasis on export. Stimulate the existing companies to increase investments in innovations, research, design, marketing and placement of products into foreign markets. There is an evident lack of private sector participation in European research programs. Also, 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, which needs to be harmonized with demands of the Montenegrin economy and the new growth model. In addition, a new strategy for stimulating competitiveness at the micro level for the period after 2015 should be adopted.

It is necessary to strengthen weak export performances. It takes a strong commitment of the Government and the private sector in order to strengthen the export potential. Strengthening export, in addition to increasing the volume, implies improving its structure towards greater diversification. Our export is dominated by metal industry products and electricity. This concentration of export makes our export sector vulnerable, with high volatility over years. At this point, it is necessary to make an analysis of export. Also, form a comprehensive database of exporters, containing information about their products, to what markets they export, the value of export, obstacles during export and the like.

The existing production and export are characterised by raw materials and low-processed manufacturing goods. The increase of product finalization affects higher prices of export products, higher wages of manufacturers and greater competitiveness. Thus, Montenegrin products require higher level of processing, based on new technologies and innovations. 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 as well as for implementation of modern technologies. Private investments in the modernization of business and innovation should be stimulated. Support to new businesses should be continued, as well as development of special programmes such as franchising, technology parks, and business incubators. Companies need support for the inclusion in foreign production lines in order to become a part of a larger and organized production chain.

There is a direct link between promotion of Montenegro abroad and stimulating export and export potentials. It is necessary to continue with current promotion of Montenegro and Montenegrin entrepreneurs at international markets, by means of participation at specialised fairs, economic meetings, promotional seminars and the like. Expand the activities of diplomatic offices abroad in terms of presentation and promotion of domestic economy. Intensify media promotional activities of the SME sector.

Enable consistent implementation of the Plan for promotion of investment potentials of Montenegro and attracting investors in the agricultural sector.

Implement and promote the policy of import substitution with domestic products. To this end, it is necessary to have a quality analysis of imports to determine what products need to be imported, and what products could be successfully substituted. Machines, sophisticated equipment, oil and gas represent product that cannot be substituted in the short-term. However, a large number of agricultural and food products can be the subject of substitution.

Therefore, the increase of production represents a prerequisite for faster economic growth and protection against excessive import. It is necessary to analyse the existing production in Montenegro. Also, form a comprehensive database of producers, register sectors in which they operate, register production volume, international standards they possess, identify weak points and bottlenecks of production, as well as expansion possibilities. Consider adopting a strategy to encourage production with a focus on two complementary objectives – increasing export and substituting import.

It is necessary to have adequate financial and non-financial support in order to successfully initiate export and production. It is also necessary to consolidate and strengthen the incentives to exporters. Improve the system of issuing loan guarantees for small and medium enterprises by the Investment and Development fund (IDF). Continue with credit and factoring support of the IDF to the sector of

small and medium enterprises, agricultural producers and entrepreneurs. Consider the possibility to continue to implement and introduce new financial instruments for SMEs (new guarantees, instruments to support export, venture capital funds). There should be a strong emphasis on financial support to new businesses, especially export oriented businesses. Encourage use of the available financial instruments within the EU COSME-HORIZON 2020<sup>30</sup> programme. Improve the quality and availability of non-financial support. It is necessary to continue to improve the existing and form new business incubators, conduct education and training for potential entrepreneurs by means of promotional activities, improved informing, and advices to the existing and new businesses. Encourage development of women entrepreneurship and ensure implementation of the Strategy for development of women entrepreneurship in Montenegro 2015-2020. Improve the operation of the Market information service. Make a comprehensive database of the EU mechanism for supporting export and start using those mechanisms.

Merging of companies dealing in similar economic activities into cluster proved to be extremely successful in terms of improving their business performance. In this regard, it is necessary to ensure further implementation of the Strategy for sustainable economic growth through introduction of clusters 2012-2016. For SMEs, clusters would facilitate access to new markets, transfer of knowledge, introduction of new technologies and reduce operating costs. Establishment and functioning of clusters should be accelerated. Establishment of regional cluster should be promoted more efficiently. Clusters in the area of agriculture, wood industry, tourism offer 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 in Montenegro. A Program of strengthening competitiveness of small and medium enterprises by forming clusters should be continued as well as cooperation towards expansion of the Plan for development of business areas.

Stronger regional cooperation with CEFTA countries represents a solid preparation for the EU accession, where there is a stronger competition. Improved implementation of CEFTA agreement should be ensured, especially when it comes to elimination of non-tariff barriers. Trade liberalization (facilitating export and import through reduction of customs procedures) and bilateral cooperation with neighbouring countries should be continued.

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<sup>30</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 and use Horizon2020 to invest in start-up and early stage of SMEs and Cosme to invest in SMEs growth phase.

There is a lot of room for innovations development in Montenegro, especially in SMEs. Strengthen projects that finance innovations. The budget for this purpose should be increased as well as the amount of funds allocated to innovators. Financial support and tax reliefs 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.

For more competitiveness and secure placement of domestic products on the EU market and other markets, it is necessary to continue to adopt quality standards. In this regard, it is necessary to increase funds to subsidize the introduction of standards. Continue to inform companies and citizens about the certificates, technical standards, and rules on origin of goods as well as producer protection at the EU market, given the importance of this market for Montenegro and future integration processes. A national strategy for standardization should be adopted. Branding of Montenegrin products and promoting trademark "Made in Montenegro" should be continued. Provide financial assistance to companies so they could obtain collective trademark "Dobro iz Crne Gore" (Good from Montenegro). Identify target groups of companies that have a potential to create and develop trademarks or brands. Pay close attention to quality standards in the food production sector.

## 2. Foreign direct investments (FDI)

<i>Key recommendations</i>	<i>Deadline</i>
Increase FDI inflow	Ongoing
Improve investment and business environment	Ongoing
Increase investments in competitive and export-oriented production sectors, aimed at encouraging economic growth and development.	Ongoing
Increase the share of greenfield investments in total investments	Ongoing
Encourage investments in infrastructure	Ongoing
<i>Main risks</i>	<i>Risk direction</i>
Large competition in attracting FDI and stronger investment activities of other countries	Increasing
Red tape preventing successful implementation of investments	Stable
Unsuccessful privatisations – failure to meet contractual investment and social programmes by strategic investors	Stable
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
Delays in implantation of large projects in tourism	Decreasing
Problem of unresolved land property disputes	Stable
Underdeveloped infrastructure	Decreasing

### *Background*

The upward trend of FDI inflow continued in 2015. According to available data for the first seven months of 2015, net FDI inflow amounted to 220.7 million euros, which represents an increase of 20.5%. Even though there was a significant growth of net inflow, total inflow of FDI increased only by 2% in relation to 2014, while there was a significant decline of outflow of 40%, which resulted in an increased net inflow of FDI. Although quantitative indicators of foreign investments are important, the experience of developed countries shows that the efficiency of those indicators holds much larger significance because it is not possible to have a long-term economic development without the increase in the efficiency of investments.

There was progress in the area of legal and institutional environment and harmonisation of legislation framework with the EU acquis. Montenegro continued to implement reforms and further improve investment and business environment. Amendments to the Law on Foreign Investments were adopted, which further liberalised foreign investments.

The Government of Montenegro adopted the Decree on Fostering Direct Investments, which regulates the conditions and the manner of stimulating development of Montenegro by attracting direct investments. The Decree defines financial incentives for new investments aimed at increasing competitiveness of the economy and opening new jobs. The adoption of this Decree aims to improve the business environment and economic growth of Montenegro by stimulating and attracting direct investments. The budget for 2015 envisaged an amount of 2.25 million euros for implementation of the Decree.

As per the results of the World Bank's "Doing Business 2015" report, Montenegro recorded progress in terms of improvement of business environment, and is ranked 36<sup>th</sup> of 189 countries. This represents an improvement by six positions in relation to 2014, when it was ranked 42<sup>nd</sup>. The biggest progress was recorded in the area of issuing construction permits, where reforms have been implemented in the field of reduction of fees for utility services, while the lower rank was recorded in the area of "getting credit", "paying taxes" and "trading across border (down one place)", "resolving insolvency" (down two places), "getting electricity" (down four places) and "starting a business" (down eight places). This requires further efforts in order to increase competitiveness and attractiveness of the country for investments.

### ***Operational measures***

Considering the existing macroeconomic environment, the challenge in the following years will be to attract new foreign investors. 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 crucial for the strengthening of competitiveness of the country's economy. Development of necessary infrastructure, acceleration of privatisation and resolving land ownership disputes represent key conditions for attracting higher amount of FDI. Interest of foreign investors for investments in Montenegro will depend on the speed of implementation of reforms.

Create conditions to increase the total inflow of foreign investments and direct foreign investments to the sectors for which Montenegro has comparative

advantages. The increase in the FDI inflow can come only with continuous work of all entities at the state and local levels on the implementation of structural reforms and further improvement of the investment climate. The strategic commitment of Montenegro for European and Euro-Atlantic integrations and active role in international cooperation are factors that will have an impact on the realization of foreign investments in our country.

It is necessary to make a clear strategy for promoting and attracting FDI in the future period, taking into account global trends and the fact that the legal framework for investments in the world is at a crossroad, while many countries and regional groups are in the process of consideration, reforms and revision of their international investment agreements. New Strategy for encouraging foreign direct investment should be adopted, bearing in mind the current situation and strategic development goals of Montenegro, as well as the fact that the previous strategy was adopted for the period 2013-2015.

One of the prerequisites for attracting FDI and successful realization of investments is to improve the investment environment. It is necessary to create a more competitive business and investment environment, bearing in mind the geostrategic position and investment potential of Montenegro. It is necessary to continue with the reforms of the regulatory framework to simplify the procedures and to create efficient administration. The reform of legal and administrative barriers for domestic and foreign investors should be accelerated. Special attention should be given to reducing the administrative barriers, as well as removing existing restrictions on operations such as illiquidity, shadow economy, access to finances, and the like.

It is necessary to strengthen measures to promote and attract FDI, especially those that ensure long-term sustainable development. Structural reforms relating to labor legislation and remove barriers to business should be continued. Confidence in the country's legal system is one of the key factors which the arrival of new investors and increasing FDI inflow in Montenegro will depend on. It is necessary to create the conditions (political and economic) for a stable and predictable regulatory framework in which foreign investors will have confidence.

Promotion of projects that will result in increased production and exports should be continued. Labour-intensive FDI that will contribute to increasing employment in Montenegro should be encourage and promoted. Agriculture and tourism, as complementary activities, should be promoted in order to better use the potential of these two sectors. It is necessary to intensify promotion of the energy sector, taking

into account its competitive advantages (hydropower potential, renewable energy, favourable geographical position), in order to attract quality investors.

It is necessary to intensify the promotion of the *Greenfield investments* and implement incentive measures aimed at increasing the number of employees and the transfer of new technologies. The key to the further development is the increase of *Greenfield investments* in total investments, especially in sectors for which Montenegro has competitive advantages. Implementation of policies of targeting foreign investors and proactive approach in encouraging and attracting foreign investments through the activities of the Agency for promotion of foreign investments should be continued.

Bearing in mind strengthening of the competitiveness of countries in the region for attracting foreign investments in the coming period, the quality and efficiency of promotion of investment potentials of Montenegro will have high importance. Possibilities for the adoption of special law (*lex specialis*) for investment projects in the priority sectors for the development of Montenegro should be considered. The experience of other countries has shown that the adoption of *lex specialis* on strategic investment projects is one way to increase the inflow of foreign investments.

Although Montenegro has a competitive regulatory framework, a problem emphasized by foreign investors is the gap between the adopted laws and their implementation, as well as poor coordination between national and local institutions. A better coordination of institutions at the state and local levels is necessary, because the successful implementation of investments is possible only with the cooperation of all institutions involved in the implementation of investment projects. It is necessary to shorten and simplify the procedures for the implementation of domestic and foreign investments. The implementation of privatized or planned projects should be accelerated by eliminating administrative barriers at the local level.

Resolving problems regarding property restitution and land ownership is a necessary precondition for higher FDI. Restitution is often a limiting factor for the realization of large investment projects. It is necessary to improve mechanisms for resolving the issue of restitution and property relations. It is necessary to improve work of the Real Estate Administration and increase administrative capacity in order to remove any doubt regarding the quality of data.

The following measures can have a positive impact on attracting FDI: further development and strengthening of institutions for the promotion and attraction of

FDI, strengthening links with diaspora in order to provide incentive measures for emigrants to invest in Montenegro, continuing cooperation with the Council of foreign investors and support their participation in the business environment, intensifying promotion of the potential of free zones, aligning education system with the requirements of the market and stimulating investments in information technology, research and development.

## 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	Ongoing
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 protection against fire	Medium
Enhancing human capacities in the sectors in charge of environment protection and sustainable development	Ongoing
Prevent illegal construction, especially in the protected locations	Short
Establish a sustainable system of environment protection financing at both, local and state levels	Short
<i>Main risks</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***

Declaration on the Ecological State of Montenegro<sup>31</sup> proclaimed Montenegro the first ecological country in the world with the strategic decision to adopt and apply the highest standards in the field of ecology and environmental protection, as well as to set economic development on the principles of ecologically sustainable system.

In recent years, the legislative and policy framework related to environmental protection and sustainable development was significantly modified and improved. It must be noted that this is largely a result of the EU accession process, and the obligations imposed in this process in terms of harmonizing national legislation with the EU legislation. The fact that the negotiation chapter 27 - Environment is rated as one of the most challenging chapters for Montenegro describes the importance and demands for improvement in this area.

Significant changes in the institutional setting were made by environmental authorities in the previous period: the Environmental Protection Agency of Montenegro was established in 2008, the Administration for Inspection Affairs in 2012 and ecological inspection has been separated from that Administration, the National Council for Sustainable Development has been reformed and renamed in the National Council for Sustainable Development and Climate Changes, which strengthened the dimension of climate changes.

In addition to these institutional changes, numerous laws and strategic documents in different areas of environmental protection have been adopted. During 2015, the Law on Amendments to the Water Law (OGM 48/15), the Law on Amendments to the Law on Air Protection (OGM 43/15 ), the Law on Amendments to the Law on Integrated Prevention and Control of Environmental Pollution (OGM 42/15), as well as the Law on Environmental Protection and the Law on Energy. The strategy of waste management in Montenegro until 2030 has been adopted, as well as the National Strategy for Integrated Coastal Zone Management with the Action Plan and Fisheries Strategy of Montenegro 2015-2020 with the proposal of the Action Plan for transposition, implementation and translation of the acquis. In addition, National Waste Management Plan for the period 2015-2020 has been adopted, as well as the Action Plan for combating land degradation and mitigating the effects of drought in Montenegro, and the first draft of the National Strategy for Climate

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<sup>31</sup>Declaration on the Ecological State of Montenegro "OGRM" no. 39/91

Changes by 2030 has been prepared. In the area of air quality, Air Quality Plan for the capital Podgorica has been prepared including measures to improve air quality.

In the framework of the GEF/UNDP project "Strengthening the system of protected areas in Montenegro" (PAS), the first regional national park "Piva" was declared in April of this year, which increased the percentage of nationally protected areas from 9.05% to 11.4%. Also, in the aforesaid project, final activities aimed at declaration of regional park "Komovi" are ongoing, implementation of which will increase nationally protected sites to 13%. In addition to the national protected area, a number of sites are protected according to international treaties.

Montenegro is the only Mediterranean country which does not have any marine protected area, and due to growing pressures in previous years, these natural values are now seriously endangered. In 2014, progress has been made by participation of Montenegro in the "MedKEYhabitats" project (together with Albania, Algeria, Croatia, Egypt, Libya, Morocco and Tunisia), which involves mapping the most important marine habitats in the Mediterranean and promotion of their protection through the establishment of protected areas in the sea.

The project "Establishment and development of information system of the environment" is ongoing and it is funded by the European Union, which aims to develop environmental information system, which should provide reliable and timely information on the state of the environment necessary for the effective implementation of environmental policy.

The most significant weaknesses of the environmental management system are bad waste management (inadequate disposal of municipal, medical and industrial waste, a growing number of unregulated landfills), poor waste water management (discharge of untreated wastewater into surface, and underground water and sea), intensive development in certain sectors (especially in tourism, construction), followed by illegal and unplanned construction, converting natural habitats into semi-natural and artificial and inadequate water management. The current level of development of infrastructure for environmental protection is not sufficient to preserve the quality of sea water, soil and air.

Waste management is not satisfactory. According to information from the National Waste Management Plan in Montenegro for the period 2015-2020, municipalities recorded 155 uncontrolled landfills. The waste management system is somewhat modernized by construction of two regional landfills in Podgorica and Bar, which represents progress for the southern and central region. However, safe landfills are

missing in the northern region. Activities aimed at the closure and rehabilitation of landfills in Bar and Cetinje are ongoing. Options for recycling raw materials are limited and separate waste collection system is at an early stage. Although most of municipalities placed containers for the primary selection of municipal waste, due to lack of equipment in most municipalities and inefficient work of utility companies, containers with selected and mixed waste are discharged at the same time on one of the landfills. Only in three municipalities (Podgorica, Herceg Novi and Kotor) there are recycling areas and recycling centres, which are still not working at full capacity, and construction of transfer stations and recycling area in the municipality of Zabljak is ongoing. Key issues in the field of waste management are poor coordination between authorities, poor implementation of the law, poor performance of utility companies founded by local governments and the like.

In October 2014, the Government with the World Bank signed a loan agreement for the project "Management of industrial waste and cleaning" (which began in November 2011), which aims to repairing ecological hot spots<sup>32</sup> and determining proper location for the construction of the National plant for the disposal of hazardous waste.

Due to high exposure to waste water, coastal waters are very sensitive to quality problems and due to a significant increase in wastewater discharges in recent years, signs of deterioration in the quality of bathing water in Montenegro are evident. Currently, systems for wastewater treatment exist in Podgorica, Mojkovac, Zabljak and Budva. Construction of the wastewater management plant is ongoing in Nikšić, Herceg Novi, and the joint plant for Kotor and Tivat.

The country's biodiversity is highly threatened as a result of increased urbanization, illegal construction, illegal hunting and fishing, illegal and excessive logging, uncontrolled collection of edible and medical plants, mushrooms and berries, as well as illegal and excessive exploitation of gravel from riverbeds. Frequent fires destroy habitats of certain species. According to the information from the first National Forest Inventory (from 2013), in the period of five years, fires damaged 4.7% of forests and forest lands. The last example of a serious threat to biodiversity was recorded in Solana Ulcinj, an area of great importance for nesting and migrating birds, where long-time bankruptcy proceedings resulted in

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<sup>32</sup> Aluminium plant KAP - repair of two red mud ponds and construction of solid waste landfill, Adriatic Shipyard "Bijela" - landfills or export of industrial waste (grit), TE "Pljevlja" - ash and slag dump; and the flotation lead and zinc waste dump "Maljevac" and mine "Šuplja stijena" Pljevlja - Gradac flotation tailings pond.

serious threat of destruction of the entire biodiversity in this area. As a result of the intervention of the European Union and the involvement of all relevant authorities, ecological disaster in this area was prevented and first significant steps towards the preservation of the area were made. The National Parks of Montenegro, which is responsible for the maintenance and improvement of the eco system of the area, took temporary control over Solana, and the study on the protection of Solana shall be prepared, which will determine the precise boundaries and define the concept of protection of the area. This case should be a warning to the competent institutions and society as a whole that this situation of potential environmental disaster should never happen again.

A significant problem for the environment is the fact that in the immediate vicinity of protected areas there are big polluters and generators of waste, which in a manufacturing processes use outdated technology<sup>33</sup>. Also, means of transport and their enormous increasing in number represent significant polluter of the environment. All these factors have a negative impact on the environment, but also economic and social situation in the country. To improve air quality and, in general, environmental protection and public health, significant is adoption of the technical requirements for vehicles that are imported or are first placed on the market in Montenegro, which is in force since May 2015. In accordance with this regulation, there are stricter provisions on the import of vehicles - for the import of used vehicles current minimum standard Euro 3 (Bj 2000-2005) is kept, while the import of new vehicles approved minimum ecological standard Euro 5 (year of manufacture 2011 to 2015).

Despite some progress in the legislative and institutional framework in previous years, key factors that threaten the natural resources of the country are still largely present. Some areas are not covered adequately yet, and general problem in Montenegro is low financing and related delay in the implementation of adopted laws and other strategic documents. Lack of implementing sanctions against pollutants represents large problem in the field of environmental protection, as well as extremely low awareness on the importance of environmental protection.

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<sup>33</sup>On the territory of Montenegro there are four environmental black spots representing key environmental problems. These are the KAP, Adriatic Shipyard Bijela, Pljevlja Thermal Power Plant and the flotation tailings of lead and zinc Gradac. In addition, there are other generators of waste, such as electrodes plant in Plužine, the coal mine "Pljevlja", plants for the maintenance of mining, construction and other machinery, and the like.

### *Operational measures*

It is necessary to continue the activities on the proclamation of nationally protected territory and as soon as possible to protect at least 10% of the territory of the coastal zone. It is necessary to establish a network of protected areas and integrate them into the planning documentation. Activities towards greater exploitation of economic potential of protected areas should be continued. The development of strategy for tourism development in protected areas is of great importance.

Aimed to protecting the environment from devastation, it is necessary to draw up plans for the use of natural resources (rivers, sea, land, and the like), as well as plans/programs for the protection of wild plant and animal species. It is necessary to effectively implement the "polluter pays" principle, in accordance with the Law on Liability for Damages in the Environment.

With a view to providing adequate protection of soil, supervision of all (real and potential) land polluters should be intensified as well as tough sanctions in accordance with the provisions of the Law on Environment, including the suspension of the production process before the fulfilment of environmental requirements. The map of locations where there is too high degree of contamination of soil should be created and polluters should be required to carry out detoxification of the mentioned locations. At contaminated sites food production should be banned, and compensation to farmers should be provided. Effective measures would be tax stimulation for the development of production processes that meet environmental standards, as well as tax discouraging for consumption of products harmful to the environment and human health. Import and use of plant protection products should be strictly supervised, as well as the application of mineral fertilizers and pesticides. Organizing practical training for producers should stimulate the increase of understanding of the ecological processes that influence the production, as well as the purposeful use of agricultural land and encourage the use of organic fertilizers and bio-pesticides. It is necessary to work on the establishment of the Regional centre for combating land degradation, which would connect Montenegro with the countries in the region with the aim of gathering information, the implementation of projects to support the institutions responsible for land protection, and the like.

One of the key resources in the coming decades will be water, so it is necessary to protect the ecological location with water resources to create comparative advantages for the future. Activities on the establishment of statutory sanitary protection zones should be continued. It is necessary to develop a strategy of water

resources management and national information system for planning and use of water resources. The establishment of the Agency for Water would be a good resolution of the issue of water protection, whose assignment would be to protect the health and property of the population from the harmful effects of water pollution, monitoring and protection of surface water, groundwater, coastal water, and care for the rational use of water, and the like.

It is necessary to improve the system of environmental protection in ports and marinas, systems of protection from spills of petroleum products into the waters, as well as systems for protection against explosions and fires in warehouses of petroleum products in the Bay of Kotor and the Port of Bar.

In the area of waste management is necessary to establish a functioning waste management system, whereby the optimum solution in terms of technology as well as taking minimum free areas would be formation of a unified centre for waste management in the country with the plant for thermal treatment of waste and regional recycling centre. This solution also offers rehabilitation of sewage sludge management problems that could be treated in this plant. At the same time, it is necessary to work intensively on the rehabilitation of uncontrolled waste disposal sites. Special attention should be focused on rehabilitation of polluted sea area, created as a result of inadequate waste disposal. It is necessary to build a national facility for safe disposal and treatment of hazardous waste. It is necessary to adopt management plans and permanent disposal of veterinary and medical waste. It is necessary to establish a functional system of waste recycling, intensify activities on organization of selective waste collection and establish a network of recycling plants.

It is necessary to improve the business of public utility companies, take advantage of the legal possibility of joint organization and carrying out activities in the field of public utilities, which would reduce the number of employees in these companies and enable lower prices of public utility services. It is necessary to organize training for persons performing public utility services in terms of proper waste treatment.

It is necessary to encourage production and use of biodegradable and environmentally friendly packaging. Therefore, we should adopt a law on the management of packaging and packaging waste. Excessive use of plastic bags creates a major environmental problem. Therefore, it is necessary to consider the possibility of a complete ban on the use of non-degradable plastic bags.

In order to maintain or improve water quality and to achieve the EU standards, it is necessary to continue activities on the project of construction of wastewater treatment facilities. At the same time, special attention should be focused on solving the problem of disposal of products of waste water treatment (sludge). Therefore, we emphasize the need for the adoption of the National strategy for disposal of products of waste water treatment and harmonization of the existing legislation with the adopted strategy.

Analysis of the air quality has shown that stationary sources and large industrial plants are the most serious sources of air pollution. Therefore, we need full implementation of the Law on Integrated Prevention and Control of Environmental Pollution, which will enable the impact of industry on air pollution to be reduced to a minimum. Law on Amendments to the Law on Integrated Prevention and Control of Environmental Pollution shifts the deadline for obtaining the integrated permit from 01 January 2015 to 01 January 2020, which is negative from the aspect of air quality and the environment in general. It is therefore essential for the plants to obtain mandatory integrated permit.

Households' heating fuel is a significant source of air pollution which contains high level of pollutants. Therefore, it is necessary to continue activities to raise public awareness about its harmful effects. It is necessary to improve the network for monitoring air quality through the purchase of additional equipment and repositioning of measurement locations where necessary.

It is necessary to continuously promote and develop transport models acceptable for the environment, where one of the priorities should be stimulating the use of public transport, especially in urban areas. As a prerequisite, it is necessary to improve the public transport system and increase its availability in a number of municipalities in the country. It is necessary to stimulate the purchase of vehicles with lower emissions of harmful substances and hybrid vehicles (for example through a decrease in the price of registration), followed by the introduction of a special tax on vehicles whose height would depend on the amount of carbon dioxide which the vehicle emits into the air (CO<sub>2</sub> tax). It is necessary to establish an appropriate legal framework to ensure production, transport, control and use of biofuels and other renewable fuels for transport. It is also necessary to focus greater attention on promoting healthy lifestyles through concrete actions, such as setting up cycling infrastructure and introduction of pedestrian zones in urban areas.

Continues work is necessary to increase the level of integration of climate change issues into sectoral policies, especially in agriculture, transport and health care. It is

necessary to pay special attention to the use of the EU funds and other available sources that are focused on renewable energy and provide incentives for their use. In this section, the importance of encouraging research, development and application of environmentally sustainable new technologies in the energy sector is particularly emphasized.

In order to improve the protection of the environment from fire, it is necessary to provide an adequate legal framework in the field of fire protection and means of establishing a more efficient system of fire protection. It is especially necessary to strengthen preventive actions in order to prevent deliberate arson, as well as the fire as a result of gross negligence. It takes work to create a regional firefighting centre and joint procurement of aircraft and helicopters for firefighting. It is necessary to take urgent measures to repair and recover degraded forests.

It is necessary to increase control and prevent illegal construction on protected areas and undertake measures to eliminate the consequences thereof.

Addressing the issue of protecting biological diversity against excessive poaching is important and it is necessary to strengthen monitoring and implementation of sanctions and other measures prescribed by the law, but also incentives aimed at changing the structure of the catch should be introduced. The capacity of fishery inspection should be strengthened.

In order to better protect national parks and other protected areas, it is necessary to establish an association of rangers and guardians of nature (in the world known as the Ranger association), which task should be direct supervision over the implementation of the Nature Protection Law, the filing of misdemeanours and criminal charges in the parks for which they are responsible. The establishment of such an association would create preconditions for its membership in the International Federation of Rangers, which would facilitate the training of supervisors of national parks of Montenegro, the exchange of experiences from different countries of the world, and the transfer of good practices and models of supervision that could be applied in our country.

In order to establish a sustainable funding system in the field of environmental protection, it is necessary to establish the Environmental Protection Fund - Eco Fund, as well as eco funds at the local level. Eco funds should be dedicated to activities related to financing and implementation of programs and projects in the field of conservation, sustainable use, protection and improvement of the environment, as well as in the area of energy efficiency and use of renewable

energy sources, as well as for the effective implementation of the "polluter pays" principle.

Investment of funds of public and private sectors are necessary for the proper implementation of all measures. In the global financial crisis developed countries identified the need for economic reforms and reducing public debt of member states which offers the possibility for these countries to move towards the establishment of resource-efficient and low-carbon economies, which should be one of priorities in Montenegro.

It is necessary to continuously organize various forms of campaigns by the government and NGO sector, as well as the public debates in order to inform the public about environmental issues. It is necessary to continue with the introduction of the program, whereby the target groups should be educational institutions and curricula at all levels of education (kindergarten, primary and secondary schools, universities), business sector, NGOs, media and local communities.

Special emphasis should be on the business sector in the country, promoting the management of companies in a socially responsible manner. In this regard, taxation and other forms of incentives should be introduced in order to stimulate investments in technology companies that do not have negative effects on the environment, and encourage the creation of products that promote respect for the principles of sustainability. Implementation of ISO 14000 series of standards in existing organizational systems of companies should be stimulated, which would provide sustainable development in accordance with the globally recognized principles and modern trends in business that has the purpose of putting the risk of environmental pollution under control.

To maintain a balance between economic development, social justice and environmental purposes, the financial infrastructure of the economy should be reoriented to the goals of sustainability. In order to achieve this, it is important to recognize the role of financial institutions and investors to initiate sustainable development. Attempting to allocate capital to those companies that operate on the principles of sustainability, financial institutions can significantly affect their clients, trying to align their activities with the long-term sustainability objectives. The role of the stock exchange may also be significant in the process of transition to a market that integrate environmental issues, by fostering transparency regarding the environmental performance of listed companies and thereby encouraging responsible and long-term approach to investments. Therefore, stock exchanges

should be encouraged to promote responsible investments and corporate sustainability of Montenegrin companies.

In order to improve the efficiency in the application of regulations, it is necessary to increase institutional and human potential for the implementation of obligations under the legislative and policy framework, and also to improve coordination of the institutions responsible for environmental protection and enforcement of relevant laws. It is necessary to work on the training and integration of municipal services to meet the challenges in all areas of environmental protection. In order to mitigate negative impacts of activities with harmful effects on the environment, it is necessary to intensify environmental inspections. In order to enhance the overall system of environmental protection, it would be useful to introduce the institute of ombudsman for the protection of the environment.

Sustainable socio-economic development cannot be achieved without a balanced development at the local and regional level. In order to achieve balanced development of the three regions (continental, central and coastal), it is necessary to intensify activities on balancing regional development. First of all, we should work intensively on the development of human resources and infrastructure in less developed municipalities. It is necessary to continue with the development of by-laws that are aimed at ensuring the consistency of the interests of local communities and general development framework which provides directing resources appropriately to all corners of the country, and equal distribution of priority investments. Special attention should be given to the use of EU funds for balanced regional development and, in this regard, we should work to strengthen program and project capacities for applying for international funds. Statistical system should start to produce basic indicators on a regional principle in order to effectively implement regional policy and monitor the development of individual regions.

## 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.	Ongoing
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 overall objective of official statistics, defined by negotiation Chapter 18 - Statistics, is full harmonization of official statistics with the EU legislation. Based on this objective, Statistical Office of Montenegro (MONSTAT) adopted strategic documents in the field of statistics. Development strategy of official statistics 2014 - 2018 defines long-term objectives on the basis of the current situation, needs and plans for future harmonization. For the needs of medium-term development of official statistics and *Program of official statistics for the period 2014 - 2018* has

been developed, followed by the adoption of the *Annual plan of surveys* as a short-term document elaborating statistical activities up to the level of statistical surveys.

MONSTAT is continuously working on improving statistical areas and surveys for which the Law on Official Statistics and Official Statistical System is in charge. During the previous period, as the user of pre-accession programs, MONSTAT successfully implemented (and continuously implements) a number of projects aimed at improving the different statistical areas. One of them is the Statistics of National Accounts. In fact, in 2015, MONSTAT has introduced a new method of calculating the quarterly GDP by expenditure approach at current and constant prices using the direct method. Results of this calculation for the four quarters of 2014 were published at end-April 2015, and in June 2015 it published the results for the first quarter of this year. Also, in September 2015, MONSTAT published for the first time the results of calculation of GDP for 2014, according to production and expenditure approach, based on ESA 2010 methodology, as well as revised data series of GDP for the period 2010 – 2013.

In April 2015, the Government adopted a *Strategy for the implementation of the ESA 2010 methodology in the area of public finance*<sup>34</sup>. On the basis of the Strategy a working group has been established. It will deal with issues of institutional classification, auditing and adjustment of economic classifications, defining reporting procedures, and other issues relevant to adjust reporting requirements with ESA 2010 methodology.

In 2014, the Statistical Office has conducted 171 regular surveys out of 174 in total, published 6 publications, 326 reports, an analysis of nine methodological instructions, took part in 102 events in order to improve the official statistical system of Montenegro (international conferences, meetings, workshops, trainings or study visits outside of Montenegro), as well as in the work of the eight inter-institutional working groups.<sup>35</sup>

In the annual plan of official statistics for 2015, 237 statistical surveys were foreseen, which are divided in the six priority sectors: Economic governance, Economic and social impact, Business Statistics, the People of Europe, Geospatial, environmental, Agricultural statistics and other sectors' statistics as well as Multidomain statistics and Production efficiency.

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<sup>34</sup>Source: Annex to the EC Montenegro Progress Report for 2015, for the period 1 April – 1 September 2015.

<sup>35</sup>Taken from the Work Report for 2014, Statistical Office of Montenegro, February 2015

## *Operational measures*

The Report of the European Commission Progress Report for 2014 highlighted the lack of human and financial resources as the key challenge of the future harmonization of official statistics with the EU standards. Therefore one of the main activities should be hiring new staff, as defined in the Programme of Montenegro's accession to the European Union 2015-2018.<sup>36</sup> At the same time, the Rules of procedure on internal organization and sistematization of MONSTAT from 2014 foresees 200 employees, which is twice more than the number of employees at the end of 2014 (100). Training and education of employees with extra stimulation (through increased wages or certain types of compensation) would, in the long term, provide quality staff who would be motivated to meet the challenges from the Chapter 18.

Although there is a continuous work on educating staff through various technical assistance programs, it is necessary to keep that skilled personnel. The fact that at the end of 2010 MONSTAT employed 125 people and at the end of 2014 only 100<sup>37</sup> employees, shows lack of personnel necessary for the successful functioning of statistical sectors, or the implementation of future obligations relating to the implementation of the acquis in the accession process.

In order to increase the space capacity of MONSTAT, the Montenegrin Government allocated additional space in 2014. However, there still remains the problem of missing and adequate spatial solutions, especially if one keeps in mind that MONSTAT should increase the number of employees.

In its work and production of final data for individual statistical areas, Statistical Office uses also data of other institutions in the system, i.e. the official producers of certain statistical data. It is therefore of the utmost importance to strengthen the role of MONSTAT in the creation of new and improvement of existing data sources, in order to increase data quality, reduce the burden of reporting units, reduce the costs of data collection and the like. Particular attention should be paid to data monitoring and regular updating of registers, in order to produce a high-quality internationally comparable indicators of official statistics by implementing European legislation in all areas.

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<sup>36</sup> Table 3.2. Administrative capacities show the employment by years, for the period 2015-2018 (page 333).

<sup>37</sup> Monstat Annual Report for 2014, p. 28.

MONSTAT is continuously working towards the harmonization of all statistical areas with the EU legislation. Programme of official statistics 2014 - 2018 provides an overview of expected results of official statistics by areas, the data on their periodicity and the degree of compliance with international standards. Although each of the following statistical areas has its own specificity and importance, the focus should be put on national accounts in the context of macroeconomic statistics. As the system of national accounts, i.e. the calculation of GDP, makes a part of a very complex and comprehensive statistics, all monthly, quarterly and annual statistical surveys should be improved. This will contribute to improving the calculation of annual and quarterly GDP, both in current and constant prices by activities on the production side. GDP by income approach is not calculated yet.

Agriculture and tourism statistics represent particular challenges in the process of harmonization, being important segments of total GDP. Although significant efforts in these areas were made, we still do not have sufficient data in the agromonetary statistics, accounts in agriculture, data on the income of the individual accommodation facilities and the like, which would facilitate the calculation of GVA of this sector in the total GDP of Montenegro.

## 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
Work on the implementation of the IAS for SMEs, which are quantitatively dominant in the Montenegrin economy.	Short
Carry out an independent assessment of the quality of audit reports.	Medium
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.	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 in the past, implementation of international accounting and auditing standards and financial statements (IAS, IFRS and ISA) of Montenegrin companies remains inadequate. Tax Administration of Montenegro has improved the delivery of the annual financial statements of companies in Montenegro through significant financial investments towards the electronization of work and control mechanisms.

Amendments to existing accounting and auditing regulations were supposed to ensure a higher level of compliance of national legislation with the directives and the EU acquis and enhance the quality of data, especially in the domain of comparability, continuity and consistency in the (fair) presentation of accounting balances and policy. However, actual implementation is still in progress. Implementation of these standards represents a way of arranging accounting practices, which can be uniquely applied to countries of different economic characteristics and, on the other hand, supports the goal of Montenegro to meet the criteria required in the process of accession to the EU in this area.

World Bank Report on the Observance of Standards and Codes (ROSC) and the recommendations relating to accounting and auditing (A&A) in Montenegro are directed towards increasing the quality of financial reporting. The recommendations are comprehensive and cover the responsibility of a number of institutions that are responsible for improving the quality of financial reporting in Montenegro (Ministry of Economic Development, Monstat, Central Bank of Montenegro, the Securities and Exchange Commission, Tax Administration, Commercial Court, Institute of Certified Accountants and the Institute of Accountants and Auditors). The National council for accounting and auditing was established for the same purpose and is engaged in the strategic improvement of accounting and auditing practice according to IAS, IFRS and ISA standards in Montenegro. Strategy, Action Plan and Program of operational reform measures and activities of "stakeholders" to improve the legal framework, institutions, and accounting profession and improving business and ethical culture with unique accounting objective: achieving higher quality of micro and macro financial reporting that will lead to the harmonization of Montenegrin regulatory framework of the balance sheet and other financial reporting with the EU acquis. This included work on the preparation of consolidated financial statements, regulations governing the work of the audit agency, the centralization of the base of annual financial statements and balance macro-aggregation, publication of financial statements and improvement of their quality, electronization of accounting

practices, work on financial classification of companies to micro, small, medium and large enterprises, and the like.

During 2014, the implementation of the Action Plan relating to the establishment of a body for the public oversight of auditors is in delay. At the same time, the adopted amendments to the Accounting and Auditing Law from 2011 determined that the annual financial statements shall be submitted to the Tax Administration. Existing legal solution determines paper and electronic annual financial statements, which includes the possibility of electronic submission of annual financial statements into a single electronic database. This form of submission of annual financial statements is not fully implemented in practice yet despite the fact that in 2014 about 85% of taxpayers submitted annual financial statements to the competent institution in electronic form.

Also, during the last two years there has been notable progress in the work on the education of accountants and auditors from the Institute of Certified Accountants through seminars, courses, publications and the like. This significantly contributed to a higher quality of accounting and auditing theory and practice in the application of IAS, ISA and IFRS standards in Montenegro. Additional education is required, especially in the direction of expansion of computerization of accounting jobs in businesses, particularly in municipalities that do not have a sufficiently developed this kind of practice.

### ***Operational measures***

It is necessary to proceed with the implementation of the "Strategy and Action Plan to improve the quality of financial reporting in Montenegro." Also, it is necessary to invite ROSC delegation to do the progress ("Follow up") of the implementation of Recommendations from 2011 and audit of progress of the accounting and auditing practice in Montenegro.

Reporting on the progress of corporate governance in joint stock companies in Montenegro and reporting on the work of managers should be continued, in order to prepare necessary measures by the authorities to improve this area.

International standards should be fully implemented through further education and translation of the audit report, contained in the IAS, that are not fully translated (the IFAC Manual) and adopted in Montenegro.

The activities within the REPARIS project should be continued in order to improve the standards in education and certification of accountants and auditors in the context of the national competent authorities. The expansion and development of the electronic database of annual financial reporting should be accelerated, primarily on the websites of the Tax Administration and the Securities and Exchange Commission.

Work on the "FIRST" initiative with two main tasks should be continued and accelerated: (1) provide technical assistance to the Government of Montenegro in determining the priority within the framework of the National Plan for improving financial reporting for the period until the end-2016 and (2) provide extension of a national action plan in the medium and long term for the Accounting and Audit Council.

Regional cooperation should be strengthened, as well as institutional and control connectivity in the accounting and auditing, especially for translation and interpretation of IAS and IFRS.

Competent institution responsible for the supervision of audit and accounting companies should be established, while organizational unit/units within the competent authority, which would work on controlling the compliance of financial statements with standard regulations, should be strengthened. Given the suspicion that some audit companies "in order to get a job" sometimes "beautify" the audit report, it is necessary to carry out an independent assessment of the quality of selected audit reports.

A higher level of business transparency and reporting business should be provided, especially insurance and reinsurance companies, investment funds, stock exchanges and stockbrokers as well as information on the members of the Board of Directors, especially in the part relating to their participation in the ownership structure and earnings of the management.

Semi-annual financial statements of joint stock companies that are listed on the website of the Securities and Exchange Commission should be prepared and published.

Work of auditors should be checked by a special body-agency which would be responsible for monitoring and evaluation of auditors' work, especially work of the reinsurance companies.

Control and sanctions for companies that do not deliver complete annual financial statements within the legal deadline should be intensified.