

**ECONOMIC POLICY RECOMMENDATIONS TO THE
GOVERNMENT OF MONTENEGRO FOR 2019**

Podgorica, October 2018

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INTRODUCTORY REMARKS

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

The 2019 recommendations were conceived so as to support medium-term development goals of Montenegro`s economy set out in the national documents “2018-2020 Economic Reform Program” and “Montenegro Fiscal Strategy 2017-2020”. The established goals include ongoing development of the legal and institutional infrastructure of Montenegro that is based on the following assumptions:

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

The Central Bank strongly supports the process of fiscal consolidation aimed at balancing current Government spending, expanding the growth base through the investment cycle in private and government sectors, and expanding the tax base, all together contributing to strengthening fiscal sustainability and stability. Attaining economic policy objectives in 2019 in the fiscal consolidation environment will be realized through the following macroeconomic indicators:

- Annual inflation rate ranging from 2% to 3%;
- Increased employment with the emphasis on domestic labour force;
- Increased industrial production;
- Budget deficit reduction.

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

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

1. RECOMMENDATIONS CONCERNING THE REAL ECONOMY

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

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

1.1. Recommendations concerning competitiveness

Improving of Montenegro's economy competitiveness is the key precondition for accelerating economic growth. To that end, the Government should:

- Create a model for measuring the informal economy and its share in GDP (based on MIMIC¹ and HTC² methods) and, based on the obtained results, define a set of clear and concrete measures to reduce the informal economy. In this regard, it is necessary to strengthen the capacities of institutions and other bodies responsible for this area, as well as to raise the level of responsibility for the effectiveness in the implementation of the measures determined;
- Intensify controls and inspection in all areas of business, especially in construction, tourism and other service activities (particularly crafts). Further strengthen the role and responsibilities of the labour inspection with a view to reducing the unregistered labour, and improve the overall capacity of inspections, with better coordination and cooperation of all inspection authorities;

¹ Latent Variable Model with Multiple Indicators

² Household Tax Compliance

- Analyse the tax policy in the part concerning the contributions for compulsory social insurance and consider the possibility of their reduction in order to reduce the burden on gross wages of employees in the economy and increase competitiveness, with simultaneous analysis of the informal economy and of the minimum wages amount. While maintaining minimum requirements for fiscal neutrality, balancing the reform in these three segments may result in creating an effective measure for increasing competitiveness and reducing the informal economy;
- Increase administrative efficiency at all public administration levels, reduce the number of procedures, accelerate the licensing process, encourage e-communications (in the Tax Administration, the Central Register of Business Entities (CRBE), when preparing technical documentation, etc.), and provide adequate infrastructure;
- Continue with the digitalisation of public administration and expand the one-stop-shop principle to other services, both at the national and local level;
- With a view to using knowledge transfer and positive experiences, continue educating employees in micro-, small and medium-sized enterprises on the possibilities of using funds provided by the EU IPA funds, and encourage their participation in international research programmes;
- Encourage the implementation of international quality standards by providing advisory support to the micro-, small and medium enterprises sector. Afford the support by providing financial assistance and raising the level of knowledge in all areas where quality standards are applied;
- Implement regulatory reforms in railway transport and improve the quality of airport infrastructure for the needs of serving a large number of passengers;
- Increase the quality and transparency of all public information to increase public awareness. To this end, the Tax Administration should improve the control of the annual financial statements submitted by businesses. Create a database of traded real estates and improve the cadastre services.

1.2. Recommendations concerning the development in priority sectors

1.2.1. Tourism

Tourism has been recognised as one of the priority sectors in Montenegro's development. To strengthen this sector, the Government should:

- Foster the diversification of the tourist offer and, for that purpose, use the potentials for the development of cultural, religious, sports, health, congress, nautical, MICE, and other special forms of tourism;

- Encourage the development of a balanced tourist offer in all country regions by building new hotel capacities;
- Implement financial support measures for the development of innovative tourist products with a view to improving the tourist offer quality; support the obtaining of quality and environmental certificates;
- Improve the promotion of Montenegro as a tourist destination in the outbound markets with a view to increasing the tourist turnover with the implementation of joint campaigns of the National Tourist Organization of Montenegro with tour operators that bring tourists from the outbound markets;
- Encourage the development of low-carbon tourism (increasing the number of “green” accommodation capacities) and achieving environmental standards in tourism; address the problem of municipal and plastic waste in the sea that has a negative impact on the tourist offer. Consider introducing duties/taxes on plastic products to reduce their use;
- Create an information system for the mandatory registration and check out of tourists, thus creating a single base of all accommodation facilities operating in the country and providing a comprehensive electronic tracking of tourist traffic.

1.2.2. Agriculture and forestry

Agriculture should be developed as a support measure to regional development, export substitution, and reducing economic and social imbalances. Thus, to strengthen this sector, the Government should:

- Increase the efficiency and effectiveness of support programmes to agricultural production with a view to improving its volume and quality.
- Work on introducing new technological achievements in agricultural production through subsidising and educating potential beneficiaries;
- Implement the EU standards on food safety; strengthen capacities of veterinary and phytosanitary inspections; improve the certification of agricultural producers particularly in specific agricultural areas (organic production, production in greenhouses, olive growing, beekeeping, production of perennial medicinal and aromatic herbs, and the like);
- Encourage the development of rural areas through renewal and development of villages and investing into the improvement of water supply, road infrastructure, i.e. the raising of life quality to increase production and stop the migration of population from these areas;
- Conduct stricter controls of complying with obligations from concession contracts with a view to ensuring sustainable use of forests and sustainable

exploitation of rivers. Strengthen staffing and technical capacity of the Forestry Administration.

- Afforest the areas degraded with fire with autochthonous species.

1.2.3. Fishery

- Encourage the development of fishery through the measures of protection and preservation of the sea resources, measures of support to registered fishermen through the improvement of the safety standards of maritime navigation and working conditions in fishing vessels with a view to reaching the EU standards;
- Increase controls against illegal fishing with a view to protecting the fish stock and achieving sustainable use of fishing resources;
- Consider the possibilities of revitalizing the fish processing plant.

1.2.4. Energy

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

- Continue to modernise and revitalise the existing and construct new infrastructure for energy production, transmission, and distribution following the principles of international technical standards with a view to minimising losses and encouraging sustainable development;
- Provide alternative sources of state subsidies (co-financing) with a view to wider application of both solar collectors, and photovoltaic energy-producing facilities;
- Implement standards into national legislation concerning the energy efficiency of housing objectives and the use of renewable energy sources (Energy Performance of Buildings Directive);
- Encourage the use of renewable energy sources with a view to substituting oil derivatives in transport by introducing electricity-run public transport vehicles (electric buses) and various incentives concerning the purchase of motor vehicles on electric and hybrid power;
- Select a strategic partner for electricity market and consider the model of its more efficient connecting with the markets in the surrounding countries.

1.2.5. Manufacturing Industry

Manufacturing industry is an important potential for the long-term development of Montenegro's economy, and a more dynamic growth of this sector is expected in the future.

Thus, to strengthen this sector, the Government should:

- Increase the efficiency in implementing the support programmes for modernising manufacturing industry for the application of new technical and technological innovations in order to improve the competitiveness of businesses in manufacturing industry, as well as a change in the economy's structure;
- Continue the projects that encourage the development of clusters in manufacturing industry to achieve easier access to the domestic and foreign market. Additionally foster the connecting of vertical clusters;
- Foster the linking of the manufacturing industry with the construction sector. Using the public-private partnership model, consider creating the facility for the production of products necessary for the construction of the remaining routes of the highway and other roads, and for the needs of improving other public infrastructure;
- Encourage the production of food products and expand activities aimed at connecting agriculture and manufacturing industry, and encourage producers to improve the quality standards of their products. Foster the networking of local companies with global value chains;
- Improve waste materials management in manufacturing industry, which would also contribute to environmental protection;
- Encourage investments in wood processing by stimulating the connections between wood assortment producers with wood processors aimed at exporting higher processing products.

1.3. Recommendations concerning structural reforms

Establishing a commercial business environment is a priority for intensifying economic activity, opening up growth potentials, and raising the quality of life in the country. The business environment is strongly influenced by the fiscal environment. Compliance with the dynamics and the quality of structural reforms is of key importance to the efficiency of the current fiscal consolidation in Montenegro. Structural reforms in times of fiscal consolidation stand as a fundamental component of the economic development. To that end, an efficient institutional environment, a flexible labour market, a sustainable pension system, effective education, and quality health care should be created.

1.3.1. Institutional environment

The Government should:

- With a view to protecting personal information in Montenegro, initiate systemic implementation of the Regulation (EU) 2016/679 (General Data Protection Regulation), that is, align the existing Personal Data Protection Law with the relevant acquis.
- Transparency and efficiency of the Central Registry of Business Entities should be increased by deleting inactive companies in order to get a realistic picture of insolvency;
- Review the implementation of criminal policy in terms of progressive punishment for repeat offenders (especially for those in the informal economy);
- Introduce a software solution that would allow the electronic submission of the employees' application in order to shorten registration deadlines;
- Increase the transparency of operations of the Intellectual Property Office of Montenegro, i.e. the register of the holders of intellectual property rights, and support these holders in their creativity in order to make the best use of the potential and/or to be recognized and valued at the market by investors;
- Simplify administrative procedures, shorten deadlines for proceeding, enable the collection of ex officio documents, align the amount of fees with administration costs; increase transparency and consistency in the work of public authorities at all levels;
- Institutionalize the status of sailors through the creation of a sailors' register

1.3.2. Labour market

The Government should:

- Efficiently and effectively continue financing programs for employment of young people, women and long-term unemployed persons;
- Make an analysis of the design and the amount of social benefits and the targeting quality of the most vulnerable social classes in order to encourage faster transition from the informal to the formal labour market;
- Intensify the function of mediation of the Employment Agency of Montenegro and employers in creating employment programs, especially when it comes to seasonal jobs and substitution of foreign labour force by domestic labour force. In this regard, direct communication of local regional units with employers and unemployed persons should be established by using/creating smart phone applications;

- Redefine minimum wages and salaries in a way to increase labour market efficiency, reduce informal economy and inequality of employees' rights. In this regard, an expert commission should be set up to propose a range of increases in the minimum wages and salaries, thus achieving the greatest contribution to the goals set, i.e. achieving a balance in the effects that with the increase in the minimum wage and salary there will be a decrease in other non-recorded earnings.
- Consider the possibility of introducing tax incentives for younger population. This measure would encourage employment of young people and, on the other hand, decrease inequality in wages and salaries resulting from the number of working years;
- Promote career orientations and the concept of lifelong learning;
- Promote employment on jobs which performance requires vocational qualification in secondary education, particularly crafts.

1.3.3. Pension system

The Government should:

- Ensure continuation of the reform with the activities of the Ministry of Labour and Social Welfare and other participants in the preparation of amendments to the relevant law in phases and gradually, in order to achieve the adequacy and financial sustainability of the pension system;
- Implement direct measures that limit early withdrawal from the labour market, early retirement through the tightening of conditions, including the increase in penalties for going to early retirement. Having in mind that Montenegro has one of the widest lists of professions eligible for reduced service years for retirement in Europe, it should be significantly shortened;
- Strengthen the conditions for disability pension, whose relative spending in Montenegro is among the largest in Europe;
- Tailor the formula for adjusting pensions that will have a higher level of direct correlation with the increase in average wages and salaries, so that in the medium term pensions cannot be reduced to an unsustainable level. Namely, in line with the IMF estimates, average pension/average net salary ratio would fall to a level of only 10% by 2100, according to the current formula for alignment;
- Take necessary measures to preserve the pensioners' standards (adjustment of pensions, participation in co-financing of housing construction for pensioners' needs and other social benefits).

1.3.4. Social benefits

The Government should:

- Revise social benefits in the manner that will not discourage employment;
- Continue developing the social welfare and services to eliminate existing obstacles in the protection of children, adults, the elderly and persons with disabilities, as well as other vulnerable categories;
- Plan measures and programs to stimulate individuals to participate actively in the labour market in order to provide social protection to those users who are in a state of real social need;
- Pay due attention to planning measures and programs that would enable easier access to the labour market for persons with disabilities and RAE (Roma, Ashkali, and Egyptians) population.

1.3.5. Education and health

The Government should:

- Modernize educational programs in accordance with the needs of the labour market. To this end, the evaluation of educational programs should be conducted, i.e. quality system and mechanisms for its tracking should be introduced;
- Organize promotional activities and introduce students and parents with educational offer of occupations and advantages of three-year education in terms of faster employment, in order to increase the interest in enrolment;
- Encourage participation in international scientific researches;
- Encourage scientific work through the introduction of a mandatory number of published scientific research papers in the academic year:
 - ✓ Ensure better scientific-research conditions, through the introduction of (online) access to the broader range of foreign journals, as well as the databases needed for research.
 - ✓ Encourage organizing a number of international scientific conferences at universities that will enable the exchange of ideas and knowledge.
 - ✓ Encourage networking of professors from abroad (especially those whose origins are from Montenegro) and universities in Montenegro.
- Enable faster and easier access to health services;
- Include children in national preventive screening programs;
- Permanently analyse the so-called basic and supplementary list of medicines in accordance with financial possibilities and prevent excessive medicine consumption. Also, the prescription of antibiotics should be

controlled in order to strengthen the fight against the antimicrobial resistance;

- Improve preventive health care and promote the importance of preventive examinations in prevention and the development of the disease;
- Plan investments, according to the territorial distribution of the population, the existing infrastructure, demographic trends, and growing needs;
- Accelerate the development of protocols and clinical guidelines for uniformity and quality enhancement in providing services and uniformity of costs in order to rationalize and control consumption at all levels;
- Consider the possibilities of securing additional financing at the expense of a part of concession revenues, excise duties, and participation;
- Improve governance and system of distributing responsibilities at all decision-making levels with the permanent education of staff;
- Continue the development of the information system;
- Financially support the resolution of housing issues for persons employed in education and health.

2. RECOMMENDATIONS CONCERNING FINANCIAL SYSTEM³

General objective of the recommendations concerning this area is the preservation of the financial system stability. With a view to achieving undisturbed and stable functioning of the financial system, as well as efficient intermediation in the area of financial services, the Government should:

- Take necessary activities to initiate the procedure for drafting a proposal to amend the provisions of the Constitution of Montenegro with a view to meeting the obligations assumed from the Action Plan for Negotiation Chapter 17. To that end, Article 143 of the Constitution of Montenegro should be harmonised, inter alia, with Articles 127 (1) and 282 (2) of the Treaty on the Functioning of the European Union and Article 2 of the Statute of the ESCB and of the ECB;
- Initiate the drafting of a national strategy for financial education in line with the OECD/INFE principles and international good practices;
- Continue with the implementation of FSAP-FSAA recommendations by the IMF and the World Bank, with a special focus on the improvement of the AML-CFT framework;
- Encourage the use of the services of the upgraded Central Bank of Montenegro Credit Registry with the aim of raising awareness and better

³The recommendations do not include the responsibilities of the CBCG, as defined by the CBCG Policy and the Guidelines for its implementation.

risk management of creditors from different business areas (Tax Administration, Electric Power Company of Montenegro, telecommunication and other similar institutions);

- Encourage financial institutions and investors to allocate capital in companies that operate on the principles of sustainability, i.e. companies that accommodate their business objectives to the long-term goals of sustainable development.

3. RECOMMENDATIONS CONCERNING FISCAL POLICY

Recommendations in the area of fiscal policy support the preservation of fiscal stability. A set of fiscal policy measures is aimed at bringing fiscal indicators to a sustainable level.

With a view to continuing consolidation process of the Budget and reaching stable fiscal indicators, the Government should:

- Continue with the implementation of the fiscal policy consolidation measures provided by the Budget Deficit and Public Debt Recovery Plan and the Fiscal Strategy of Montenegro 2017-2020, especially in areas related to the reduction of expenses that accounts for a high share in total expenditure (gross wages, non-productive spending, and the like) and the collection of tax arrears;
- Further work on improving the Public Debt Management Strategy, and strategies for investor relations. Reorganize debt management units to *Front office, Back office and Middle office*;
- With a view to further creating the yield curve, develop a domestic government bond market with a maturity of one to five years;
- Create enhanced fiscal rules that will avoid pro-cyclicality and ensure consistency in implementation;
- In order to avoid the “draining” liquidity from the domestic market, long-term borrowing should be dominantly carried out on the international financial market, and use the domestic financial market primarily to bridge short-term liquidity problems in public finances;
- Improve the process of budget planning and execution and the assessment of outstanding liabilities, so as to prevent their accumulation;
- Improve cash planning at quarterly and annual levels, the necessary monthly buffers. With a view to improving transparency and reduce prices, create a preliminary annual calendar for the issue of government bills;

- With the aim of limiting additional outstanding liabilities in the health sector, implement strict budget constraints and introduce sanctions for breaching the budget limit. Analyse the sustainability of health system financing through a detailed overview of consumption. Improve the supervision mechanism over the Health Insurance Fund;
- With a view to limiting the fiscal risk of potential outstanding liabilities, create a detailed database of all companies that have the state owned capital in the Ministry of Finance, implement the OECD principles of corporate governance for these companies, and strengthen their financial supervision;
- Implement the public administration reform, in accordance with the Public Administration Strategy Reform of Montenegro 2016-2020. Take into account the following recommendations:
 - ✓ Optimise the number of employees in public administration through horizontal allocation of functions within the public administration;
 - ✓ Define the type and frequency of reporting of the Human Resources Management Authority in order to increase the transparency of the business and the effectiveness of the results.
- Conduct centralisation of public procurement, by stages. Enhance the activities of supervising the entire public procurement process from the initial tender until the final handover of the procured good, services and/or work. Increase the transparency in the work of the State Commission for Control of Public Procurement Procedures;
- Accelerate the process of enacting the Law on Public-Private Partnership and the Law on Concessions with the aim of creating new growth potentials in this connection, especially in the areas and projects that are crucial for the economy, and the state is not able to independently implement, restructure or modernize. Create capacities in the Ministry of Finance that will perform the assessment, management and supervision of fiscal risk arising from public-private partnership projects;
- Carry out an efficient selection of concessionaires, clearly and transparently define the conditions for granting concessions, for mutual benefit of both the concessionaire and the state;
- Streamline the process of enabling submission of electronic tax returns, through the adoption of the Electronic Fiscalisation Law, with no further delay, so as to better collect tax arrears and improve the conditions for the business dealings of the registered companies;
- Consider the possibility of adjusting the form and level of fiscality at local levels;
- Reduce unproductive budget spending, with special emphasis on the following positions:

- ✓ costs of consulting services, with prior analysis and evaluation of their necessity;
 - ✓ costs of lawyer services, through the use of internal resources, assistance from other consumer units or the Protector of Property and Legal Interest;
 - ✓ material expenditures, through instructions to consumer units to rationalize the consumption of office supplies, spare parts, small inventory, fuel, and electricity.
- Strengthen internal financial controls in the public sector with the consistent implementation of existing regulations (Law on the Internal Financial Control System in the Public Sector);
 - Further strengthen the independence and increase the transparency of work of the Agency for Protection of Competition, which, in accordance with the new Law on State Aid Control, has taken control over the allocation of state aid;
 - Consider the possibility of providing adequate fiscal reserves in case of materialization of certain risks that may cause additional expenses (late completion of the first section of the highway, the calling of guarantees, repayment of foreign obligations, and so on).

4. RECOMMENDATIONS CONCERNING STATISTICS

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

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