EUROPEAN
COMMISSION

Brussels, 22.4.2021
SWD(2021) 94 final

COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

MONTENEGRO (2021-2023)

COMMISSION ASSESSMENT

Montenegro failed to submit the 2021-2023 Economic Reform Programme (ERP) to the Commission by the deadline of end-January. Instead, the authorities made an effort to provide informally parts of a draft ERP in February, in particular on the structural reform agenda, and supplementary elements, including some macroeconomic and fiscal projections, in March. The ERP was formally adopted by the government on 1 April 2021 and transmitted to the Commission on the same date. Preliminary macroeconomic and fiscal figures were amended in the final version, and these last-minute changes and the absence of statistical tables in the annex did not allow for a full-fledged and detailed Commission assessment, in particular of the macroeconomic and fiscal programmes and outlook. This applies to a somewhat lesser degree to the key structural challenges and reform priorities part, on which the Commission received more comprehensive programme details.

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY

The official version of the ERP was submitted late, on 1 April 2021. In spite of some earlier but partial draft contributions from the authorities, last minute changes in the macroeconomic scenario and the absence of a fully-fledged medium-term fiscal strategy and statistical tables, means that the Commission could only prepare a less detailed assessment of the macro-fiscal outlook and programme.

The central scenario foresees an overly optimistic recovery of the economy. The restrictions imposed in the context of COVID-19 brought the tourism-dependent economy to a standstill. Due to the significant deterioration in external and domestic demand, real GDP dropped by an estimated 15.2% in 2020. The ERP baseline scenario expects the economy to rebound in 2021, supported by improvement in the health situation in the second half of the year. The economy is expected to return to its pre-crisis level already in 2022. The completion of the first section of the Bar-Boljare highway in 2021 together with an expected recovery of tourism would lead to a narrowing of the current account deficit, making net exports the key driver of growth. However, as elsewhere, risks are to the downside, and delays in the launch of COVID-19 vaccination could challenge this recovery scenario. Moreover, credit activity is expected to remain subdued as crisis-related support to lending activity is withdrawn.

The fiscal strategy projects a significant improvement of the fiscal position over the medium term. The impact of the pandemic widened the budget deficit, which rose to 11% of GDP in 2020, while public debt surpassed 100% of GDP. From 2021 onwards, the programme foresees a sizeable improvement in the budget balance, which is set to reach a surplus in 2023. The rebound of GDP growth, the reimbursement of maturing debt using accumulated government deposits, together with a tight control of expenditure would significantly reduce the public debt-to-GDP ratio (by some 34 pps.). However, a high degree of uncertainty surrounds that favourable scenario. Although the programme provides some budgetary savings, these are offset by concurrent expenditure increases. Over the medium term, fiscal consolidation appears to rely on a rebound of the economy to improve tax revenue, a large reduction in capital spending once the first section of the highway is completed, and the withdrawal of crisis-related fiscal support. Current spending would be contained by, among others, optimising the number of public administration jobs. Given the prevalence of ad hoc decisions and a track record of fiscal slippages, there is a need to continue strengthening fiscal frameworks and governance.

The main challenges facing Montenegro include the following:

- **Stabilising public finances requires a stronger commitment to a credible consolidation path once the economic recovery takes hold.** The public debt burden remains the highest in the region, rendering its sustainability a key challenge. Non-discretionary spending is also a significant burden on public finances, calling for a rebalance of current spending, particularly on the wage bill in order to release fiscal space for health and growth-enhancing expenditure. The resilience of budget revenue needs to be enhanced by broadening the tax base with measures to boost the fight against informality and tax evasion, and streamlining tax exemptions.

- **Fiscal governance needs to be reinforced in order to prevent budget slippages and unburden the private sector.** Strengthening fiscal governance would require reinforcing fiscal oversight in line with plans to set up an independent fiscal institution. Fiscal policy could assist the recovery and resilience of the economy by reducing public sector arrears and accelerating VAT refunds.

- **Making the regulatory environment friendly for businesses requires constant commitment on the part of the state and local authorities.** Delays, discretionary behaviour and inconsistencies in interpreting and implementing laws are yet to be addressed. Mechanisms for continuous dialogue with businesses and social partners need to be developed, as demonstrated during the COVID-19 crisis. E-procurement rollout and simplification of taxation should be prioritised.

- **Tackling the large informal economy is still an important structural challenge.** The government is yet to rethink its approach and adopt a more comprehensive action plan to reduce informality in the economy. Preventive and educational actions, as well as incentives for the formalisation of businesses and labour are needed, along with controlling and suppressing actions. Ensuring full cooperation between central and local-level authorities is paramount.

- **The persistence of unfavourable labour market outcomes undermines potential growth and the improvement of living standards.** Although the labour market continued to improve prior to the COVID-19 pandemic, the persistently low activity and high unemployment rates, especially among women, young people and the low-skilled, reflect structural issues. Measures were taken to address youth unemployment, albeit they do not tackle the challenge comprehensively. Addressing skills mismatches is key to improving labour market performance. The social protection system is neither effective in protecting the most vulnerable segments of the population nor in activating those willing to work.

The policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2020 has been partially implemented. Both the previous and the current governments made use of consistent fiscal policy responses to mitigate the consequences of the pandemic and support the recovery. Good progress was recorded on public finance management with the establishment of a centralised public sector employment payroll system and the implementation of an electronic fiscal invoice system. The Central Bank of Montenegro took financial sector support measures to cushion the impact of the crisis while continuing to implement an asset quality review of domestic banks. However, the public administration optimisation plan did not yet achieve a meaningful permanent reduction of staff.

The government adopted four packages of economic measures, aimed at supporting businesses and employees during the COVID-19 pandemic. However, they were only partially implemented. The dialogue with the business associations, social partners and civil society appeared to be continuous throughout the crisis, but cooperation on crisis mitigation between central and local authorities was sporadic. The support measures endeavoured to preserve employment, but no new active labour market policies have been introduced or existing ones strengthened to facilitate transition to work. Coordination measures and e-healthcare provision have improved the healthcare system's ability to manage the COVID-19 crisis; however, the structural weaknesses of the healthcare system have not been addressed.

The ERP is broadly aligned with the reform priorities identified by the Commission, but the reform process lost momentum. The analysis of the main challenges facing the macroeconomic and fiscal frameworks is broadly consistent with the Commission's views. However, some parts suffer from a lack of detail, particularly beyond 2021. This is the consequence of the absence of a budget by the official deadline for submission of the ERP. The authorities are in the process of drawing up a new multi-annual fiscal strategy, which should provide a more solid basis for next years' programme. On structural reforms, the ERP reiterates the huge majority of the 2020 measures, with some recalibration and few new reforms. This is, in part, because many activities foreseen for 2020 were delayed or completely stalled by the COVID-19 pandemic.

2. ECONOMIC OUTLOOK AND RISKS

The COVID-19 pandemic and the subsequent introduction of lockdowns and travel restrictions took a very heavy toll on Montenegro's tourism-dependent economy. The shock had widespread effects, depressing not only tourism and retail services, but also trade, investment, and employment. The significant deterioration in external and domestic demand resulted in a very deep 15.2% contraction of GDP in 2020 according to preliminary estimates, in contrast to a 4.1% expansion of the economy recorded a year before. The labour market particularly suffered in 2020, with employment declining by an estimated 7.3% y-o-y while the unemployment rate climbed by 2 pps. over the year to 17.2%, in spite of several state-support packages to preserve employment.

The ERP projects a fast recovery of the economy. A comparison with the previous programme is not meaningful due to the massive shock in 2020 and the ensuing base-effect distortion. In the ERP's baseline scenario, GDP growth is expected to expand by 10.5%[1] in 2021, supported by a partial rebound of investment and private consumption. Growth is projected to ease to 6.5% in 2022 and to 5.8% in 2023 when tourism would recover – or even exceed – its pre-crisis level. Export growth is seen outpacing imports, making net export a key driver of growth as of 2022. Investment in digitalisation and the green transition is expected to sustain a high level of gross fixed capital formation over the medium term (at around 27.6% of GDP), even after the completion of the highway works in 2021. Having supported the economy in 2020 and 2021, government consumption is seen to remain flat in 2022 and record some marginal increase in 2023. The sharp decline in economic activity in 2020 plunged the output gap into negative double-digits. However, authorities expect a very fast recovery of employment to pre-crisis level already in 2021. Overall, the economy is expected to recover its pre-crisis level, and close the negative output gap, already in 2022.

The projected recovery path seems overly optimistic. The macroeconomic outlook continues to be affected by high uncertainty due to the COVID-19 pandemic. Overall, the projected evolution of GDP components is broadly compatible with the assumptions on the development of the pandemic and pressing fiscal consolidation efforts. However, GDP growth projections for 2021 and 2022 appear to be 3.3 pps. higher on average than estimated in the Commission Autumn Forecast. ERP expectations seem optimistic given the very high incidence of the virus in Montenegro, the late start of vaccination, and the strong reliance on other countries for the recovery of its tourism industry. Moreover, the low diversification of Montenegrin exports remains a constraining factor. The expected recovery of the pre-pandemic unemployment rate already in 2021 seems at odds with a partial recovery of tourism activity in the second half of the year. The ERP includes an

[1] The final ERP submitted to the Commission in April 2021 presents a more optimistic macroeconomic scenario than previous ERP draft contributions, which foresaw a more gradual growth path of 7.3% in 2021, 5.9% in 2022 and 6.3% in 2023. This late revision makes even more pertinent the Commission staff's assessment that the projected recovery path seems overly optimistic.

estimate of the impact of some reforms on the macroeconomic scenario. Accordingly, five projects related to public works in 2015-2022 would increase GDP growth and employment by an additional 7.1 and 2.4 pps. respectively by the end of the seven-year period. While being of interest, this analysis could be brought up to date by including, rather than infrastructure projects dating from 2015, some more recent key structural reforms from this year's ERP exercise.

Table 1:

Montenegro - Comparison of macroeconomic developments and forecasts

	2019		2020		2021		2022		2023	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
Real GDP (% change)	4.1	**4.1**	-14.3	**-15.2**	6.8	**10.5**	3.7	**6.5**	n.a.	**5.8**
Contributions:										
- Final domestic demand	1.9	**1.9**	-13.4	**-6.4**	5.4	**5.8**	3.0	**4.5**	n.a.	**3.5**
- Change in inventories	1.4	**1.4**	0.0	**1.0**	0.0	**0.0**	0.0	**0.0**	n.a.	**0.0**
- External balance of goods and services	0.7	**0.7**	-0.9	**-8.8**	1.5	**4.7**	0.7	**2.0**	n.a.	**2.3**
Employment (% change)	2.2	**2.7**	-2.6	**-7.3**	2.3	**6.2**	1.9	**2.3**	n.a.	**1.6**
Unemployment rate (%)	15.3	**15.1**	18.1	**17.2**	16.6	**15.6**	15.9	**14.3**	n.a.	**13.8**
GDP deflator (% change)	n.a.	**2.0**	n.a.	**-0.2**	n.a.	**0.0**	n.a.	**1.0**	n.a.	**0.7**
CPI inflation (%)	0.5	**0.4**	-0.5	**-0.3**	1.0	**1.2**	1.4	**1.4**	n.a.	**1.2**
Current account balance (% of GDP)	-15.0	**-15.0**	-15.8	**-26.0**	-14.3	**-18.7**	-13.9	**-15.1**	n.a.	**-11.6**
General government balance (% of GDP)	-2.0	**-2.0**	-8.8	**-11.1**	-4.7	**-2.9**	-3.6	**-0.2**	n.a.	**1.5**
Government gross debt (% of GDP)	76.5	**75.6**	87.3	**104.3**	85.6	**88.4**	83.0	**77.4**	n.a.	**69.9**

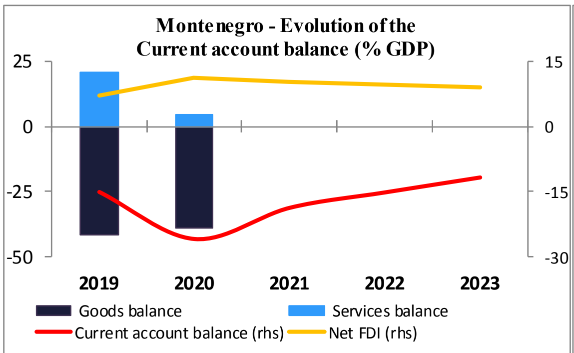
Sources: Economic Reform Programme (ERP) 2021, Commission Autumn 2020 forecast (COM).

The ERP presents a clear view of economic risks and uncertainties, developing two alternative macroeconomic scenarios based on some of their implications. Apart from the pandemic-related risks, given the extraordinary importance of tourism for the domestic economy, any factor hindering tourism, such as structural changes to travel behaviour, unfavourable weather conditions or delays setting up a new national airline following the bankruptcy of the previous one, would hinder the recovery. The programme also acknowledges risks in the event of lower than expected investment. The alternative macroeconomic scenario gauges the effects of external shocks affecting investment and tourism. The 'low-growth scenario' assumes a slower recovery of tourism revenues in 2021 (to 55% of its 2019 level, compared to 65% in the baseline), resulting in lower GDP growth by 3.2 pps. in 2021 compared to the baseline. The shock would largely affect exports, which would be lower by 10.5 pps., while imports would increase marginally, by 0.8 pps., in 2021. The impact would also be asymmetric on labour, with employment declining by 1 pp. and the unemployment rate remaining (abnormally) flat at 15.6%. Overall, the low-growth macroeconomic scenario does not seem plausible given some inconsistencies in some of the underlying assumptions, and therefore it appears inadequate for sustaining a solid fiscal strategy. Authorities also consider a 'high-growth scenario', based on a much higher recovery of tourism revenue (i.e. to 75% of its 2019 level already this year), resulting in a 12% growth of the economy in 2021. However, the underlying prerequisites for this scenario (e.g. mass vaccination providing collective immunity of the population already in the first half of 2021) seem unlikely.

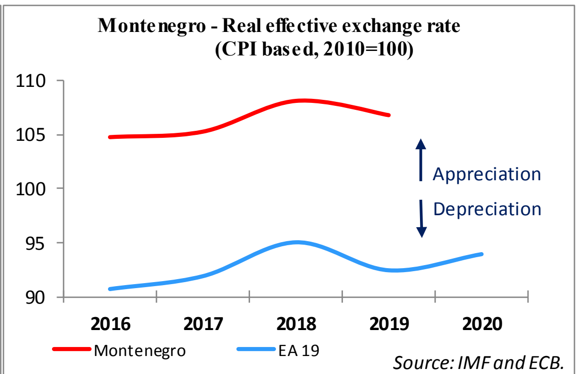
Inflation is expected to remain low in spite of the foreseen acceleration of economic activity. Montenegro witnessed a prolonged period of negative inflation in 2020. Inflation remained in negative territory in the last ten months of 2020, lowering consumer prices by 0.8% on average over the year. The ERP envisages a rebound of inflation in 2021 to 1.2%, easing afterwards to 1.4% in 2022 and 1.2% in 2023. On the assumption of a rapid improvement of labour market performance and subsequent strengthening of aggregated demand, notwithstanding the expectation of stable food and oil prices, the inflation rates for the two outer years seem underestimated. The fact that the ERP's inflation projections for 2022-23 remain very similar or the same in the low-growth scenario seems to support this view.

The current account deficit is one of Montenegro's key structural challenges. A narrow production base and large consumption and investment needs result in large and persistent trade deficits. The merchandise trade gap improved in 2020, as goods imports fell by 19% y-o-y. However, tourism was heavily affected by travel restrictions and Montenegro's traditional surplus on the services account therefore plunged from 20% of GDP in 2019 to just 4% in 2020. The primary account posted a small surplus of 1.4% of GDP thanks to the reduction in compensation to non-resident employees. Remittances held up relatively well and the secondary account surplus increased by 2 pps., to 7.2% of GDP. Overall, the current account deficit worsened markedly in 2020, expanding to 25.5% of GDP, compared to a 15.0% deficit a year earlier. The ERP foresees a substantial decrease in the current account deficit by 6.1 pps. between 2021 and 2023, thanks to the services account being supported by the recovery of travel activity. Moreover, the completion of the first section of the Bar-Boljare highway in 2021 would also contribute by reducing import needs for construction material and services. Overall, despite the expected improvement, the current account deficit is set to remain very high, at 11.6% of GDP in 2023. The ERP provides an analysis of external sector competitiveness, projecting some improvement thanks to a gradual decline in unit labour costs.

Graphs: external competitiveness and current accout



Source: Economic Reform Programme (ERP) 2021



Source: IMF and ECB.

Foreign direct investment resisted the pandemic shock so far. In spite of the deep recession, net FDI inflows surged by 53.2% y-o-y to 10.9% of GDP in 2020 compared to 6.2% the year before, covering 42.9% of the current account deficit, the rest being financed by net inflows from portfolio investment and loans. The increase in net FDI was driven by a marked decline in investment outflows compared to 2019, when the government bought back the state utility EPCG shares from foreign investors. The composition of FDI inflows changed in 2020, with investments in equity (namely in firms, banks and property), declining on annual basis. Conversely, intercompany debt increased (by 21.1% y-o-y), and accounted for 58.8% of FDI inflows as parent companies supported local subsidiaries during the pandemic. The ERP's assumption of continuing strong FDI inflows over the next few years seems plausible if supported by macroeconomic stability and economic reforms. At the end of 2019 (latest available data), Montenegro's net international investment position (NIIP) represented -168.6% of

GDP, the same level as a year before. However, the negative net position is expected to have deteriorated driven by the high external financing needs in 2020. The redemption of old debt in early 2021 should slightly reduce the negative investment position. However, given Montenegro's strong reliance on foreign sources of finance, the external investment position is expected to remain in highly negative territory in the medium term. According to 2019 data, the share of FDI in Montenegro's net international investment position accounted for 43.0% of which 60% relates to equity investments, while other investments (mostly loans) account for around 40%. Overall, the strong reliance on foreign loans increases Montenegro's vulnerabilities to external shocks.

The financial sector proved resilient in spite of the COVID-19 crisis, but credit activity is expected to remain subdued as crisis-related support for lending activity is withdrawn. Banks' capital adequacy ratio remained comfortably above the regulatory threshold. The aggregated capital adequacy ratio reached 18.5% in 2020, well above the statutory minimum of 10%. Payment deferrals and loan restructuring helped contain the share of non-performing loans (NPLs), which increased to 5.5% nonetheless, up from 4.7% a year before. NPL coverage with loan-loss provisions (at 88.3%) remains substantial, and banks with high NPLs are subject to special supervisory scrutiny. Profitability indicators remained positive in 2020, but profit fell 53% over the year. In 2020, return on assets and on equity reached 0.5 and 3.6%, respectively. In the context of the COVID-19 pandemic, the Central Bank of Montenegro has so far implemented six packages of temporary measures aimed at preserving the liquidity and credit-worthiness of clients, while boosting the banks' lending potential. These measures, such as cutting the reserve requirement ratio by 2 pps. had an asymmetric impact. Thus, while new loans to legal persons grew by 15.2% y-o-y in 2020, natural persons borrowed 42.5% less due to increased COVID-19 related uncertainties and rising unemployment. In addition to a loan moratorium and debt restructuring, both legal and natural persons also resorted to withdrawing their bank deposits, which declined by an average of 4% y-o-y.

Table 2:

Montenegro - Financial sector indicators

	2016	2017	2018	2019	2020
Total assets of the banking system (EUR million)	3 790	4 182	4 407	4 604	4 586
Foreign ownership of banking system (%)	75.5	73.0	74.3	67.9	81.3
Credit growth	1.3	11.8	8.5	4.5	3.2
Deposit growth	9.4	13.8	5.9	0.5	-3.0
Loan-to-deposit ratio	0.8	0.8	0.8	0.9	0.9
Financial soundness indicators (end of period)					
- non-performing loans	10.3	7.3	6.7	4.7	5.5
- net capital to risk-weighted assets	16.0	16.4	15.6	17.7	18.5
- liquid assets to total assets	24.5	25.3	22.6	20.8	22.2
- return on equity	1.5	7.6	8.5	10.0	3.6
- forex loans to total loans (%)	1.1	0.7	0.5	0.4	0.2

Sources: National Central Bank, Macrobond.

The programme foresees credit growth to the private sector to recover strongly in 2021, and ease gradually in the outer years broadly in parallel but at a faster pace than economic recovery. It also identifies credit risk as key, and refers to the Central Bank of Montenegro's completion (expected for April 2021) of an asset quality review of all domestic banks, which is crucial to further reinforcing the financial soundness of the banking sector and addressing any potential capital shortfall. However, the supervision of the non-banking sector also needs to be reinforced, as it may hold a large part of the NPLs shifted off-balance sheet by the banks. Overall, the full impact of the crisis on banks asset quality will only show once the loan moratorium expires and potential corporate bankruptcies rise once the government crisis response programmes are phased out.

3. PUBLIC FINANCE

The economic recession had a much greater negative impact on the revenue side of the budget than on spending. The general government registered a high deficit of 11.0% of GDP in 2020 compared to the revised budget plan's target of 7.2% of GDP. In 2020, the government adopted three packages of support measures in the context of the COVID-19, worth some 6.1% of GDP. Measures included tax deferrals, wage subsidies, one-off payments to pensioners and welfare recipients as well as targeted support for key sectors of the economy such as tourism and agriculture. The sharp contraction of the economy, combined with discretionary support measures on the revenue side, had a very strong impact on tax revenue. Thus, budget revenue fell by 13.1% over the year, with nearly all revenue categories underperforming compared to 2019. Meanwhile, in order to restrain overall spending, the government reallocated certain expenditure to healthcare services and supplies, while reducing capital spending by one third. Nonetheless, total expenditure grew by 4.8% y-o-y. Overall, the programme estimates the direct fiscal impact of the COVID-19 pandemic in 2020 resulted in a tax shortfall equivalent to 6.2% of GDP, while discretionary measures in support of the economy and citizens increased expenditure by 1% of GDP.

Table 3:
Montenegro - Composition of the budgetary adjustment (% of GDP)

	2019	2020	2021	2022	2023	Change: 2020-23
Revenues	44.7	44.6	45.8	43.5	42.8	-1.8
- Taxes and social security contributions	39.3	39.6	39.8	39.4	38.7	-0.9
- Other (residual)	5.4	5.0	5.2	4.1	4.1	-0.9
Expenditure	46.7	55.6	48.7	43.7	41.3	-14.3
- Primary expenditure	44.4	52.9	44.5	40.4	39.0	-13.9
of which:						
Gross fixed capital formation	7.0	6.3	5.6	3.0	2.8	-3.5
Consumption	16.3	19.0	16.4	16.6	15.6	-3.4
Transfers & subsidies	18.0	22.2	20.2	19.2	18.3	-3.9
Other (residual)	3.1	5.4	9.4	7.9	7.7	2.3
- Interest payments	2.3	2.7	2.5	2.3	2.2	-0.5
Budget balance	-2.0	-11.0	-2.9	-0.2	1.5	12.5
- Cyclically adjusted	-4.4	-7.0	-0.8	0.7	0.1	7.1
Primary balance	0.3	-8.4	-0.3	2.2	3.7	12.1
- Cyclically adjusted	-1.3	-3.2	2.5	3.6	1.9	5.2
Gross debt level	75.6	104.3	88.4	77.4	69.9	-34.4

Sources: Economic Reform Programme (ERP) 2021

The main objective of Montenegro's medium-term fiscal strategy is to consolidate public finances in order to achieve an almost balanced budget in 2022 and a budget surplus in 2023 by strengthening budget revenue and phasing out crisis- and highway-related spending. Fiscal consolidation relies on three pillars. First, recovery to the pre-pandemic public revenue level would depend on the recovery of economic growth and further broadening of the tax base thanks to the introduction of fiscal cash registers, more efficient tax inspections, and certain ad-hoc measures (such as a new legislation on games of chance). The second pillar focuses on the optimisation of current spending by introducing some discretionary expenditure cuts and containing overall spending in nominal terms (i.e. a faster growth of nominal GDP compared to current spending). Moreover, the extraordinary pressure on health and social spending during the pandemic is not expected to last beyond 2021, and its withdrawal should help to reduce budget expenditure. In addition, the ERP announces a revision of the public administration optimisation plan in order to reduce the number of staff. Thirdly, capital spending is expected to decline significantly following the completion of works on the first section of the Bar-Boljare highway. Overall, the budget balance would improve rapidly, reaching a close-to-balanced position in 2022 and a surplus in 2023 of 1.5% of GDP. The fiscal objectives seem ambitious and would require budget spending to be kept in check.

The government formed in December 2020 decided to postpone the approval of the 2021 state budget until the end of March. According to the law on budget and fiscal responsibility, the Ministry of Finance approved temporary financing for the first months of 2021. Spending units are therefore receiving monthly funding worth 1/12 of the actual expenditures realised in 2020. Although economic output will begin to recover in 2021, overall activity is expected to remain below 2019 levels, hindering the full recovery of budget revenue to its pre-pandemic level. Moreover, continued demands on the budget from intensified social welfare payments and medical spending, as well as additional expenditure under the recovery packages would still encumber 2021 budget expenditure. According to preliminary budget plans, the central government deficit would reach 3.0% of GDP, assuming real GDP growth of 10.5% and an inflation rate of 1.2%. The local government budget is planned to register an aggregated surplus of 0.15% of GDP in 2021, resulting in a marginally lower deficit in the general government budget of 2.9% of GDP (just below the fiscal rules' threshold of 3% of GDP). Compared to 2020, the preliminary 2021 budget plans for an increase in revenue of some 0.8% of GDP and a sharp decline in expenditure of around 6.9% of GDP, reflecting the withdrawal of crisis-related spending starting in 2021 and a reduction in some non-discretionary spending.

Most of the budgetary measures in 2021 focus on the revenue side, and particularly on broadening the tax base. The implementation of the electronic monitoring of fiscal cash registers (e-fiscalisation) already started in January 2021. This, in combination with more efficient work by inspection services, should contribute to reducing informality and increasing tax proceeds. Amendments to the legal framework for games of chance should create conditions for some new budget revenue streams at the end of the year. The ERP also announces a further increase in excise rates as well as the introduction of new excises duties. The Law on Restructuring Tax Liabilities would continue to facilitate the reimbursement of taxpayers' arrears in monthly instalments. There are no new measures on the expenditure side apart from a new public administration optimisation plan aimed at reducing the wage bill. The programme presents some budgetary savings of discretionary nature; however, these are offset by concurrent expenditure increases. Overall, the effects of the proposed consolidation efforts have proved rather modest in the past and may therefore not yield significant budget savings in the future.

Box: The budget for 2021

* The government adopted the draft central government budget for 2021 on 30 March 2021, and presented for adoption to the parliament in April.

* The ERP's target for this year's general government deficit is 2.9% of GDP.

* The draft budget law includes some novelties; for instance, the abolition of the upper threshold for the payment of social security contributions. Moreover, other measures like the financial support required for the establishment of a new national airline were not covered.

* The reduction in the number of ministries (from 16 to 12) adopted by the new government had no immediate impact on budgetary outcome. A revision of the structure and composition of several public administration areas has been announced. However, the scope and budgetary impact of that reform remains unclear.

Table: Main measures in the budget for 2021

Permanent Revenue measures*

- Electronic monitoring of fiscal cash registers (e-fiscalisation)
- Intensified work of inspection services
- New law on games of chance
  (to be adopted in the fourth quarter)
- Further increase in tobacco, carbonated drinks, alcohol, sweets and ice cream excises
  (estimated impact: EUR 29 million)
- So called 'fuel marking' (to fight illegal trade in petroleum products)
  (estimated impact: EUR 12 million)
- Abolition of upper threshold for the payment of social security contributions
  (estimated impact EUR 3.5 million)
- Distribution of income from dividend and profit tax from state owned companies
  (estimated impact: EUR 43.5 million)
- Increased revenue from increase of minimal salary (i.e. labour taxes and contributions)
  (estimated impact: EUR 11.4 million)
- Fee from property acquisition not justified
  (estimated impact: EUR 20 million)

Temporary Revenue measures

- Tax deferrals
  (negative impact on 2021, neutral after 24 months)

Permanent Expenditure measures**

- Public administration optimisation plan
- Reduction of VAT on eggs
  (from 21% to 7%)
  (estimated impact: EUR 2.3 million)

* Estimated impact on general government revenues.
** Estimated impact on general government expenditure.
Source: ERP

The government adopted four packages of measures to support the economy in the context of the COVID-19 pandemic. Overall, most of the measures are temporary. However, many of them have had their timeline and coverage extended in subsequent packages. The government's policy response was timely. The first package was rapidly adopted on 19 March 2020, focusing on rapid support for the most vulnerable categories of the population and supporting real sector liquidity. The second package (in April 2020) placed more emphasis on supporting employment. The third one (in July 2020) was very ambitious, providing short-term measures in support of the economy, but also a recovery plan worth more than one billion euros, involving public and private investments until 2024, in order to increase the resilience and diversification of the economy. The new government (formed on 4 December 2020) adopted a new package in January 2021, broadly in line with the previous ones.

Box: Measures taken for 2021 to support the recovery and increase the resilience of the economy

a. Incentives to increase employment

Incentives introduced with the second package of support measures aim to support the retention of workers by reducing the labour tax wedge. Namely, subsidies for new staff recruited before 31 December 2021 will exempt the employer from paying income tax and contributions for pension and disability insurance (up to the amount of the gross average wage for the previous year). The exemptions will cover 90% of taxes and contributions paid in 2021, 60% in 2022, and 30% in 2023. In contrast, programmes for skills upgrading or short-time working schemes to support job transition, remain less developed.

b. Support public and private investment, and the green and digital transition

The third package of government measures included a very ambitious reform agenda until 2024, linked to the strategic policy objectives of the green and digital transition with the aim of diversifying the economy. The green transition plans investments on clean energy projects amounting to one billion euros. A substantial part relates to investments by the state-owned electric power company in new production plants. The digital transition will require EUR 28.9 million in public and private investments. It will include establishing an IT cluster, a centre for e-commerce support, a virtual and augmented reality innovation centre, and the establishment of Montenegro's Innovation Fund.

c. *Support demand by providing temporary tax cuts and promoting a growth-friendly tax system*

Support for households through temporary tax cuts may help sustain the recovery as it takes hold in 2021, especially to support aggregate demand. All tax deferrals are temporary in order to avoid a deterioration in the underlying fiscal positon. Measures concern one-off financial assistance for vulnerable categories of citizens, with an estimated total cost of EUR 7 million. An additional EUR 5.5 million was allocated to support local tourism by means of EUR 200 tourism-vouchers (valid until July 2021) for all workers in the education and healthcare sectors.

d. *Support solvent businesses*

Efforts are made to provide taxpayer support to economic sectors impacted by the crisis. However, the general support approach does not distinguish solvent firms from those in difficulties before the crisis, and could result in rising delinquency rates once the support is over. Measures concern the postponement and rescheduling (in 24 monthly instalments) of income taxes and social security contributions incurred in the period from 1 July to 31 December 2020. The state-owned Investment and Development Fund set up specific credit lines to bolster the liquidity of micro, SME and large companies operating in the sectors of tourism and hospitality, transport, medicine and food production.

e. *Liquidity measures*

Measures such as tax deferrals are justified in providing further liquidity while reducing accumulated tax refunds in order to avoid or alleviate solvency problems for firms. Key measures involve increasing of the turnover limit for mandatory VAT registration (to EUR 30 000 from EUR 18 000), shortening the VAT refund period (from 60 to 30 days), reducing (until July 2021) the VAT for catering services (to 7% from 21%) and reducing the rental costs for state-owned property by 50% (only in 2021). In addition, government interventions on the market are foreseen as well as support for purchasing domestic agricultural products, fisheries and aquaculture products.

There are no new features on the revenue or expenditure side for 2022 and 2023. Some measures present in 2021 are to be maintained over the following years too, in particular the regular increase of the tobacco excise rate and the further reduction of tax arrears in the context of the Law on rescheduling tax receivables. However, other measures presented in the previous ERP are not mentioned, particularly the economic citizenship programme or the concession of Montenegro's airports. On the expenditure side, capital spending would fall to 3.5% of GDP per year after the conclusion of the first section of the highway in 2021. Overall, public spending is set to decline significantly by 14.3 pps., from 55.6% of GDP in 2021 to 41.3% of GDP in 2023 (or by 6% in nominal euro terms).

The stock of public debt soared at the end of 2020. Last year's ERP expected the public debt to fall to 72.3% of GDP in 2020, down from 78.7% a year earlier. Instead, there has been the unplanned surge in the budget deficit due to the COVID-19 crisis, but also massive borrowing at the end of 2020 in order to secure financing at favourable terms to meet debt-rollover needs in 2021 pushed public debt above 100% of GDP in 2020. The ERP expects the debt ratio to decline rapidly, by more than 34 pps. in 2020-2023, driven by the improving primary balance, the rebound in GDP growth and the use of large government deposits to repay maturing debt (see box below). In spite of the high stock of public debt, annual gross financing needs are set to fall rapidly (from 12.7% of GDP in 2021, down to 6.2% in 2022 and 3.4% in 2023) due to both lower debt rollover and deficit financing needs. A highway-related credit line with China would cover 85% of the road's financing needs. Moreover, the amount of accumulated government deposits is substantial, totalling some 20% of GDP at the end of 2020. Of this, some 4.9% of GDP was used in March 2021 to reimburse maturing debt. Some 80% of the public debt is in euros, and 18% in USD. To reduce the related currency risk related to USD borrowing, authorities are negotiating a hedging arrangement with a group of banks. Interest rate risk is also low, as 73.2% of the total debt has been issued at a fixed rate. The ERP announces the preparation of a new public debt management strategy until 2023, to be endorsed after the adoption of the 2021 budget.

Box: Debt dynamics

The rebound in GDP growth, the significant improvement in the primary balance, which is projected to turn into a surplus as from 2022, and favourable large stock-flow adjustments are expected to drive the very sizeable reduction in the public debt ratio, which is projected to fall by some 334 pps. in 2021-23. Stock-flow adjustments remain largely dominated by liability management operations. In particular, the sizeable issuing of Eurobonds in 2019 and 2020 boosted the gross public debt stock with the purpose of building government deposits to repay maturing debt and to cover financing needs in 2020 and 2021. The use of these deposits will reverse the sign of stock-flow adjustment in the period 2021-2023. Decreasing investment related to the highway will result in primary surpluses in the two outer years, further contributing (together with a favourable snowball effect) to quick debt reduction.

Montenegro

Composition of changes in the debt ratio (% of GDP)

	2019	2020	2021	2022	2023
Gross debt ratio [1]	**75.6**	**104.3**	**88.5**	**77.4**	**69.9**
Change in the ratio	5.5	28.7	-15.8	-11.0	-7.5
Contributions [2]:					
1. Primary balance	**-0.2**	**8.4**	**0.3**	**-2.2**	**-3.7**
2. “Snowball” effect	**-1.9**	**16.3**	**-7.5**	**-3.9**	**-2.6**
Of which:					
Interest expenditure	2.2	2.7	2.5	2.3	2.2
Growth effect	-2.8	13.5	-9.9	-5.4	-4.2
Inflation effect	-1.4	0.1	-0.1	-0.8	-0.5
3. Stock-flow adjustment	**7.6**	**4.0**	**-8.7**	**-5.0**	**-1.2**

[1] End of period.
[2] The snowball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator).
The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other effects.

Source: Economic Reform Programme (ERP) 2021, ECFIN calculations.

Fiscal plans are subject to significant risks and uncertainties. The ERP presents a matrix of economic and fiscal risks emphasising that the recovery of the economy, and therefore of public finances, relies primarily on the return of tourism. However, this factor does not only depend on Montenegro, but also on the countries of origin. The rate of vaccination, both in origin and destination countries, will be key to this recovery. The poor performance and governance of some state-owned enterprises (particularly in the transport sector) is identified as a key fiscal risk, given their dependence on state subsidies and tax arrears for their survival. Authorities also recognise the possibility of higher (and unplanned) costs when concluding the works on the first section of the highway. However, continuing the remaining sections of the highway (including through PPP arrangements) also represent a risk to public finances, not included in the ERP. The introduction of the new child benefit would require careful planning of its fiscal impact as well as the sources of financing in order to avoid fiscal risks, as witnessed in the past in the case of the poorly planned benefits for mothers of three or more children. There is also a risk of early elections given the heterogeneous government coalition’s narrow parliamentary majority, which could see an increase in fiscal pressures in the context of a new electoral cycle. Containing current spending, particularly on the wage bill, might prove challenging as previous plans for reducing current spending have repeatedly been derailed in the pre-pandemic years.

Box: Sensitivity analysis

The programme offers a detailed analysis of the deficit, with a comparison between scenarios as well as with the previous ERP. The comparison among scenarios offer a detailed risk matrix including potential positive and negative events. However, the impact of such risks are not quantified. While the previous programme predicted a balanced budget for 2020, followed by surpluses in the two outer years, this year's ERP confirms a very large deficit in 2020, and estimates a fast recovery path towards budget surplus, expecting budget revenue not to recover to pre-pandemic levels until 2022. The analysis highlights the asymmetric nature of the pandemic shock on budget performance, resulting in a much sharper deterioration of the revenue side than of expenditure.

The quality of public finances is hindered by the rigid structure of the budget. Non-discretionary items such as spending on wages and benefits dominate the expenditure side of the budget. Public finances were further strained by the COVID-19 pandemic due to increases in health-related spending. Thus, after increasing public spending on the health sector, no measures are proposed to reinforce the health fund to reduce its persistent deficit. In addition, the introduction of amendments to the pension law further deteriorated the chronic deficit of the pension fund. To support the stability of the pension system, the ERP includes the postponement of the early retirement age by one year (to 63) and the abolition of the special retirement conditions at the end of 2021. These measures seem insufficient to compensate for the reduction of the retirement age (by one year for men and by three years for women) introduced in 2020. To reduce the wage bill, the ERP announces a review of the public administration optimisation plan, including maintaining the restriction for new recruitments. However, these schemes have produced poor results in the past. Unfavourable demographic trends increase the pressure on the long-term sustainability of public finances. Overall, although the ERP diagnostic is accurate, the policy response lacks ambition.

Several projects are being implemented to strengthen Montenegro's budgetary framework. The Law on Budget and Fiscal Responsibility provides the formal framework for Montenegro's fiscal policy. Amendments to this law were prepared and adopted by the government along with the 2021 budget on 30 March 2021. These amendments aim to establish an independent fiscal council to strengthen the oversight of fiscal policy. Programme budgeting and medium-term planning were also included with the 2021 budget. These amendments also introduced the development of performance indicators with the aim of fully implementing programme budgeting with the 2022 budget. Internal control mechanisms need to be reinforced, including making the budgetary inspectorate department fully operational. There is a considerable delay in the introduction of accrual accounting and the production of government finance statistics based on ESA2010 standards. The problem is primarily due to the lack of human resources at the Ministry of Finance, but also at the statistical office (MONSTAT).

4. KEY STRUCTURAL CHALLENGES AND REFORM PRIORITIES

Montenegro's comparative advantage is built on its geographical location, climate and landscape. Its small and open economy is service-oriented and largely focused on tourism as the principal source of income. Services account for nearly 80% of total exports, while foreign tourists alone generate over 20% of the country's GDP. It's tourism potential is still far from being fully exploited, with the mountainous northern region offering significant opportunities for further growth, including outside the summer holiday season. At the same time, given the country's reliance on one sector and its small size, the economy remains vulnerable to external shocks and the challenges of climate change.

Montenegro is one of the countries most exposed to pandemic-induced distortions, given tourism's large share of GDP and employment. This calls for renewed efforts to promote diversification and increase the value added in economic activities, as well as prioritisation of skills development programmes, in response to smart specialisation priority areas with high potential in the post-COVID-19 period, and in light of the digital and green transitions.

The Commission has conducted an independent analysis of the Montenegrin economy to identify the key structural challenges to competitiveness and inclusive growth, drawing on Montenegro's ERP itself, and other sources. This concise analysis shows that, despite progress achieved in some areas, the country suffers from several structural and cross-cutting weaknesses across many sectors of economic activity. However, the main challenges in terms of boosting competitiveness and securing long-term inclusive growth are (i) increasing employment, particularly of women and young people, and tackling long-term unemployment; (ii) strengthening the regulatory environment and (iii) formalisation of the economy. This assessment therefore focuses on those three key challenges.

Montenegro also needs to tackle corruption, improve the rule of law and strengthen institutions in order to promote competitiveness. Addressing these fundamental concerns is a prerequisite for a successful transformation of the economy. The Commission is closely following the issues of strengthening the rule of law and fighting corruption in the annual Montenegro report.

Key challenge #1: Increasing employment, particularly of women and young people, and tackling long-term unemployment

Positive labour market trends that could be observed before March 2020, were negatively impacted by the COVID-19 pandemic and the ensuing halt of economic activity. In the third quarter of 2020, the unemployment rate (15-74) rose to 19.4%, compared to 16.6% in the first quarter and 15.6% in the third quarter of 2019. The activity rate (20-64) in the third quarter of 2020 stood at 66.2%, 6.1 pps. lower than in the third quarter of 2019. The employment rate (20-64) continued to decline throughout 2020 to 53.5% in the third quarter of 2020, compared to 60.1% in the first quarter of 2020 and 61% in the third quarter of 2019. By way of comparison, in the EU the unemployment rate was 7.4% in the third quarter of 2020 (6.5% in the third quarter of 2019), the activity rate was 78% in the third quarter of 2020 (78.1% in the third quarter of 2019) and the employment rate was 72.4% in the third quarter of 2020 (73.1% in the third quarter of 2019). Despite a slight improvement, there are still great geographical disparities. The unemployment rate in the Northern region (36.3%) was more than six times than that in the Coastal region (5.5%). Roma and persons with disabilities face additional challenges in accessing the labour market, despite the continued support from employment and education programmes targeting those groups. Montenegro reacted quickly and adopted unprecedented measures aimed at mitigating the socio-economic impact of the pandemic. Three packages of measures were adopted in 2020 and a fourth one in 2021, which was aimed at job retention through support for businesses, workers affected and certain vulnerable groups.

As a direct response to the 2020 policy guidance to "take measures to preserve employment including by ensuring short-time work schemes and flexible working arrangements", *Reform Measure 16 – "Improvement of labour legislation by introducing new work schemes"* was proposed. While the aim of the measure is appropriate, it lacks clarity on the specificities of the schemes and arrangements intended to be implemented. It is unsure whether the new work schemes will be introduced in time to curb the impact of the COVID-19 pandemic on the labour market.

The most vulnerable groups on the labour market remain women, young people and the low skilled while long-term unemployment continues to be a structural challenge. While the unemployment rate for women is only slightly higher than that of men, the gender employment gap remains high with a 13.1 pps. difference. The pandemic had a significant, negative impact on youth employment (15-24) (17.6% in the third quarter of 2020 compared to 29.5% in the third quarter of 2019) and unemployment (15-24) (38.1% in the third quarter of 2020 compared to 23.9% in the third quarter of 2019) rates as well. Even before the outbreak of the pandemic, the rate of youth (15-24) neither in employment, nor in education and training (NEET) increased from 2018 (16.2%) to 2019 (17.3%), reflecting significant difficulties in transitioning from education to employment, paired with a mismatch between skills provided through formal education and those required on the labour market. It could also indicate weak job creation. The highest share of unemployed persons continue to be those with lower educational attainment. High long-term unemployment persists (65.5% in the third quarter of 2020). The decrease in the share of long-term unemployed compared to 2019 can be attributed to the increasing number of unemployed persons overall, rather than any improvement in the situation. The National Employment Strategy 2021-2024 was not adopted as planned in 2020.

While female inactivity remains high, an increased participation in early childhood education and care is expected to support their access to employment. In the third quarter of 2020, women's inactivity rate (20-64) remained far above men's at 41.8% compared to 24.2%. Employment gains continue to be larger for men than for women. This is partly due to traditionally lower engagement of women on the labour market, a significantly higher share of unpaid work done by women (ILO, 2019), as well as the structure of the social benefits system which can discourage women from entering the labour market. Women have also been more affected by the increasing unemployment due to the COVID-19 crisis. The enrolment rate of children up to 3 years old in child care rose to 37.21% in 2019 (Monstat) and reached 72.62% for those aged 3 to 6 (Monstat), indicating a clear positive trend. However, regional disparities remain with low take up in the North. The forthcoming adoption of the Strategy and Action Plan for Early and Preschool Education 2021-2025 should reinforce this positive trend.

Despite the numerous, long-term activation programmes in place, these continue to be ineffective in activating the working-age population. Active labour market policies (ALMPs) are not adequate to assist jobseekers in finding sustainable, long-term employment and still focus insufficiently on re- and up-skilling. Although an evaluation of ALMPs is expected to be finalised in 2021, the lack of a comprehensive monitoring and impact assessment of the effectiveness of ALMPs, including following-up on the number of beneficiaries that remain employed in the long term, prevents continuous policy adjustments from being made to render the ALMPs fit for purpose. Efforts to improve the currently ineffective institutional set-up and functioning of Montenegro's public employment service, the Employment Agency of Montenegro (EAM), are on-going. These considerations are reflected in *Reform Measure 17 – "Operational capacity building at the Employment Office for the performance of services and measures through digitalisation"*. The digitalisation of EAM based on the results of the identification and revision of the procedures should facilitate its work and improve the provision of tailor-made and targeted services.

Informality remains an obstacle to improving labour market outcomes. While it is assumed that the wage-subsidy measures in response to the pandemic have prompted employers to formalise some of their employees, disincentives to formalisation remain, requiring comprehensive measures to fight undeclared work. The Labour Law adopted in December 2019 aims to increase the flexibility of the labour market, but the effects of its implementation remain to be seen. The capacity of the Labour Inspectorate remains limited. A specific ALMP has been established since 2019, targeting young people and incentivising their participation in the labour market through employment or self-employment, however its effectiveness is yet unknown. A horizontal policy overview combining various measures to activate youth, such as the EU Youth Guarantee, is lacking.

Skills mismatch continues to be a significant challenge, particularly for young people. It is a problem for both those with secondary education and those with higher education. There are high levels of transition from VET to higher education and other programmes with lower labour market relevance. Occupational mismatch (i.e. over-qualification) is highest for those with tertiary education (around 14%). While tertiary educational attainment is still lower than the EU average, the labour market cannot absorb tertiary graduates in certain subjects, such as business and humanities, while there is still a shortage of medical and STEM graduates (ETF, 2019), which is detrimental notably in view of their significance for the occupational domains targeted by the smart specialisation strategy. A professional training programme for higher education graduates has been implemented for nearly a decade, however no comprehensive analysis on its impact has been conducted. Up to 2019, around 3 000 unemployed graduates took part, only 50% of whom continued to be employed after participating in the programme. With the help of the ILO, a tracer study has been implemented which should help evaluate the programmes' efficiency.

Reform measure 15 – "Reform of study programmes for bachelor and master studies with strong focus on apprenticeship", is in line with the European Commission's policy recommendations and is expected to improve the overall quality of education, including through the establishment of an adequate monitoring and evaluation mechanism for practical learning in higher education.

Prior to the COVID-19 pandemic, enrolment in dual VET education was rising significantly (834 in 2019/2020 compared to 277 in 2017/2018 and 570 in 2018/2019). However, as in many EU Member States, the pandemic had a negative impact on practical education, as shown by the fall in the enrolment rate for 2020/2021 of 740 students. With the increasing number of students, in 2019, the government commissioned an evaluation in an effort to improve the quality and relevance of the programmes (ETF, ILO 2020). It was followed up via a further internal review in 2020.

Reform measure 14, which follows on from the previous year's measure 15, on the "*establishment of the system for continuous monitoring of the quality of apprenticeship at the employers"*, is expected to facilitate fact-based policy making, adapt the apprenticeship programme and improve labour market transitions. The dual education review published in 2020 (ETF, ILO 2020) should serve as a good basis for further analysis.

Participation in lifelong learning has further decreased to 2.5% in 2019 (down from 3.2% in 2018) less than a quarter of the EU-27 average (10.8%), and there are limited opportunities for re- and up-skilling. Lifelong learning and adult education with up- and re-skilling does not play a sufficiently prominent role, including in facilitating the green and digital transitions. Adult education programmes are included in ALMPs. In 2019, 896 unemployed persons took part in adult education programmes, only 13.2% of whom found a job within 6 months of completing the programme. The programmes are not targeted and designed in a manner that would effectively help integrate jobseekers into the labour market. Given the very high share of long-term unemployment, the development of such measures remains essential. No reforms have been announced in the area of adult learning, though a first iteration of the Lifelong Learning Strategy is expected in 2021.

Social support schemes, including unemployment benefits and social assistance schemes, are in place, but are not effective in protecting the most vulnerable segments of the population or in activating the population. The complex web of social benefits and services combined with a lack of systematic follow-up of individual activation plans contributes to the high inactivity rates and discourages formal employment. In line with the Social and Child Protection Strategy, the government has commissioned a study to review the social protection system, the delivery of which has been delayed due to the COVID-19 crisis. However, a preliminary assessment and recommendations are expected to be ready in early 2021 enabling the government to draft an outline of measures to reform the social protection system.

Key challenge #2: Strengthening the regulatory environment

Improving the institutional and regulatory environment in Montenegro requires long-term commitment on the part of the state and local authorities. The regulatory environment is not business-oriented and hinders more dynamic development of local companies and foreign investors' activities. **As the key areas for improvement,** businesses point to inefficiencies and delays when dealing with the administration, excessive complexity and administrative burden from local taxation and para-fiscal charges, and a lack of established mechanisms for continuous structural dialogue between authorities and the business world. Close behind on the list of top concerns are insufficient transparency in decision-making, inconsistencies and arbitrary interpretation and enforcement of the law by public authorities, and shortcomings related to public procurement procedures. Companies stress that these deficiencies lead to unpredictability in the regulatory environment at central and local level and hold back the Montenegrin economy.

Routine administrative relations between the business community and authorities are not focused on the needs of businesses. Conducting business is often hindered by the slow pace of administrative responses or lack of deadlines for some administrative procedures. The authorities seldom provide a rationale or feedback regarding decisions affecting businesses, and when such decisions are questioned the authorities tend to invoke business secrecy rather than allowing the interested party free access to information. On top of this, there are regular reports of conflicting interpretation of laws between different decision-making authorities, between the state and the municipal level, and between local authorities.

Public consultation processes would benefit from a more inclusive and stakeholder-oriented approach. Many legislative proposals require effective and proactive communication strategies targeting stakeholders from the outset. Inclusive public consultations should take place at a sufficiently early stage in a legislative process. Businesses and the organisations representing their views are natural partners of the public authorities; their input is needed at the design stage in order to assess the impact of new laws and regulations on the economy. However, public debate appears only to come very late in the process and is often restricted in scope and time, resulting in very limited feedback from the business world and social partners.

Apart from the high-level Competitiveness Council, there are no established technical mechanisms and practices allowing for continuous structural dialogue between authorities and the business world. There is no overall, central coordination of public consultations by the Secretariat General of the government or any other structure. The practice of consultations seem to differ not only between ministries and administrative bodies but also depending on the topic discussed. Consultations tend also to be formal, one-off affairs, focusing on procedures rather than substance. The authorities' low responsiveness, insufficient transparency and lack of continuous engagement in the public debate processes is another issue to be addressed.

Businesses are also affected by the lengthy processes for adoption of secondary legislation. Frequent delays between the adoption of primary laws and the adoption of their implementing legislation are another source of instability and erratic decision-making by the public administration at the central and local levels.

While the government Montenegro has made some progress in improving the quality of public consultations during 2020 (particularly in the context of the adoption of COVID-19 mitigation measures and the preparation of the ERP structural reforms), the systematic inclusion of business and social partners in designing, drafting and implementing measures affecting the economy has yet to be achieved.

The area of public procurement and concessions is undergoing significant transformation, with the rollout of the electronic procurement system from January 2021. Efficient, competitive, transparent and non-discriminatory public procurement procedures are an integral part of a business-friendly regulatory environment. Public procurement in Montenegro accounts for around 12% of the country's GDP and is generally fulfilling its purpose, although, as noted in the European Commission's country reports, there are some weaknesses in the preliminary selection procedures and particularly at the remedies (appeals) stage.

The launch of the electronic procurement system in 2021 is expected to bring significant improvements to the functioning of public procurement over the coming years. The system is based on the recently-adopted legal framework (the law on public procurement and the law on public-private partnership) providing a good degree of alignment with 2014 EU Procurement Directives on classical procurement, utilities and concessions. The implementation of centralised e-procurement via a single, dedicated portal could make it significantly easier to access information on tenders from all contracting authorities, speeding up procedures and improving their transparency.

The proposed ERP *reform measure 9 – "Implementation of the electronic public procurement system (EPPS)"* is credible and appropriate, as it should help to increase the transparency of public procurement processes, increase the efficiency of procedures and reduce the possibility of corruption and breaches of competition rules. On the technical side, a broader spectrum of risks to the project could be better reflected in the document (expected timeline for adoption of secondary legislation, progress in digitalisation of the state administration, technical preparedness of civil servants and bidders despite trainings provided etc.). Practical implementation by public procurement officers and contracting authorities will be the key to the success of the project and its ultimate impact on the country's competitiveness and long-term growth potential.

Local taxation, transparency and the fairness of the State as a regulator should remain the authorities' focus. While the income tax for companies at state level remains low at a rate of 9%, municipal fees, charges and other financial obligations are seen as a major obstacle for investment in Montenegro. Taxation's legal framework is based on at least 10 different laws, thus increasing its complexity. According to the Montenegrin government, there were 659 different taxes, fees and charges in Montenegro in 2017. Businesses therefore find the tax system arbitrary, unpredictable, confusing and non-transparent. Planning the payment of tax commitments remains notoriously difficult due to the frequency of payments and legislative changes, making this another area for improvement.

Moreover, the business community often questions the general implementation of tax system, denouncing tax discrimination between local and foreign-owned companies, and between small and large companies, citing the government's leniency towards some large local debtors. Preferences, subsidies or aid provided to certain enterprises over recent years increase the perception that politically well-connected businesses enjoy preferential treatment and unfair advantages.

Recognising the challenge of local taxation, the government launched two important actions in this area. Both initiatives are seen as important reforms and encouraging steps in the process of the expected further reforms of the local taxation system. Firstly, the laws on administrative fees and on local communal fees, adopted in March 2019, aim to simplify, restructure and reduce some of the local fees and charges. Some 7% of administrative fees have been abolished, another 11% reduced and 9 out of 12 legal bases for setting local communal fees have been banned, while maximum caps for fees have been introduced for the remaining 3 legal bases. This was the first effort in years to simplify and harmonise business taxation. Secondly, in 2020, in cooperation with business organisations represented in the Competitiveness Council, the government launched the register of fiscal and para-fiscal charges. The register features some 2030 levies and 580 different regulations affecting the financial obligations of businesses.

The proposed ERP *reform measure 8 – "Establishing the register of fiscal and para-fiscal charges"* - relates to the establishment and further development of the register that would consolidate fiscal and para-fiscal charges at the national and local levels. The updating and expansion of the register's functions are among the policy conditions in the Memorandum of Understanding (MoU) in the context of the macro-financial assistance granted to Montenegro during the COVID-19 crisis. The register is expected to become operational by March 2021. Introducing the register of fiscal and para-fiscal charges should address one of the important bottlenecks in the regulatory environment and increase transparency, though it is difficult to assess its impact on the competitiveness of the Montenegrin economy. The measure appears well drafted and clear.

The development of transactional electronic government services is a way to support Montenegro's regulatory environment. The digitalisation of the public sector can greatly enhance the business environment, in addition to the obvious gains in efficiency and transparency of relations between businesses and public authorities. The recent introduction of e-registration for businesses, ongoing efforts to set up the e-cadastre and the launch of e-procurement procedures are prime examples of the strong potential for change. The outbreak of the COVID-19 pandemic sped up some of the e-government projects (e-registration, launch of the online system for payments of administrative fees – NS-NAT). Implementation of e-government services could also lead to a significant reduction in possibilities for corruption and unequal treatment between different businesses.

Overall, the Montenegrin authorities appear committed to a number of actions to improve the efficiency and transparency of the regulatory environment through digitalisation and, despite the COVID-19 pandemic, managed to maintain the momentum of ongoing reforms and launch a new initiative. Development of the administrative processes and practices for an inclusive, business-oriented regulatory environment and the implementation of a business-centric culture among the central and local public administrations should remain the authorities' focus over the coming years. The accelerated digitalisation of the economy and the roll-out of new e-government services, partly due to COVID-19 developments, may contribute to addressing key challenges 2 and 3. An independent, efficient and effective judicial system will be key to creating and maintaining an attractive business environment.

Key challenge #3: Formalisation of the economy

The informal economy is estimated to account for around 30% of GDP. Informality has many different causes and is closely linked to other key challenges discussed in this document. Montenegro's sizeable informal sector is fuelled by deficiencies in the institutional and regulatory environment, weaknesses in the labour market, insufficient enforcement capacity of the public authorities, corruption and high tolerance for tax non-compliance. A further layer of complexity is caused by social and cultural factors, low awareness of the negative societal impacts of the informal economy and the high importance of extended family links and personal connections, as these often tend to increase the acceptance of, and willingness to engage in, informal and undeclared work, the informal economy and informal transactions.

Yet another dimension of informality could be traced to the Montenegrin diaspora and large remittances flowing into the country through formal and informal channels. These payments support family incomes, which could partly explain the very high level of cash transactions in the economy, and fuel a largely informal market in housing construction and renovation.

Policies aimed at reducing informality need to be broad and comprehensive due to the diverse causes of the phenomenon and the complex relationship between labour market structures, the institutional and regulatory environment, taxation, social policies and cultural factors. They need to create incentives and conditions for the formalisation of businesses and labour, apply strong disincentives and sanctions for those economic operators that remain in the informal sector and unfairly compete with legitimate businesses, and act decisively in order to close any gaps in the legal and institutional system that are subject to abuse. The authorities need to employ a wide spectrum of different instruments to combat informality effectively.

The high level of informality in the economy has far-reaching consequences. It hinders the efficient allocation of state and business resources, reduces the revenues of companies and of state and local budgets, slows down economic development, and has negative long-term outcomes for workers. In the Montenegrin context, the impact of unfair competition from the informal sector is particularly heavy on SMEs and microenterprises, which dominate the economy. The smallest companies, which constitute over 90% of Montenegrin businesses and serve the local market, perceive informal competition as the most costly obstacle to doing business. An equally important concern is that the costs of informality and corruption are higher for innovative companies, thus particularly hindering the development of the sectors of the economy based on knowledge and skills.

The presence of informality is also reflected in the labour market. Informal and undeclared work is estimated to represent some 30% of employment (UNDP). Employment is under-reported in the tourism sector and agriculture. The labour taxation system and structural challenges on the labour market may create disincentives for formal employment, with adverse implications for informal workers, the budget and the social security system. The new labour law, adopted at the end of 2019, is also expected to have a positive longer-term impact on informality and undeclared work by improving flexibility on the labour market and improving formal employment.

Reducing the scale of the informal economy has become a priority for the government. An action plan to combat the grey economy was initially adopted in 2017, and a Government Commission for the Suppression of the Grey Economy, chaired by the deputy prime minister for economic policy, was appointed in 2018 to coordinate different actions, encourage cooperation between government bodies and assist local authorities. The Commission included representatives of the Ministry of Finance, the tax administration, customs administration, police administration and the administration for inspection affairs. However, the action plan lacked the necessary scope and a comprehensive approach to informality, focusing instead on the rather narrow range of activities (such as checks and suppressive action on businesses via different inspection services, with the focus on the tourism sector) that could increase the revenues of the state budget.

A new attempt at reducing informality became a more prominent feature among government priorities following the adoption of the Joint Conclusions of the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey in May 2019 and of the ERP 2020-2022 in January 2020. Both documents acknowledged that the absence of a strategy and adequate monitoring tools of informality are key obstacles to preparing, implementing and assessing informality-targeted reform measures. Furthermore, they underlined the crucial importance of close cooperation between central and local authorities, as well as the involvement of legitimate businesses and social partners in efforts to reduce the informal economy.

The outbreak of the COVID-19 crisis in early 2020 stalled progress on reducing informality. The pandemic delayed virtually all activities scheduled under the structural reforms section of the ERP 2020-2022 and effectively put on hold any progress on implementing the informality-related aspects of the 2019 Joint Conclusions. This is particularly visible as regards the design of a strategy and the implementation of preventive actions and incentives to support formalisation. No progress was made in establishing monitoring tools to assess the informal economy and its dynamics. Contrary to expectations, a new law on inspections failed to address the issue of access to the private premises of natural persons suspected of informal activities, thus undermining the enforcement powers of the inspection services.

In addition, the economic measures, adopted by the government in response to the COVID-19 crisis, appear to have missed the opportunity to provide state support as an incentive to legalise informal businesses. On the flipside, they certainly provided valuable support to legally operating businesses and helped some of them to remain in the formal economy. At the same time, incentives provided for new employment may have attracted some of the employees or businesses that operated previously in the informal sector (among some 1000 new jobs that were created).

Due to these developments, the 2021-2023 ERP features a refocused *reform measure 6 – "Improving and implementing the measures for suppression of the informal economy"* - based largely on measure 8 of the ERP 2020-2022. The measure still does not envisage a full strategy on informality, accompanied by benchmarking tools allowing for the continuous assessment and reduction of the informal economy and leading to the design of concrete actions, as agreed in the 2019 Policy Guidance. Instead, it merely brings together previously proposed and unrealised activities, and a few concepts, which should become part of an Action Plan, to be developed in the second half of 2021. At the same time, the measure remains rather vague in terms of the concrete actions to be taken on the suppression of informal economy and on the incentives provided for legal entrepreneurship and employment. Activities are not set to start until 2022, with no concrete actions on informality foreseen for 2021. Further work is needed as regards the impact on social outcomes and the environment. Furthermore, as the only overarching measure on informality, it should be clearly linked to all other currently planned reform measures contributing to the reduction of informality. The Action Plan should give further consideration to preventive and educational action that specifically target micro and small enterprises.

The fight against the informal economy requires sustained efforts and planning in order to achieve tangible results. The government action plan to combat informality still requires updated and more concrete actions to better coordinate the efforts of the different institutions at central and local level and to address additional areas that could contribute to reducing informality, such as actions to incentivise the use of electronic payments. Other important aspects of informality that require the government's attention relate to closing the gaps and inconsistencies in the law that facilitate the development of informal activities. This can often be achieved through the digitalisation of public sector's services, a process that falls under the key challenge on strengthening the regulatory environment.

Specifically in relation to informality, the government launched three important initiatives in 2019. The first of these, carried out in 2020, was the introduction of new excise duty stamps supported by smartphone applications enabling the authenticity of excise goods to be verified online. The other two, which will continue into 2022 and 2023 respectively, were e-fiscalisation (supporting proper taxation of all cash register transactions) and the introduction of an integrated revenue management system in the tax administration (IRMS).

The latter two projects continue under the proposed ERP reform *measure 7 – "Suppression of informal economy by reforming tax administration"* - re-defined from the ERP 2020-2022. The measure is credible, though ambitious and appropriate in terms of promoting competitiveness and long-term growth potential. It is aimed at improving the efficiency of the Tax Administration and reducing costs for taxpayers, which should also help to reduce the informality in the economy. The restructuring of the Tax Administration into a Revenues Administration may cause some delays in the reform. Further work is needed as regards the effects the government expects to see on competitiveness (e.g. curbing of tax evasion, additional revenues to the budget, better planning of tax flows, level playing field for enterprises etc.). The cost of maintenance and necessary staff training for the IRMS, which are both key to successful and timely system roll-out, do not appear to be taken into account. Delays are likely if these factors are not factored in, given the current capacity of the tax administration and the high turnover of qualified staff. The description of the envisaged reform should go into more detail on how the control will be enforced and how various risks (e.g. resistance to endorsing the new system and paying taxes) will be mitigated. In particular, risks related to the cost of moving to the formal economy (which may be too high for some employers in the grey area) should be considered, together with possible incentive schemes to stimulate such a move.

In summary, the Montenegrin government has recognised the need to address the diverse causes of informality by initiating a number of reforms in the institutional and regulatory environment. Nonetheless, the progress achieved in these areas is, with some exceptions, difficult to measure, not least because of the outbreak of the COVID-19 crisis. Many of the actions described are yet to be implemented, some necessary legal changes are still to be adopted and more ambitious reform measures would be welcome. At the same time, reducing unfair competition and informality is heavily dependent on the successful implementation of reforms to the labour market and the regulatory environment, as these address some of the pertinent causes of informality. The impact of the changes that have been made needs to be sustained by proper and steadfast implementation of ongoing reforms over the coming years. The determination of the public authorities to enforce the new rules through administrative and judicial means will play an equally important role in the process.

Box: Monitoring performance in light of the European Pillar of Social Rights

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 key principles and rights concerning equal opportunities and access to the labour market, fair working conditions, and social protection and inclusion for the benefit of citizens in the EU. Since the 20 principles are essential for countries if they are to achieve fair and well-functioning labour markets and welfare systems, they are equally relevant for candidate countries and potential candidates. The new reinforced social dimension for the Western Balkans includes an increased focus on employment and social reforms through greater monitoring of relevant policies (EC, 2018). The Western Balkans Ministers' Declaration on improving social policy in the Western Balkans (6 November 2018) confirms that they will use the Pillar to guide the alignment of their labour markets and welfare systems with those of the EU.

Montenegro faces challenges with regard to a number of indicators of the Social Scoreboard[2] supporting the European Pillar of Social Rights. This is the case for equal opportunities and access to the labour market. While improvements in employment and unemployment rates have been maintained, structural challenges on the labour market persist, such as low activity, high long-term unemployment and the share of young people (15-24) not in employment, education or training (NEETs), as well as regional disparities. Some improvement as regards the gender employment gap has been noted between 2018 and 2019, even though the figure remains above the EU-27average (13.3 pps. in Montenegro v. 11.7 pps. in EU-27).

MONTENEGRO		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Better than EU average, improving
	Gender employment gap	Worse than EU average, improving
	Income quintile ratio (S80/S20)	Worse than EU average, improving
	At risk of poverty or social exclusion (in %)	Worse than EU average, improving
	Youth NEET (% of total population aged 15-24)	Worse than EU average, deteriorating
Dynamic labour markets and fair working conditions	Employment rate (% of population aged 20-64)	Worse than EU average, improving
	Unemployment rate (% of population aged 15-74)	Worse than EU average, improving
	GDHI per capita growth	N/A
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	Worse than EU average, deteriorating
	Children aged less than 3 years in formal childcare	Better than EU average, improving
	Self-reported unmet need for medical care	Worse than EU average, deteriorating
	Individuals' level of digital skills	N/A

High youth unemployment, a high share of the low-skilled in inactivity, coupled with a high incidence of undeclared work, point to weak transitions within and into employment. The adoption of the new labour law aimed at increasing labour market flexibility and contributing to the reduction of undeclared work, though effects are yet to be seen. Skills mismatches and weak provision of adult learning affect school-to-work transitions and result in insufficient adaptability of workers to find appropriate and sustainable employment.

Employment remains the best way out of poverty. The social protection system is not well equipped to target and assist those in need. In addition, it is insufficiently linked to labour market activation to encourage and facilitate employment. The country's demographic structure puts pressure on both the labour market and the pension system, reformed in 2020, and puts even greater pressure on its sustainability.

Collection of timely and reliable data needs to be sustained and strengthened. The results of the first Statistics on Income and Living Conditions (SILC) survey from 2018 were updated in 2019 and 2020. Efforts should continue to bring the employment and social statistics even further into line with EU standards and they should be systematically sent to Eurostat.

---

[2] The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance (https://ec.europa.eu/eurostat/web/european-pillar-of-social-rights/indicators/social-scoreboard-indicators). The indicators are also compared for the Western Balkans and Turkey, with one small adjustment in the age bracket for the unemployment rate (reducing the upper age limit to 64 instead of 74) for Albania and Kosovo* due to data availability. The assessment includes the country's performance in relation to the EU-27 average (performing worse/better/around the EU-27 average; generally 2019 data are used for this comparison) and a review of the trend for the indicator based on the latest available three-year period for the country (improving/deteriorating/no change). Data from 2017-2019 are used and can be found in Annex A.

5. Overview of the implementation of the policy guidance adopted at the Economic and Financial Dialogue in 2020

Overall: Partial implementation (57.4%)[3]	
2020 policy guidance	**Summary assessment**
PG 1: Use fiscal policy to mitigate the crisis-induced impact on growth and employment.	There was **substantial implementation** of PG 1: 1) **Substantial implementation:** The government adopted four packages of socio-economic measures to support citizens and the economy, including tax deferrals as well as wage and loan subsidies to sustain the economy and employment. To broaden fiscal space further, the government secured sufficient financing to cover 2021 and part of 2022 budgets' needs well in advance, borrowing the equivalent of 17.5% of GDP in December 2020.
While allowing for due reinforcement of healthcare spending during the crisis, reinforce the medium-term sustainability of public finances by limiting overall spending on wages, also by taking concrete steps towards implementing the public administration optimisation plan.	2) **Limited implementation:** Healthcare workers received a 15% pay rise in March and April 2020. Salaries of public administration upper categories (A and B) were decreased by 50% in May and June 2020. So far, the public administration optimisation plan failed to achieve a meaningful permanent reduction of staff. Overall, in 2020, gross wages increased by 4.3% y-o-y. The ERP announces continuing the medium-term optimisation strategy to reduce public spending.
Establish a fully-fledged centralised public sector employment payroll system.	3) **Substantial implementation:** Completion of this project is estimated at 75%. IT equipment was installed in November 2020, and the interface connecting the system with Human Resources Administration data, enabling real-time exchange between the two systems, is in the final stage. The Ministry of Finance and Social Welfare started gradually training and migrating all budget units to the new system.
PG 2: To support economic recovery, make sound cost-benefit analysis an integral part of public investment management.	There was substantial **implementation** of PG 2: 1) **Partial implementation:** To advance the public investment management process, a new Decision on Development of the Capital Budget and Setting of and Evaluating Criteria for Selection of Capital Projects was adopted; enabling the preparation of the capital budget for 2020. The government adopted a decision to carry out Public Investment Management Assessment (PIMA). Activities were initiated and meetings held with representatives of the IMF and experts who will conduct the PIMA assessment.

[3] For a detailed description of the methodology used to assess policy guidance implementation, see Section 1.3 of the Commission's Overview and Country Assessments of the 2017 Economic Reform Programmes available at https://ec.europa.eu/info/publications/economy-finance/2017-economic-reform-programmes-commissions-overview-and-country-assessments_en.

Take steps towards the establishment of a fiscal council, following consultation of the related options paper with stakeholders, including the EU. Introduce the electronic fiscal invoice system (e-fiscalisation).	2) **Substantial implementation:** The options paper for establishment of a fiscal council was adopted and shared with the Commission. Draft amendments to the Law on Budget and Fiscal Responsibility were also prepared in order to create the formal conditions for setting up a fiscal council. 3) **Full implementation:** The system has been fully operational since Jan 2021.
PG 3: Closely monitor financial stability challenges arising as a result of the coronavirus pandemic and take appropriate action if needed, while developing further the supervisory capacity of the central bank. Identify and prioritise the removal of obstacles for the swift and successful resolution of non-performing debts, particularly by improving legal, judicial and institutional procedures. Ensure the participation of all banks in the asset quality review on equal terms, transparently publish its findings and promptly take remedial action where needed.	There was **substantial implementation** of PG 3. 1) **Substantial implementation:** The central bank has taken forceful financial sector support measures to cushion the crisis impact including loan repayment moratoria and loan restructuring, and monitoring activities have been sound, including on the impact of the measures. There was some good progress in strengthening supervision, including the functioning of a professional Supervisory Committee to support central bank decision making and increasing off-site supervision capacity. The full impact of the crisis in particular on asset quality is yet to become visible, likely requiring further adjustments. 2) **Partial implementation:** The central bank has continued NPL monitoring and gave recommendations to the Government on ways to further improving the NPL resolution framework. Further progress requires inter-ministry work with Ministry of Justice and other key stakeholders on the legal and judicial framework to expedite NPL disposal. 3) **Substantial implementation:** An AQR has started with all banks participating, but progress was delayed by the pandemic.
PG 4: Ensure smooth and effective support to the private companies and their employees affected by the crisis, in particular micro, small and medium-sized enterprises and self-employed. Extend social protection coverage and provide incentives for businesses and employees in the informal economy sector to register and to facilitate their transfer to the formal economy.	There was **partial implementation** of PG 4. 1) **Partial implementation:** The government adopted four packages of measures aimed at supporting businesses and employees during the pandemic. The support included loans for SMEs, wage subsidies and job protection measures in the sectors most affected by the pandemic. Overall measures are in line with the guidance provided, however many supportive actions targeting companies were implemented only partially. **2) Limited implementation:** No measures specifically targeting the informal economy sector and providing social coverage to its vulnerable employees could be identified among the actions taken by the government. Other support measures, at the very least, provided disincentives for companies to move to the informal sector in the time of crisis. Incentives provided for new employment may have attracted some of the employees or businesses that operated previously in the informal sector (among some 1000 new jobs that were created).

In order to ensure a swift recovery, focus on simplifying tax legislation and reducing the diversity of para-fiscal charges affecting businesses.	3) **Partial implementation:** In relation to simplification of tax legislation, amendments to VAT Law were adopted in July 2020, which introduced minor facilitations for taxpayers. Some progress was achieved in the areas of electronic company registration and electronic payments of administration charges. The laws on administrative fees and local communal fees were implemented by more of the municipalities, while work on the register for fiscal and para-fiscal charges at central and local levels progressed on time.
PG 5: Maintain continuous dialogue with social partners, business organisations and civil society on all decisions taken in response to the COVID-19 pandemic. Provide an active feedback from this dialogue to the public domain. Ensure close cooperation between central and local authorities on all crisis mitigation and economic recovery measures, including through joint and coordinated actions.	There was **partial implementation** of PG 5. 1) **Substantial implementation**: Stakeholders were consulted on three out of the four packages adopted in response to the COVID-19 pandemic, with no major objections to the process from stakeholders. The dialogue with the business associations, social partners and civil society seemed to be continuous throughout the crisis. Feedback has been regularly provided to the public. 2) **Limited implementation:** Cooperation between central and local authorities was sporadic at best and on a case-by-case basis only. It would be difficult to identify examples of smooth and coordinated actions uniting central and local authorities.
PG 6: Take measures to preserve employment including by ensuring short-time work schemes and flexible working arrangements, as well as through increased provision of active labour market policies to facilitate transition to work and support workers at risk of job loss. Ensure adequate income support and social assistance for the unemployed, and for those at risk of poverty and of social exclusion. Strengthen the healthcare system's resilience and capacity to improve access and quality provision of health care services.	There was **partial implementation** of PG 6. 1) **Partial implementation**: The government has adopted four economic support packages, which, including through wage subsidies and support to businesses, have endeavoured to preserve employment. Short-time work schemes and flexible working arrangements are planned to be introduced during 2021-2022. Active labour market policies have been continuously provided, but their provision has decreased due to the pandemic and no new measures have been introduced to facilitate transition to work. 2) **Partial implementation**: All four economic support packages included one-off payments to unemployed and/or vulnerable groups, reaching a large majority of the target population. Analysis as regards the adequacy of such income support is not available. 3) **Partial implementation**: Additional finances allocated, measures improving the administration and coordination of the healthcare system, as well as the provision of e-healthcare services have improved the healthcare system's ability to manage the COVID-19 crisis. At the same time, measures reviewing structural weaknesses in the system and consequent reform measures boosting the system's resilience and capacity to improve access and quality provision of health care services have yet to be adopted.

6. ASSESSMENT OF OTHER AREAS AND STRUCTURAL REFORM MEASURES INCLUDED IN THE 2020-2022 ERP

Research, development and innovation

Public and private investments in research, development and innovation (RDI) are low. Montenegro is a modest innovator (European Innovation Scoreboard 2020). The RDI sector suffers from a low number of researchers and weak links between academia, research institutes and business. Only 2.2% of Montenegrin MSMEs invest in R&D (compared to 22% at regional level) and over 90% of research staff are employed by the government and the higher education sector. With a rate of 0.50% of GDP invested in R&D (2018, last available data), Montenegro's spending represents just above one fifth of the EU-28 average (where spending amounted to 2.18% of GDP in 2018).

On the other hand, the adoption of a Smart Specialisation Strategy (S3) in June 2019, allows Montenegro to concentrate its scarce resources on thematic sectors for R&D as a basis to strengthen sectoral policies based on innovation. The areas of specialisation are agriculture and food processing, energy and sustainable environment, sustainable health tourism and ICT. Other measures supporting an innovative ecosystem include: (i) a programme of support to innovative start-ups and innovation initiatives through smaller-scale support schemes; (ii) support for pre-acceleration of start-ups; (iii) a collaborative grant scheme to engage young researchers and holders of PhDs and (iv) support for intensive education and training programmes for professionals in S3 fields. Two new centres of excellence (covering food science and biomedical science) began operating in January 2020. Overall, statistics gathering in the R&D field remains an important issue to be addressed.

Measure 11: "Improvement of the programme framework for implementation of the Smart Specialisation Strategy of Montenegro"

A new measure that includes elements of R&D-related reforms from previous ERPs, notably of the ERP 2020. It is linked to other measures, targeting the development of MSMEs. Aligned with national strategic documents, the measure aims to optimise the framework of financial instruments and resources in support of S3 and is well justified, though rather ambitious. However, it appears output-based and prescriptive as to what grants it will distribute, providing little detail regarding the innovations, specializations and field of research on which it will focus. The indicators are designed in a similar manner. Values expressed in the expected impact on competitiveness can well serve as indicators of the measure (spending on research, employment rates, etc). The high risks indicated for the implementation call into question the timeline and feasibility of this reform.

Measure 12: "Improvement of legislative and institutional framework for the development of research, innovation an digital transformation of sectors"

Continuation of measure 12 of the ERP 2020. The improvement of the legislative framework started with the adoption of two laws – the Law on Innovation Activities and the Law on Incentives for Research and Innovation Development - that provide the basic legislative framework for innovation. New activities include the development of five secondary laws, the establishment of an integrated information system and of the Innovation Fund. The measure is based on the national Strategy of the Scientific and Research Activity 2017-2021 and is designed in light of the EU Innovation Agenda for Western Balkans and the EU Communication on European Research Area. It is also aligned with the Smart Specialisation Strategy. The measure is appropriate and credible. However, the activities planned for 2021, 2022 and 2023 may be too ambitious to be implemented. The basis for the calculation of the expected costs is not quite clear.

Digital economy

Access to broadband networks is seen as key to the further digitalisation of the economy. It is also fundamental to the implementation of the smart specialisation strategy in the ICT industry. Montenegro's information society strategy set a number of ambitious goals, to be achieved by 2020. As a result, by September 2020, some 93% of Montenegrin households were in the area of availability of high-speed broadband connection (defined as 30 Mbit/s). However, the actual penetration of high-speed broadband or better among households is much lower, reaching some 29% in 2020. Fixed broadband services, and in particular the optical fibre sector, show strong growth, but mainly in the larger towns. Meanwhile 25% of households still had no internet access in 2019, despite its technical availability, with the figure increasing to 37% in rural areas. The process of mapping existing telecommunication infrastructure has been ongoing since 2018, but it only started in earnest in 2020. The legislative framework for high-speed broadband development is also yet to be adopted. Low population density increases the costs of private broadband deployment and discourages investment by existing private operators in less populated areas, resulting in slow connection speeds.

Measure 10: "Improvement of legislative-regulatory framework and further development of infrastructure for broadband internet connection"

This technical measure is repeated for the third consecutive year. Input indicates that no substantial progress was achieved during 2020. COVID-19 pandemic delayed the National Plan for development of the broadband internet connection and coverage of the population by next-generation access networks, as well as the planned legislative alignment on broadband internet cost reduction. However, the 2021 measure proposes an expanded scope, with the inclusion of the preparatory phase for a new Law on Electronic Communications (to be aligned with Directive (EU) 2018/1972) in the 2021 work plan. While the proposed measure is justified, the indicators need to be reworked (e.g. newly connected households in the isolated areas or outside cities, indicators on skills development and e-government services etc.). After progress is made on "classical" broadband development, including on infrastructure mapping (a prerequisite for installing the 5G network) the measure could possibly be expanded to reflect the planned rollout of the 5G network. Impact on competitiveness, society, labour and environment should be better elaborated.

Investment activity

Public and private investment growth is expected to see a substantial decline in 2020 due to the COVID-19 pandemic and the lack of fiscal space for major public investments. Public investments, which remained at record high levels in 2018-2019, are likely to slow even further with the completion of the first section of Bar-Boljare highway in 2021. Nonetheless, strategic investments in the priority sectors of the economy (transport, energy, agriculture and tourism) will continue at a sustainable pace. Smart specialisation sectors of environment other than energy and ICT do not yet have the rank of strategic priority for investments. Private investments focus mostly on hotel and tourism infrastructure in the coastal area. Efforts are being made to incentivise investment in the north of the country, including through the citizenship scheme, but so far, they have produced very few results.

Foreign direct investment slightly increased in 2019 and remains high in comparison with regional peers. The net inflow of foreign direct investment (FDI) into Montenegro rose to EUR 344.7 million in 2019, from EUR 322.5 million in the previous year. The FDI per capita indicator for the last 10 years averaged around 19% of GDP, while the EU contribution to FDI in Montenegro averaged 43% over the same period. FDI contributes significantly to Montenegro's current account deficit financing.

Trade performance

The trade deficit in goods remains at a record high, reaching 47% of GDP in 2019. The trade deficit in goods widened by 1.6% year on year in 2019. The export of goods remains modest due to low diversification and a predominance of low value added products and raw materials in its structure. Imports, meanwhile, are dominated by manufactured goods, construction materials, machinery, transport equipment and food. On the other side, the trade in services balance recorded another big surplus and a year-on-year increase of 8.5% by the end of 2019, driven mostly by tourism activities.

EU-27 Member States dominate both exports and imports, accounting for 37% and 47% of all trade in 2019. Serbia, Bosnia and Herzegovina and China are the main trade partners outside the EU, accounting for 19.2%, 6.3% and 8.5% of imports respectively and 26%, 7.2% and 4.2% of exports. Trade openness remains relatively high at 108.2%, while tariffs are low and non-tariff barriers relatively low, due to the EU accession process and WTO membership. There is significant potential for greater intra-regional trade within the Central European Free Trade Agreement (CEFTA) framework and with the EU, as trade preferences allowing for access to the EU market without customs duties apply for 98.6% of Montenegrin products. The Economic and Investment Plan for the Western Balkans and the development of a Common Regional Market have the potential to increase trade and enable competitiveness and growth.

Measure 13: "Implementation of measures to facilitate trade in goods and services in accordance with WTO obligations and CEFTA Additional Protocols 5 and 6"

This measure is repeated for the third year in a row, with the same milestones, targets and timelines. The focus is on trade facilitation, i.e. (i) reducing the time and cost of customs clearance procedures; and (ii) better coordination between the different administrative bodies involved, including the connection of information systems (between customs and different inspections). The reform is relevant and relies heavily on the EU funding (implementation of Additional Protocol 5 and Additional Protocol 6). Some activities planned for 2020 were partially implemented due to delays within the SEED+ project (electronic data exchange system between customs administration). This also remains a relevant potential risk to further implementation. Overall progress on this measure will depend on developments and delays of the regional integration. However, risks related to national activities, such as possible delays in the introduction of the New Computerised Transit System, should not be underestimated. The social outcome and environmental impact of this measure could be better developed, as already pointed out last year.

Energy

The energy market needs to improve its infrastructure and efficiency. Energy transmission losses amounted to over 17% of electricity consumption in 2017, five times higher than the EU average. The reliability of the electric power supply in rural areas also needs to improve. However, the use of renewable energy sources is high and increasing. In 2017, some 40% of the country's electricity production (significantly above the EU average of 31.8% in 2017) came from renewable sources, mostly hydropower and biomass. Energy legislation is aligned with the third energy package for electricity and gas, but a natural gas market does not exist because there is no access to gas pipelines. The wholesale and retail electricity markets in Montenegro are open for competition, but new providers are yet to come.

Energy production and cross-border trade in energy should significantly increase in over the coming years. The interconnection of the electricity network with Italy was established in November 2019 and contributed to the completion of the national electricity transmission ring, strengthening the robustness of electricity supply and setting the basis for extending it to neighbouring countries. Several wind, solar and hydropower projects are under way.

Measure 1: "Financial support to the households enabling them to adopt energy efficiency measures and generate electricity for their own needs"

This new measure appears credible and justified. However, there are some doubts regarding its timelines (possibility/reluctance of citizens to invest currently, availability of the loan scheme for less well-off households) and the feasibility of this measure under budget for 2021 and 2022, due to the present economic situation under COVID-19. The risk analysis needs to be reviewed to take account of these factors. The analysis does not consider the clear risk that the delay in approving the state budget will cause delays in public competition procedures for the selection of banks to service the programme. The current description does not establish proper baselines and indicators are unrealistic. Furthermore the description does not provide any links to national Smart Specialisation Strategy, in which 'renewable energy sources and energy efficiency' are a priority area.

Transport

Montenegro's long-term sustainable economic development would benefit greatly from further developing and improving transport infrastructure and from ensuring a good connection with European transport corridors. The country's geographical situation makes better transport links with the wider region and the rest of Europe particularly important. Montenegro scores very low on road, airport and shipping connectivity. The number of road accident fatalities (per 1 million inhabitants) is almost twice the EU average and is increasing.

Following the expected completion of the first section of the Bar-Boljare highway in 2021, major reflection is needed before any further section is attempted. The results of the ongoing cost-benefit analysis, financed by the EU, and the impact on the public debt should be carefully examined. There is slow progress on improving and modernising sections of the road and rail networks, while ensuring sufficient funding for the current maintenance of rail and road network remains an issue. Further steps are also needed to open the rail market up to competition. The ongoing tender for a concession to maintain and upgrade the country's two main airports in Podgorica and Tivat could address the issue of limited accessibility by air transport over the next few years, once the effects of COVID-19 crisis on air transport have been reversed. While Montenegro Airlines went bankrupt in December 2020, a new national airline '2 Montenegro' is expected to start operations in 2022. The efficiency of border-crossing procedures (and customs) is a related area where improvements are needed.

Agriculture

Significant investments are planned to develop the agricultural sector (including forestry and fishery), which currently faces a number of challenges. The government is expecting to invest EUR 75 million to facilitate progressive modernisation over the next 3 years, mainly from EU funds. Agricultural land in use accounts for 18% of the country's territory, although 94% of those areas are pastures and meadows. Agriculture is the main or partial source of income for close to 50 000 households. With the exception of a few larger agricultural enterprises, agricultural production is fragmented and characterised by small, often family-run parcels with high production costs, limited organisation and a lack of adequate equipment. The problem is exacerbated by limited skills and poor access to credit and markets.

Montenegro is a net importer of food, reaching EUR 500 million annually in imports and only EUR 50 million in exports. Wine tops the exports list. Neighbouring Western Balkan countries, Serbia in particular, account for over 80% of the trade in agricultural goods. The Stabilisation and Association Agreement gives Montenegro unrestricted access to the EU market for nearly all agricultural products. However, agricultural exports to the EU remain mostly unexploited due to the limited scale of agricultural production and because of the need to meet the EU veterinary and phytosanitary requirements.

Measure 2: "Supporting investments in the food manufacturing sector with the aim of boosting competitiveness"

The measure is repeated for a third year in the ERP. As the agriculture and food production are a major sector in the Montenegrin economy, the reform is justified. The measure was also attuned to the Smart Specialisation Strategy. The description should clearly explain that IPARD funding ensures the financial feasibility of this measure. There are no indicators proposed for 2021 for Component I and II. Result indicators should report further on the success achieved by the entities supported (e.g. increase in profit, exports, increase in number of employees) and not on administrative outputs. The text fails to reflect adequately the major risks in the context of COVID-19 pandemic and its economic and social impact (e.g. projected decline in exports of agricultural products in 2020, consumer purchasing power and diminished market demand with the loss of tourism revenue, etc.). The project description, particularly the risk analysis framework, needs to be re-adjusted.

Industry

Montenegro's industrial base remains modest and hampered by low product diversification and low labour productivity. New investments in energy and aluminium production (the country's top exports) aim to improve the competitiveness of these sectors, but modernisation efforts in other areas are less pronounced. The production of higher value added products remains limited and local industry is characterised by low participation in European and global supply chains. The government's efforts focus on SME support and SME policy, a natural choice in a small economy. Industrial policy receives support from the Investment and Development Fund of Montenegro (IDF) among others, but access to finance still remains a significant obstacle for micro and small enterprises.

Measure 3: "Stimulating investments in manufacturing sector with the aim of boosting competitiveness"

The measure has been renamed, yet it is part of the ERP from 2016 and it continues to show the same deficiencies. Drafting quality and clarity has not improved in 5 years and the assessment remarks from previous years still apply; e.g. the measure still lacks details in the description of its scope and analysis, there is no specific outcome tied to the competiveness component, as observed last year, etc. The measure fails to focus on the smart specialisation industries, ICT and food production. Result indicators should be reworked, as they are not capturing changes at the beneficiary level (e.g. no link to employment, or to any increase of the GVA at the beneficiary company). Moreover, the impact of the measure on competitiveness remains overestimated, given the low level of budgetary commitment (EUR 1.3 million per year). Data on allocated grants for 2016-2019 period has been provided, but there is no reference to how the previously received subsidies affect companies' eligibility for for the programme lines. No evaluation of the measure has been conducted since its inception. The budgetary commitment in the text and table do not match (EUR 1.3 vs. 1.6 million) Risk analysis needs to be better developed.

Measure 5: "Boosting competitiveness of MSMEs and access to the new markets"

The measure is refocused from the ERP 2020 and based on the rolling programme for the Improvement of Competitiveness of the Economy, set in the context of COVID-19, with a more extensive analysis on the major bottlenecks in the MSME sector. The information on the evaluation of past programme lines is welcomed, but the figures do not prove or disprove the effectiveness of the programme, as the indicators used are general rather than beneficiary-oriented. Qualitative information is somewhat more helpful. Indicators are good, though a reference to competitiveness would be welcomed – e.g. the number of MSME employing innovative methods, newly digitalised MSMEs, the number of SMEs adopting international standards, new cooperation links created between SMEs domestically and abroad, etc. The target values for the proposed indicators seem unambitious. There are many risks in this area and the risk analysis needs to be much improved. The COSME guarantee fund programme seems to have been excluded from the measure this year although the agreement should have continued through 2021. Budget allocations seem adequate.

Services

Services were heavily affected by COVID-19 pandemic and are unlikely to recover fully before 2023. Services, particularly tourism services, are the country's main export and accounted for around 80% of total exports in 2019. The sector provided over 72% of GVA in 2019 and employed close to three quarters of the workforce. Retail and wholesale trade and tourism are the main contributors to GVA and employment in the services area; ICT, financial and professional services remain far less developed. Over 90% of the tourist capacity is concentrated in the coastal region. Spa and congress tourism are possible niches that could be exploited, which would also help to offset the high seasonality of the current tourism trends. Further diversification of the services sector beyond the current focus on tourism would reduce the economy's vulnerability to external factors such as the current health crisis, geopolitical risks, intense competition for tourism in the Mediterranean region and climate change.

Measure 4: "Sustainable tourism in the new reality"

The measure concerning the diversification of tourist products from the ERP 2020 became a component of much broader action intended to preserve the tourism industry hit by the COVID-19 crisis. The measure is broad and it contains an ambitious plan to include green growth and digitalisation components in the tourist offer under the new reality. The measure links appropriately with all strategic framework documents, though the reform reads like a compact presentation of a more comprehensive action document. However, after the initial ambitious plan for 2021, the measure has been downsized both in scope and in budget terms (from over EUR 100 million to EUR 0.5 million), focusing on initial activities regarding the development of green accommodation and the rollover of projects for diversified tourism products from previous years. The measure looks realistic, but its implementation will greatly depend on further developments in the health and economic fields. The result indicators would require some work to further develop additional indicators directly related to the expected impact (e.g. the number of businesses introducing digitalisation or green practices, increase of viable alternative businesses in the north, increase/recovery of employment rates in the tourism sector, etc.).

Education and skills

See analysis above in section 4 under key challenge #1.

Despite significant efforts to improve the quality and the labour market relevance of education, the system continues to perform poorly. The tertiary educational attainment rate of 30-34 year olds increased steadily to 36.8%, narrowing the gap with the EU average (40%). Montenegro continues to outperform both the Western Balkan region and the EU average (10.3%) when it comes to the rate of early school leavers, although the rate rose compared to 2018 to 5% in 2019. Access and participation in the formal education system is good, though the insufficient quality of education and training prevents it from being capitalised upon in the labour market. Past years saw a number of reforms aimed at improving the quality of the education system at all levels, but the results remain to be seen.

Employment and the labour market

See analysis above in section 4 under key challenge #1.

Social dialogue

While social partners were consulted on all but the first package of economic support measures adopted in response to the pandemic, the consistent involvement of social partners in decision-making remains relatively weak. Due to the pandemic, meetings of the Social Council have been interrupted, as has the negotiation of the general collective bargaining agreement following the adoption of the new Labour Law in 2019. Efforts were made to involve social partners in decision-making, but the effectiveness of social dialogue and the mainstreaming of the consultation of social partners across all relevant ministries and departments still needs to be improved.

Social protection and inclusion

See analysis above in section 4 under key challenge #1.

The social situation in Montenegro has been stagnating after previous years of improvement. **Employment remains the best route out of poverty.** The at-risk-of-poverty-or-social-exclusion (AROPE) rate is lowest for employed persons (10.5% in 2019, below the 11.2% EU average) while the AROPE rate for those not employed is 39.9%. Activation measures coupled with targeted social assistance therefore remain key. Children are at the highest risk of poverty of all age groups. Short working lives and an increasing dependency ratio put pressure on the sustainability of the pension system, with additional pressure expected due to the new pension reform.

Reform Measure 18 – "Building and functioning of senior citizens' homes", continuing from previous years, though a welcome effort towards improving the social situation of the elderly, cannot, due to its scope, be considered a structural reform addressing the key social challenges and is too limited to have an impact on employment and competitiveness. The measure has been rolled over from past years.

Reform Measure 19 – "Reform of the national disability determination system" aims to establish a single body for disability determination and to digitalise its system linking it to the e-Social Card and e-Health Card. It should facilitate the evaluation of individual cases and budget forecasting. While the measure is essential for the reform of the social care system, it does not elaborate on the expected impact on beneficiaries, the adequacy and accessibility of their entitlements, or the sustainability of the system.

The healthcare system faces a number of challenges, which have been exacerbated by the COVID-19 pandemic. Few data are available on the healthcare system. While Montenegro ranked 68th out of 195 in the 2019 Global Health Security Index (GHSI), performing well overall, there are significant challenges related to low capacities (NTI and Johns Hopkins, 2019). Financing of the healthcare system is significantly below the EU average resulting in out-of-pocket payments amounting to around 26.7% in Montenegro, compared to an EU average of 16.3% (Master Plan Health 2015-2020). Health insurance coverages ranges from 99.3% (age 65 or over) to 81.3% (18 to 24) (CeMI, 2017). The rate of self-reported unmet medical needs has increased to 3.1% in 2019, above the EU average of 2%. The government adopted a Strategy for Improving the Quality of Health Care and Patient Safety (2019-2023) in 2019, focusing on improving and monitoring the quality of health care.

Reform measure 20 – "Use of telemedicine services in Montenegro through the establishment of the information system for telemedicine and development of Health" is relevant in the context of the COVID-19 pandemic, but it lacks the perspective of a holistic overview of the weaknesses of the healthcare system, including its availability, accessibility and affordability. Furthermore, its feasibility is questionable in terms of the absence of preconditions for its implementation across rural areas.

ANNEX A: OVERVIEW OF THE MAIN INDICATORS PER AREA/SECTOR OF THE ECONOMY

Area/Sector	2016	2017	2018	2019	EU-27 Average (2019 or most recent year)
Energy					
Energy imports dependency (%)	34.9%	40.9%	30.9%	N/A	60.62%
Energy intensity: Kilograms of oil equivalent (KGOE) per thousand Euro	260.69	260.73	260.44	N/A	112.92
Share of renewable energy sources (RES) in final energy consumption (%)	41.55%	39.71%	38.80%	37.37%	19.73%
Transport					
Railway Network Density (meters of line per km^2 of land area)	18.1 [w]	18.1 [w]	18.1 [w]	18.1 [w]	49.0 (2018)
Motorization rate (Passenger cars per 1000 inhabitants)	297 [w]	310.6 [w]	331.7 [w]	350 [w]	519 (2018)
Agriculture					
Share of gross value added (Agriculture, Forestry and Fishing)	9.0%	8.4%	8.2%	7.9%	1.8%
Share of employment (Agriculture, Forestry and Fishing)	7.8%	7.9%	8.0%	7.1%	4.3%
Utilised agricultural area (% of total land area)	18.4% [w]	18.6% [w]	18.6% [w]	N/A	40.0% (2017)
Industry					
Share of gross value added (except construction)	12.2%	11.3%	12.5%	11.9%	19.7%
Contribution to employment (% of total employment)	9.9%	9.5%	9.9%	9.5%	18.1%
Services					
Share of gross value added	72.1%	73.4%	72.3%	72.3%	73.0%
Contribution to employment (% of total employment)	74.7%	75.0%	73.1%	73.4%	70.8%

Business Environment					
Rank in WB Doing Business (Source: World Bank)	48	51	42	50	N/A
Rank in Global Competitiveness Index (Source: World Economic Forum)	70	77	71	73	N/A
Estimated share of informal economy in GDP (as % of GDP) (Source: IMF)	Up to 37.2%	25% to 33%	N/A	N/A	N/A

Research, Development and Innovation					
R&D intensity of GDP (R&D expenditure as % of GDP)	0.32%	0.35%	0.50%	N/A	2.20%
R&D expenditure – EUR per inhabitant	20.60€	24.10€	37.7€	N/A	656.5€
Digital Economy					
Percentage of households who have internet access at home	69.8% [w]	71%	72%	74%	86%
Share of total population using internet in the three months prior to the survey [NB: population 16-74]	69.9% [w]	71.3% [w]	71.5% [w]	73.5% [w]	85%
Trade					
Export of goods and services (as % of GDP)	40.6%	41.1%	42.9%	43.7%	49.4%
Import of goods and services (as % of GDP)	63.1%	64.5%	66.7%	64.8%	45.7%
Trade balance (as % of GDP)	-43.9%	-44.9%	-46.2%	-44.1%	N/A

Education and Skills					
Early leavers from education and training (% of population aged 18-24)	5.5%	5.4%	4.6%	5.0%	10.2%
Youth NEET (% of population aged 15-24)	18.4%	16.7%	16.2%	17.3%	10.1%
Formal child care - children aged less than 3 years (% of total)	28.9% w	32.89% w	34.13% w	37.21% w	35.3%
Individuals' level of digital skills (% of individuals aged 16-74 who have basic or above basic overall digital skills by sex)	N/A	50%	N/A	N/A	56%
Employment					
Employment Rate (% of population aged 20-64)	57.1%	58.2%	59.8%	60.8%	73.1%
Unemployment rate (% of labour force aged 15-74)	17.8%	16.1%	15.2%	15.2%	6.7%
Gender employment gap (Percentage points difference between the employment rates of men and women aged 20-64)	11.7 pps.	13.8 pps.	13.8 pps.	13.3 pps.	11.7 pps.
Social Protection System					
% of population at risk of poverty or social exclusion	34.6%	33.7%	31.4%	30.5%	20.9%
Impact of social transfers (Other than pensions) on poverty reduction	17.24%	24.84%	23.72%	16.95%	32.38%
Self-reported unmet need for medical care (of people over 16)	2.7%	2.7%	2.3%	3.1%	1.7%
Income quintile share ratio S80/S20 for disposable income by sex and age group (Comparison ratio of total income received by the 20% with the highest income to that received by the 20% with the lowest income)	7.38	7.57	7.37	6.72	4.99

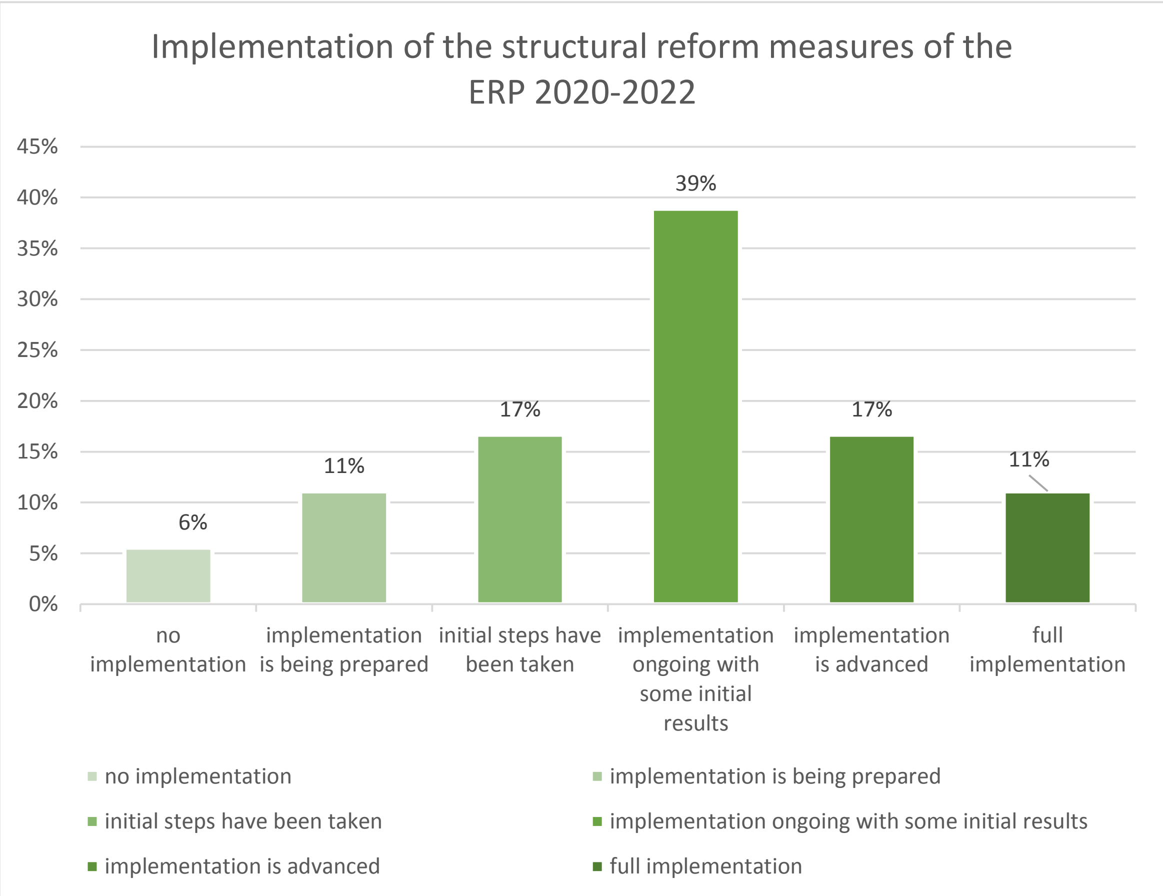
w: *data supplied by and under the responsibility of the national statistical authority and published on an "as is" basis and without any assurance as regards their quality and adherence to EU statistical methodology'*

Source of data in Annex A: EUROSTAT, unless otherwise indicated

ANNEX B: PROGRESS WITH STRUCTURAL REFORM MEASURES FROM 2020-2022 ERP

There was very moderate progress on implementing the measures in 2020, with an average score of 2.97 out of 5. Reporting on the structural reform measures from 2020 is often insufficient, missing or not against the set indicators, while the scoring of the implementation stage appears inflated. Information provided on some reforms was scarce to the point that scoring is only tenuous for some of the reforms and should be taken with caution. Downward adjustment to the scoring was made for six of the reforms, based on the description of the implementation and explanations covered by the table, and on the Commission's own research.

Implementation has been stronger for some measures, such as measure 7 on the introduction of electronic public procurement system and measure 10 on support to micro, small and medium-sized enterprises sector. Implementation has been weaker for most other measures, such as measure 3 on support to technological modernisation of the manufacturing industry and measure 12 on enhancement of legislative and institutional framework for innovation. Implementation was particularly weak for measures 1 and 8 – on enhancement of ownership and managerial structure at electric power companies with state dominant ownership and on enhancement and implementation of measures for suppression of informal economy.



ANNEX C: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The 2021-2023 Economic Reform Programme (ERP) of Montenegro was submitted with a significant delay. Instead, the authorities made an effort to provide informally parts of a draft ERP in February, and supplementary elements, including some macroeconomic and fiscal projections, in March. The ERP was formally adopted by the government on 1 April 2021, and transmitted to the Commission the same day. However, the latter submission and lack of statistical tables hindered the elaboration of a full, comprehensive and detailed assessment of the Montenegrin macroeconomic and fiscal situation and of its programme of structural reforms.

Inter-ministerial coordination

The preparation of the 2021 ERP was centrally coordinated by the Office of the Prime Minister and the Ministry of Finance. An inter-ministerial working group involved all relevant ministries. The high-level Competitiveness Council, chaired by the Prime Minister, continued to monitor the implementation of the ERP structural reform measures and the jointly agreed policy guidance.

Stakeholder consultation

The national ERP coordinator organised an initial consultation on the design of the ERP measures in September 2020. The European Commission was not informed on any further consultations of the draft ERP before the partial submission of the document on 15 February.

Macro framework

The absence of detailed statistical tables and last minute changes to the macroeconomic scenario were major obstacles for its assessment. The programme presents a clear and concise picture of past developments, albeit not so detailed for those beyond 2020. Similarly, the programme reported on most of the relevant data until 2020. The partial submission received in February did include neither a description of risks to the baseline scenario nor an analysis of the prospects for the country's export performance and the country's price and cost competitiveness position. However, this information was supplemented later in March and completed beginning of April.

Fiscal framework

The absence of a budget was a major obstacle for an early assessment of the fiscal framework, in particular for developments beyond 2021. The programme provided a general description of the new government’s fiscal policy objectives as well as the main fiscal measures for 2021. However, medium-term measures are scarce or vague, hampering any quantitative estimation of the impact of fiscal policy measures. Further efforts are also required to ensure the fiscal data are compatible with ESA 2010 as well as to complete fiscal notification reports.

Structural reforms

The structural reform parts follow the guidance note. A dedicated section of the ERP provides information on the implementation of the policy guidance for 2020. Reporting on the structural reform measures from 2020 is often insufficient, vague and not against the set indicators, while the scoring of the implementation stage appears inflated. The number of reform measures in the 2021-2023 ERP is limited to 20 and the page limit is respected. The structure of the reform measures is mostly good in terms of scope and timeline and in terms of budget for activities planned.

REFERENCES

Centre for Monitoring and Research (CeMI) (2017), *Health Care System and Patient's Rights in Montenegro*.

European Commission (2018), *Commission Communication on "A credible enlargement perspective for and enhanced EU engagement with the Western Balkans", COM(2018)65final.*

European Commission (2020), *Commission Communication on An Economic and Investment Plan for the Western Balkans*, *COM(2020) 641 final*

European Commission (2020), *2020 Communication on EU Enlargement Policy, COM(2020) 660 final* and *2020 Montenegro Report, SWD(2020) 353 final*

European Training Foundation (ETF) and International Labour Organization (ILO) (2020), *Dual Education in Montenegro: Practical training in three-year educational programmes*.

European Training Foundation (ETF) (2019), *Skills mismatch measurement in Montenegro.*

Government of Montenegro, *Economic Reform Programme 2020-2022 and Economic Reform Programme 2021-2023 (partial submission).*

International Labour Organization (2019), *Decent Work Country Programme 2019-2021: Montenegro.*

Master Plan of the Development of Health System in Montenegro 2015-2020 (Master Plan Health 2015-2020).

Milorad Katnic and Colin C. Williams, Employment and Social Affairs Platform – ESAP (2018), *Diagnostic Report on Undeclared Work in Montenegro.*

Montenegrin Employers Federation (2014), *Informal economy in Montenegro Report.*

Montenegrin Foreign Investors Council (2020), *White Book 2019.*

Nuclear Threat Initiative (NTI) and Johns Hopkins Center for Health Security (2019), *Global Health Security Index: Building Collective Action and Accountability.*

Pension and Disability Fund of Montenegro (2018), *Statistics.*

UNDP National Human Development Report (2016), *Informal work: from challenges to solutions.*

United Nations Development Programme, UNDP (2016), *National Human Development Report 2016 - Informal work: from challenges to solutions.*

The World Bank Group, *DataBank.*

World Bank (2017), *Revving Up the Engines of Growth and Prosperity in the Western Balkans.*

World Bank (2020), *Doing Business Report.*

World Economic Forum, *The Global Competitiveness Report 2020.*

WTO, *Country profile – Montenegro.*