Report No. 160404-ME

DOCUMENT OF

THE WORLD BANK GROUP

Montenegro Systematic Country Diagnostic Update

June 2021

Europe and Central Asia Region

Table of Contents

Acknowledgements

This report was prepared by a World Bank Group team led by Milan Lakicevic, Trang Van Nguyen, and Marc Schiffbauer, and consisting of: Denis Mesihovic, Dragana Varezic (country office); Jeren Kabayeva, Silvia Mauri (agriculture); Paul Scott Prettitore, Olivera Jordanovic (land); Frank Van Woerden, Klas Sander (environment and climate change); James Gresham, Bojana Naceva, Nathalie Lahire (education); Pedzi Makumbe (energy and extractives); Alper Ahmet Oguz, Dusko Vasiljevic (finance and private sector development); Ana Maria Oviedo (gender); Mediha Agar, Aleksandar Crnomarkovic, May Olalia, Srdjan Svircev, Orjana Ibrahimi (governance); Sevil Kamalovna Salakhutdinova (health, nutrition, and population); Gonzalo Javier Reyes Hartley, Zoran Anusic (social protection and labor); Marc Schiffbauer, Milan Lakicevic (macroeconomics, trade, and investment), Trang Van Nguyen, Carlos Ospino (poverty); Svetlana Vukanovic; Elena Lungu (transport); Natalija Gelvanovska (Digital Development); Axel Baeumler (urban); Roxanne Hakim, Bekim Ymeri, Ifeta Smajic (social); Berina Uwimbabazi, Igor Palandžić (water); Lada Busevac, Kazumasa Oba, Levent Karadayi (IFC); and Olanrewaju Malik Kassim (MIGA).

The report was prepared under the overall guidance of Linda Van Gelder (Regional Director, Western Balkans), Emanuel Salinas Munoz (Country Manager), Jasmin Chakeri (Practice Manager), Salman Zaidi (Practice Manager), and Ary Naim (Regional Manager, IFC). The team would like to thank Enrique Blanco (Lead Economist), Jamele Rigolini (Program Leader), and Simon Ellis (Program Leader) for their advice throughout the preparation of the report. The team is grateful for comments received from the peer reviewers, Javier E. Baez, Simon Davies, and Marco Hernandez. The report benefited from several rounds of discussions held within the Montenegro country team as well as in-country consultations with the Government of Montenegro, the private sector, academic and think tanks, the international community, and civil society organizations. The team would like to thank Dragana Varezic and Armanda Carcani for their support in the preparation of the report.

1. Introduction

1. **Strong boom and bust cycles and Montenegro's vulnerability to these fluctuations are a critical obstacle to greater prosperity and opportunities for its citizens.** Montenegro is a small, open, and upper-middle-income economy that aspires to join the European Union (EU) and reach European prosperity. In the past fifteen years, strong boom periods fueled by temporary construction booms, reinforced by tax incentives and public spending, were followed by bust periods correcting overheated markets that have emerged from the macro-financial imbalances. These strong boom-bust cycles have led to macro-financial instability, temporary gains followed by reversals in social progress, and lack of adherence to long-term policy planning and resource management. These costly fluctuations and their associated vulnerabilities are a symptom of weak progress in aligning the quality of public institutions with EU standards to ensure consistent implementation of laws and regulation and safeguard sustainable and inclusive development.
2. **Montenegro's vulnerability to boom-bust cycles was already emphasized as a key development challenge in the previous Systematic Country Diagnostic (SCD).**[1] In 2015, Montenegro was coming out of the bust following the global financial crisis and a sudden stop in foreign investment, with high public debt, high unemployment, and household income only starting to recover. The 2015 SCD argued that Montenegro needed to manage volatility and strengthen resilience, address unemployment and inactivity, strengthen the private sector, and improve governance and institutional capacity. It also identified the importance of increasing access to opportunities, including for vulnerable groups, and strengthening social protection to raise income for most and safeguard citizens against shocks. And it highlighted that, with a heavy dependence on tourism, Montenegro needs to safeguard against environmental risks and protect natural resources.
3. **Several social and economic indicators improved during the period of high economic growth from 2015 to 2019 supported by a construction boom based on large public and private investments in transport, energy, and tourism.** Table 1 summarizes the key progress since the 2015 SCD. Economic growth of 4 percent (annualized 2015-2019) was fueled by the large public spending on the Bar-Boljare highway and private investments in energy and tourism, the latter concentrated in few prestigious real estate projects. Gradual fiscal consolidation reduced the general government deficit from 5.7 percent of GDP in 2017 to 2.7 percent in 2019, but public debt continued rising to almost 80 percent of GDP. The financial sector has demonstrated stability as the share of non-performing loans (NPL) dropped from 15 percent in 2015 to just over 5 percent in 2019, while private-sector credit, especially to households, has grown almost uninterruptedly since 2016. From 2015 to 2019, Montenegro created around 22,100 net new jobs. The unemployment rate among people aged 15 and above declined from 17.5 percent in 2015 to a historic low of 15.1 percent in 2019, while the employment rate increased from a low base of 44 percent to 49 percent. As a result, the poverty rate, measured as income per capita below US$5.5/day in revised 2011 purchasing power parity (PPP), fell from 20 percent in 2013 to 16 percent in 2017. Rural and low-income households were able to benefit from this boom period. The income of the poorest 40 percent grew by an annualized average of 4.7 percent between 2013 and 2017, higher than the income growth of 3.0 percent for the whole population. These positive developments are being reversed in the COVID-19 crisis.
4. **But the temporary construction boom based on few prestigious megaprojects also bolstered Montenegro's vulnerabilities—it elevated macro-financial imbalances, did not create enough good jobs, discouraged the enforcement of environmental standards when competing with strategic**

investment, and created a narrow group of primary beneficiaries reinforcing vested interests. Montenegro's growth strategy has been based to a large extent on a few large investment projects triggering construction booms. The 2015-2019 boom created jobs in the low-wage construction, tourism, and trade sectors, but many of these new jobs were temporary or seasonal. For example, the generous tax incentives for the construction and operation of luxury resorts has created few permanent skilled jobs or linkages with domestic suppliers and entrepreneurs as these have relied heavily on imported goods and services. Despite the historic low, Montenegro's unemployment rate remained high in 2019. But the growth strategy also created large fiscal and external imbalances: the fiscal deficit averaged 4.6 percent of GDP and a current account deficit (CAD) 15 percent of GDP during 2015-2019. And construction and tourism contributed to an environmental degradation as solid and water waste management and enforcement lag in coastal municipalities and plastic leakage into the Mediterranean Sea surged, posing a substantial threat to sustainability. The concentrated ownership structures of the recent large investments are also more likely to lead to conflicts of interests which can undermine the mandate of state institutions and legal enforcement, including of environmental legislation, and hinder the necessary reforms to address vulnerabilities. The latest boom cycle since 2015 started cooling off in 2019 and was brought to an abrupt halt by the COVID-19 pandemic.

5. **The COVID-19 pandemic has exposed and exacerbated these vulnerabilities.** Montenegro is among the hardest hit countries by COVID-19 in the world. The pandemic is having substantial impacts on economic growth, the labor market, the private sector—particularly tourism, which accounts for a quarter of Montenegro's GDP—and people's livelihoods. COVID-19 led to a surge in government debt and in the newly poor. It is projected to widen economic and social inequality since poor, marginalized, and vulnerable populations are disproportionally affected by the pandemic, including the long-term impacts on their human capital.[2] Crisis response measures have alleviated the social impact. But Montenegro's longstanding vulnerabilities prevented a stronger and more effective policy response as fiscal space has been largely exhausted, financial sector restructuring after the previous crisis has been incomplete, efficiency of social services including social protection mechanisms has been limited, and low private sector productivity and innovation impede a sustainable economic recovery.

6. **As a result of this unsustainable growth strategy, many of the constraints causing Montenegro's vulnerabilities and hindering sustained progress in shared prosperity remain relevant today and threaten its social contract, as well as its pristine natural assets.** Table 1 also highlights how many of the key issues identified in the 2015 SCD have not fundamentally changed. The country's fiscal space is largely exhausted as public debt exceeds 105 percent of GDP, the highest compared to its regional and aspirational peers. The continued focus on exclusive real estate investments in tourism had boosted growth temporarily but is limiting economic diversification and productivity spillovers to the domestic economy. Some improvements were made in the business environment, but issues remain related to institutional progress and the control of vested interests, such as inconsistent implementation of laws and regulation, the enforcement of competition and state aid policy, and an inefficient public administration and investment management, that hold back fair market competition and inclusive private sector development and job creation. High labor tax and structural labor market issues like high inactivity, informality, unemployment, skills mismatch, and disparities across groups further contribute to hindering economic opportunities and shared prosperity. Equity and efficiency of service delivery in education, health, and social protection remain a challenge, with fewer opportunities for Roma, women, the youth, and people living in rural and less developed areas. And

despite its dependence on tourism thanks to its pristine natural resources, Montenegro faces significant challenges in environmental sustainability, protection of natural assets (e.g., river system, coastal landscapes), and climate resilience. Addressing these vulnerabilities became imperative in the current crisis.

7. **Improving economic resilience is key to a sustainable recovery and a virtuous cycle of inclusive growth and poverty reduction in Montenegro.** This SCD Update focuses more sharply on the need to improve economic resilience, including by addressing the internal sources of Montenegro's vulnerabilities and the structural constraints holding back shared prosperity. The medium-term response to the COVID-19 crisis requires some shifting of the emphasis among the individual policy priorities previously identified, particularly more weights on those most critical for strengthening resilience and enabling a green, resilient, and inclusive recovery. The SCD Update uses the list of priorities identified in the 2015 SCD as a starting point and focuses on the most critical for resilience to prioritize among these policy messages.
8. **What would reducing vulnerabilities and improving economic resilience entail?** Figure 1 illustrates the organizing framework of the SCD Update. The first cornerstone of improving resilience is to address macroeconomic and financial sector vulnerabilities and raise domestic private sector productivity by removing constraints to firm entry, innovation, and strengthening the linkages between foreign investment and domestic services and supplies (especially in tourism). This would support the creation of well-paid formal sector jobs and lead to the diversification of investment and ownership structures, broadening the sources of and beneficiaries from growth. The second cornerstone requires making health, education, and social protection services more inclusive and efficient and further strengthening the incentives to work to help address high unemployment and inactivity. This will provide better opportunities for all Montenegrins to become healthy and productive individuals and share the benefits of economic growth. The third cornerstone is natural resource management and climate resilience, the basis of Montenegro's comparative advantage in tourism and clean energy. But, while legal frameworks have often been modernized in the EU harmonization process, limited progress and reversals in their implementation have undermined more tangible progress in these areas. Strengthening public institutions that enforce the rule of law and prioritize medium-term planning is thus the foundation for successfully implementing and sustaining reforms in all three areas. This includes safeguarding medium-term planning in public finance and social sectors, the enforcement of pro-market regulation and anticorruption mechanisms, and an efficient merit-based public administration. These areas are consistent with the issues examined in the 2015 SCD, and this update puts a stronger focus on public institutions that enforce these policies to build economic resilience, the key to more sustainable and inclusive development in Montenegro. This focus is fully aligned with the government program. The new government, formed in December 2020, has announced commitments to improve transparency, strengthen the rule of law, and reduce corruption.

Figure 1: Organizing framework

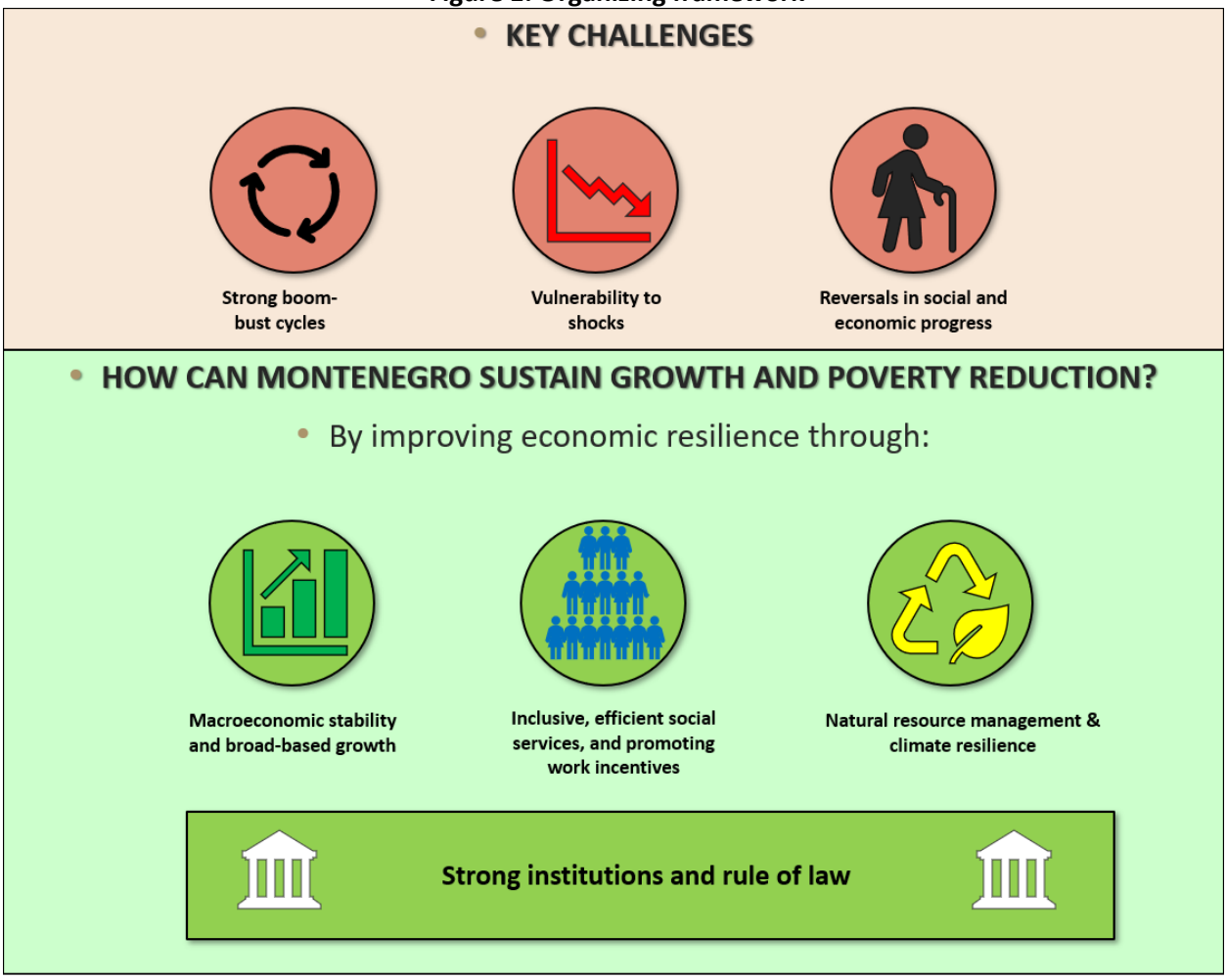


Table 1: Evolution of Key Issues Identified in the 2015 SCD

2015 SCD: Main findings	How these issues have evolved since
• Average annual growth 1.6% in 2008-2013, down from 5% in 2000-2008. • Progress in poverty reduction partly reversed after the crisis, consumption of the bottom 40 percent fell. • Boom/bust, small state vulnerabilities, closely follow business cycle in Europe. 2 transitions: from state to sovereign nation in 2006 and from controlled to market economy. Strengthening resilience to shocks and volatility should be at the center of Montenegro's strategy. • Montenegro needs to manage volatility and strengthen resilience, address unemployment and inactivity, strengthen the private sector, and improve governance and institutional capacity. EU accession process is an important anchor for reforms.	• GDP growth 4% (annualized 2015-2019). 2017-19 was period of fiscal consolidation, GDP growth (tourism, services), job creation and falling unemployment. With COVID-19, recession in 2020, unemployment back to 2014 levels. • Poverty declined, income of the bottom 40 percent increased before COVID-19. Poverty estimated to increase in 2020. • Montenegro still needs to manage volatility and strengthen resilience to shocks (both external and due to its development model). • Gradual fiscal consolidation reduced the general government deficit from 5.7% of GDP in 2017 to 3% in 2019 but widening in 2020 due to COVIDS-19. Debt rising. • Governance and institutions: selected improvements, but new and continuing problems around the rule of

• High unemployment (especially youth), low labor force participation (especially women) and high reservation wage, skill gaps hinder shared prosperity and growth. Addressing labor market issues is critical. • Increasing access to opportunities, including for vulnerable groups (youth, rural population) and strengthening the social protection system are necessary to help raise income for most and safeguard citizens against shocks. • Given heavy dependence on tourism, Montenegro needs to safeguard against environmental risks and protect natural resources.	law holding back progress. EU accession process remains an important anchor for reforms and strengthening economic resilience. • Little progress in economic diversification beyond high-end tourism • Some improvements in business environment, but deeper issues remain related to governance and market structure. • Infrastructure: Large investments in energy and transport but improvement in Public Investment Management needed to raise productivity. • Employment rising before COVID-19, but now reversing, and structural issues remain with still high inactivity, unemployment, informality, and disparities across groups. Skills gaps remain an issue for business. • Equity and efficiency of service delivery has largely remained a problem, despite some improvement. Now further challenged by Covid-19 crisis. Little progress in improving effectiveness of social protection. • Significant challenges in environmental sustainability, protection of natural assets (e.g. river system, coastal landscapes), and climate resilience. • Formation of a new coalition government by November 2020 following parliamentary elections in August. The new coalition majority has announced commitments to improve transparency, de-politicize the judiciary, and reduce corruption. Social and political risks relate to increased political polarization.

2. What drives Montenegro's boom-bust cycles and why they matter

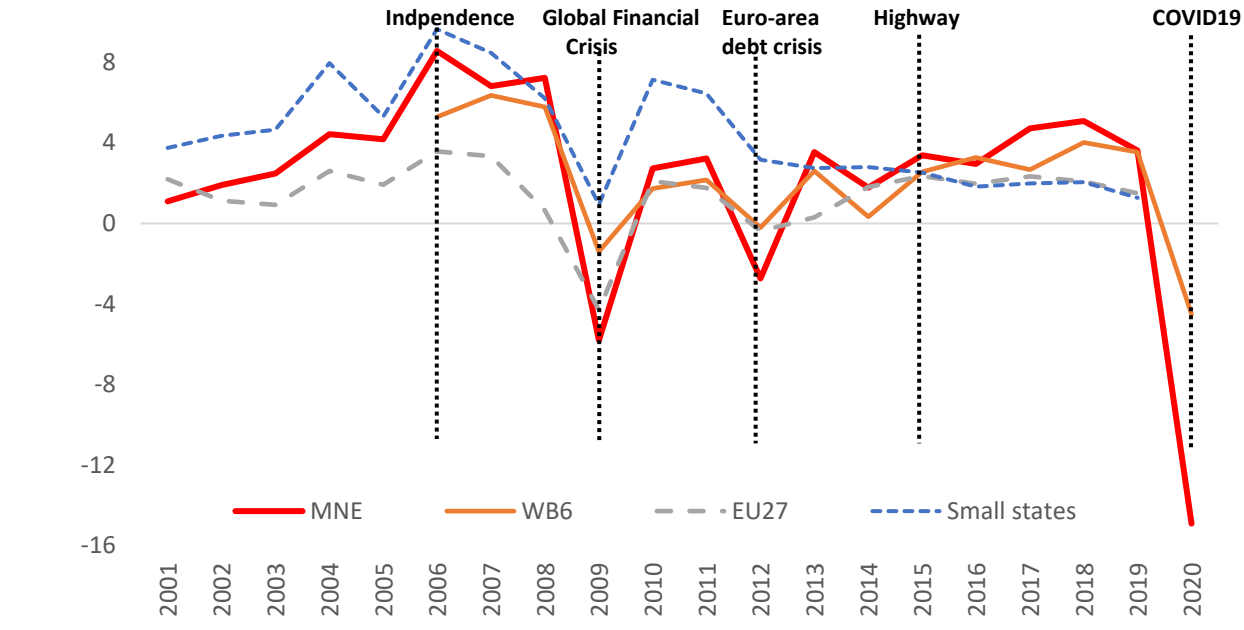
9. **Montenegro's development path is characterized by strong boom and bust cycles that, coupled with vulnerability to shocks, undermine more sustainable and inclusive development.** Since its independence in 2006, the country has seen three boom-bust periods with relatively large growth volatility (Figure 2). Following independence, Montenegro experienced an economic boom, driven by large capital inflows into real estate and tourism and rapid increase in consumption. The economy suffered from subsequent busts triggered by the global financial crisis (GFC) and another sudden stop in capital inflows after the Euro area debt crisis in 2012. In 2014, the government signed a highway construction contract of EUR809 million (23 percent of 2014 GDP), which initiated a new boom cycle (Annex 1: Bar Boljare Highway). In addition, Montenegro offered generous tax incentives for the construction of luxury resorts and hotels, fueling growth during the construction periods but creating few medium-term domestic linkages. These cycles have been associated with macroeconomic and financial sector instability in Montenegro: periods of high fiscal revenues and expenditures, ad-hoc social spending, soaring property prices, and banking profitability were followed by fiscal consolidation and financial sector vulnerabilities. High uncertainty associated with strong boom-bust cycles and inconsistent implementation of regulations discourage private sector entrepreneurship and innovation. Financing and planning uncertainty in social protection, health, education, and

infrastructure result in inefficient allocation of resources and suboptimal outcomes. Ultimately, these shortcomings are caused by governance challenges that favor policies focusing on short-term gains but reinforce Montenegro's vulnerabilities over the medium term.

2.1 Recent developments illustrate the recurring challenge of strong boom-bust cycles

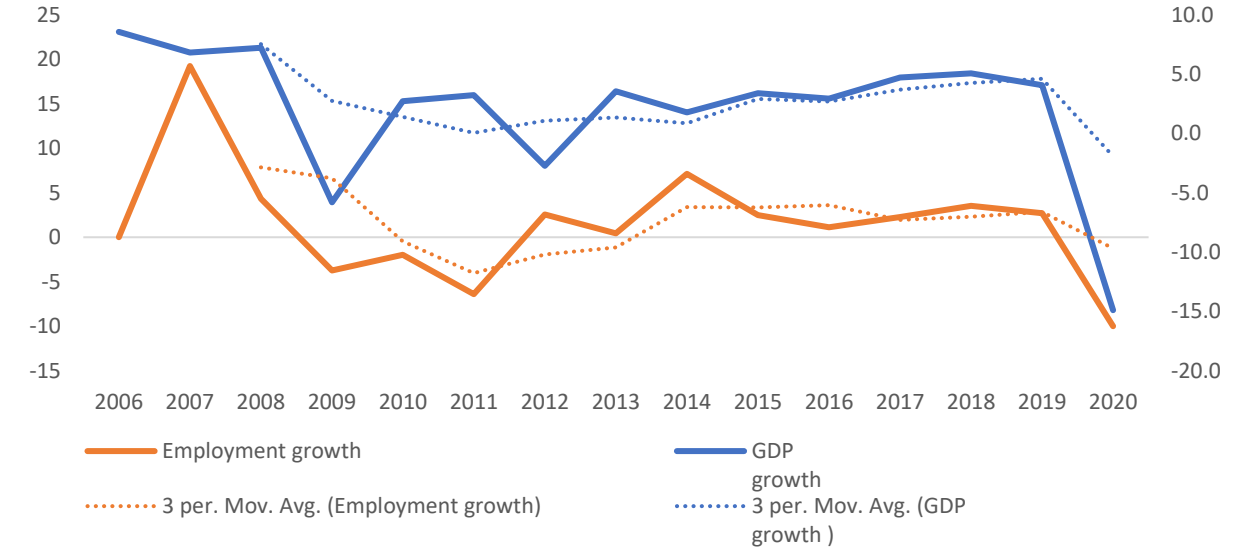
10. **The latest boom cycle since 2015 started cooling off in 2019 and was brought to an abrupt halt by the COVID-19 pandemic, which further exemplified Montenegro's vulnerabilities**.[3] Montenegro ranks third in the number of infected per million inhabitants and records among the highest death rates per capita due to COVID-19 in the world. The crisis wiped out the progress in social and economic indicators since 2015. Policy response measures have cushioned the impact, but Montenegro had entered the crisis with long-lasting economic vulnerabilities, limiting the strength of the crisis response. The pandemic is thus having significant consequences for the country's economic and social development (Box 1).
11. **Montenegro's economic growth averaged 4 percent during the five years before COVID-19 but fell off a cliff in 2020.** The latest boom episode was strongly driven by investments, averaging 28.5 percent of GDP over 2015-19, particularly the highway construction and private investments in energy and prestigious tourism projects. Growth was further boosted by domestic consumption and services exports driven by record tourism seasons, solid bank lending to households and the private sector, and employment growth. On the supply side, services, which account for over 70 percent of GVA and over 75 percent of employment, were driving growth, and to a lesser extent industry and agriculture. From the production approach, capital and labor accumulation contributed to growth, while total factor productivity contribution was almost negligible. The COVID-19 pandemic and related restrictions brought about a strong contraction of economic activity, estimated at 15 percent, and led to a collapse in exports (primarily of tourism services) and, to a lesser extent, falling consumption and investment. During 2015-20, inflation averaged 1.3 percent: it was slightly higher in 2017-18 due to an increase in the VAT rate and excises but dipped to -0.3 percent during the crisis in 2020.

Figure 2: Montenegro's growth volatility is stronger than that of its peers.



Source: World Bank RER.

Figure 3: Employment growth has closely followed GDP growth, yet at slower pace



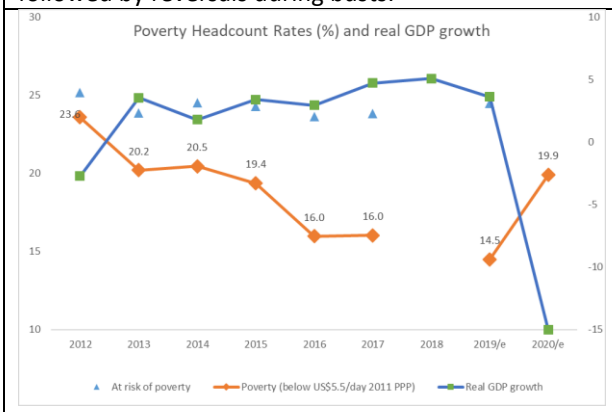
Source: World Bank RER and Labor Force Survey data.

12. **Unemployment fell during the boom years, though still at high levels, but quickly increased during a bust.** Employment growth followed GDP growth through the economy's booms and busts but at a lower rate (Figure 3). Employment increased by 2.4 percent on average in 2015-19, mostly in the labor-intensive and low-wage sectors of construction, tourism, and trade. However, a significant portion of these new jobs were temporary and seasonal employment. Despite falling to a historic low of 15.1 percent in 2019, the unemployment rate is stubbornly high, suggesting a large structural component beyond the business cycle, as recognized in the 2015 SCD. The crisis has wiped out recent

gains: In 2020, employment fell by 10 percent, while unemployment was up by 10 percent. According to the administrative data, the number of employed persons in December 2020 was at the lowest level in 9 years. The most affected have been the sectors with the strongest labor participation such as tourism, construction, and auxiliary services. COVID-19 impacts also disproportionately hurt women: in 2020, female labor force participation and employment rates fell by 8 and 11 percent, respectively, compared to 2019, more than for men.

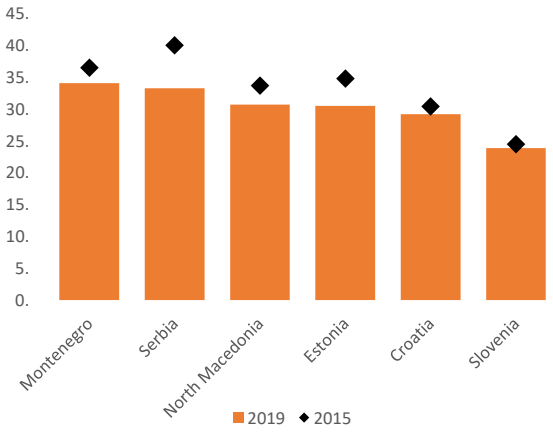
13. **Poverty reduction and shared prosperity during the boom were reversed by COVID-19, and social challenges and regional disparities remain significant.** Had there been no policy response, the poverty headcount of living on less than US$5.5/day in PPP would have increased from 14.5 percent in 2019 to an estimated 21.2 percent. However, the government responses cushioned the impact; still, poverty is estimated to have increased to 19.9 percent in 2020 (Figure 4). In 2019, 24.5 percent of Montenegro's population was at risk of poverty, higher than in Serbia, North Macedonia, and EU countries. As analyzed in the 2015 SCD, Northern and rural areas have higher poverty rates (around 27 and 25 percent, respectively, compared to the national rate of 16 percent in 2017), and the poor and bottom 40 percent continue to have lower levels of education and weaker labor market attachment. Income inequality in Montenegro remains among the highest in the region and when compared to Central and Eastern Europe and the Baltics (Figure 5). This reflects persistent gaps in access to human development and economic opportunities, which disadvantage Roma, women, the youth, and people living in rural and lagging regions (see Section 3.2). Six in ten unemployed individuals are from the North, and unemployment in the Northern region was over 36 percent in 2019 despite recent economic growth. There is a persistent outmigration of people from that region to Podgorica and the coast.[4]

Figure 4: Poverty reduction during booms were followed by reversals during busts.



Source: Calculations based on SILC data and WDI.

Figure 5: Inequality remains relatively high (Gini coefficient of equivalized disposable income)



Source: Eurostat

14. **The COVID-19 crisis response measures prevented even worse consequences for businesses and people, but fiscal space has been largely exhausted.** The government adopted a wide set of support measures to mitigate the impact of the crisis, but their scope was limited by fiscal constraints. The measures included, among others, wage subsidies to the most affected sectors, credit lines, cash transfers to the most vulnerable, and additional support for tourism and agriculture. Though the

measures were well-targeted, a share of the vulnerable population depending on the informal sector may have received little support, reflecting limited fiscal space and institutional weaknesses in social protection mechanisms to safeguard against shocks.

15. **Montenegro's fiscal and external imbalances remain high and reflect the structural vulnerabilities from institutional shortcomings.** Over the last 10 years, Montenegro has been running a fiscal deficit of 5.5 percent of GDP on average, and a current account deficit (CAD) of 15 percent of GDP. The government often did not commit to fiscal targets and lagged behind in the implementation of multiannual budgeting and planning, which, combined with the debt-financed construction of the highway, resulted in a sharp rise of public debt. Strong investment activity has kept the CAD elevated due to high import dependence of the infrastructure and real estate investment and consumption. But deficiencies in public investment management have curtailed some of the economic benefits. The CAD has been traditionally financed by net foreign direct investment (FDI), although net FDI have moderated from almost 17 percent of GDP in 2015 to just over 6 percent of GDP in 2019. At the same time, total external debt remained close to 170 percent of GDP. The international reserves have remained stable during the past five years, covering, on average, over 4 months of merchandise imports.
16. **Hard-won fiscal consolidation gains, although smaller than planned by the Fiscal Strategy have been wiped out by COVID-19.** The fiscal consolidation effort of 2017-18 resulted in a steady decline in the fiscal deficit: from 5.7 percent of GDP in 2017 to 2.7 percent in 2019. Yet, the period of strong economic activity and solid revenue collection was not used to reduce more deficit and debt. Current spending was not sufficiently contained and lagged the targets defined in the government Fiscal Strategy 2017-20, in part due to weaker-than-expected implementation of the public administration reform. Moreover, political pressures led to the introduction of the fiscally and socially costly mother's benefits[5] in 2016 and amendments to the pension law in 2020, risking the long-term sustainability of Montenegro's pension system. As a result of persistent deficits and the COVID-19 crisis, public debt tripled since independence to reach over 105 percent of GDP in 2020, requiring a very vigilant fiscal and debt management in the medium term. Since 2018, Montenegro has been proactive in managing its debt, most recently securing EUR750 million in Eurobonds to service its debt. However, given the mounting debt levels and uncertainty in the global recession, Montenegro's access to the financial market cannot be taken for granted. Strong efforts are needed to return to the debt reduction path.
17. **The financial sector has so far been resilient, but the full impact of the crisis on asset quality will not be clear until government crisis response programs phase out.** The recovery from the aftermath of the earlier global financial crisis witnessed constant improvement in the asset quality, appropriate capital buffers, and a pickup in loan growth. Banks dominate Montenegro's financial sector. During 2015-20, lending growth was steady and strong, but largely driven by household credits. Deposits grew almost at a double-digit rate until mid-2019 but turned negative in 2020. The number of banks remains high in comparison to the size of the economy, reflecting a potentially unsustainable business model of smaller and domestic banks. This market structure, coupled with a weak supervision framework, led to the failure of two domestic banks in 2019, activating resources from the deposit insurance fund. These events still reflect an ongoing restructuring of part of the banking sector after the global financial crisis. Montenegro further adopted a comprehensive banking legal framework in 2019, aligned with EU directives, but institutional capacities for its implementation must be strengthened (discussed further in Section 3.1).[6] Key financial sector indicators have been steady in the COVID-19 crisis so far, but the full impact on bank asset quality and corporate bankruptcies will

only show once the loan moratoria granted in this crisis expire and response programs have been phased out.

2.2 Strong boom-bust cycles result from both country characteristics and policy choices

17. **Both country characteristics and homemade vulnerability have contributed to Montenegro's large boom-bust cycles. First, enabled by its natural assets and pristine landscape, Montenegro's economy has pivoted around booms in tourism and real estate with overreliance on foreign capital inflows.** Montenegro is one of the smallest European countries with the population size of just above 600,000. Since 1990, it has been undergoing a transition from a state-dominated to a market economy. Since the country declared independence in 2006, this process was accelerated, further boosted by the EU accession aspiration of the country, its main strategic goal. As a small open economy with about a quarter of GDP generated from tourism service exports, Montenegro is particularly exposed to external shocks. This is reinforced by the low production base and high import dependence of investment and consumption, with one of the lowest good export-to-GDP ratios (9.4 percent in 2019) in the world. As a result, Montenegro's external imbalances are high, and the country is more vulnerable to terms-of-trade shocks. Montenegro's population is aging, and the emigration of highly qualified and highly skilled (mostly young) is a challenge for sustaining a strong workforce for innovative firms. Moreover, Montenegro is a euroized economy, leaving the entire burden of stabilization on fiscal and structural policies.
18. **Second, Montenegro's growth strategy has contributed to the excessive cycles.** Periods of high investment activity boosted growth during the construction period but neither sustained it nor created sufficient high-quality jobs for large segments of the population. The growth strategy has been based to a large extent on a few large investment projects, apart from the highway, mostly in energy and tourism. These investments initiated temporary construction booms, contributing to growth and jobs in low value-added sectors during the construction period, but also creating external vulnerabilities due to a surge in imports of investment goods. What is more, they often brought few medium-term growth and jobs benefits. For example, Montenegro offered generous tax incentives for the construction and operation of luxury resorts and hotels. But these typically created few permanent skilled jobs or domestic linkages as they rely heavily on imported goods and services, limiting the potential for productivity spillovers to domestic suppliers. Until recently, the exemption from VAT for on-site services in luxury resorts even disadvantaged smaller domestic service providers which had to pay the full rate of 21 percent.[7]
19. **Third, weak commitment to medium-term planning and selective policy implementation have exacerbated the boom-bust cycles.** Necessary medium-term institutional mechanisms to mitigate shocks such as countercyclical macroeconomic policy and effective social protection systems are lagging. Montenegro has followed pro-cyclical fiscal policy half of the time since 2008, contributing to the strong boom-bust cycles it faced. Insufficient commitment to medium-term fiscal planning, partly a result of institutional shortcomings, are reflected in frequent budget revisions and weak execution, lack of binding ceilings for multiannual sectoral spending, and often detachment of sectoral strategies from medium-term budget plans. Frequent policy reversals and partial and selective policy implementation undermine institutional progress and discourage firm entry and more productive activities, reducing private sector resilience.

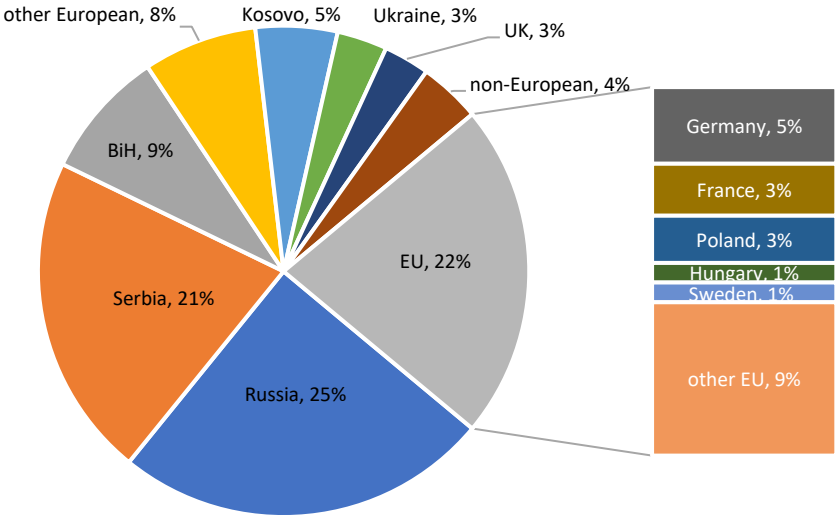
20. **Governance and institutional weaknesses more broadly continue to hinder the necessary reform policies to reduce the Montenegro's vulnerabilities.** EU membership remains the top priority and has been driving the reform process. Montenegro has been working to align its legislation and institutional setup with EU standards. Yet, translating the new framework laws into effective implementation is lagging. There is a need to strengthen transparency, stakeholders' participation, and the government's capacity to implement reforms.[8] Slow institutional progress results in partial policy implementation, policy reversals, public sector inefficiencies, and concentrated ownership of business activity (see Section 3.4). Moreover, the political environment is characterized by high polarization which makes it more difficult to reach consensus and build more inclusive institutions.

Box 1: Montenegro's tourism and COVID19 impact

The COVID-19 pandemic and the associated travel restrictions and changes in consumer behavior present an unprecedented challenge, as an almost complete standstill of international travel and tourism took place starting in March 2020. The World Tourism Organization estimates that in 2020, global tourist arrivals collapsed by over 70 percent.

Tourism is Montenegro's key economic sector and driver of growth: the direct share of transport and tourism in Montenegro's GDP is 11.9 percent, with estimated direct and indirect contribution of travel and tourism of close to 25 percent of GDP. In 2019, Montenegro's international tourism and transport receipts accounted for two-thirds of Montenegro's total goods and services exports. Tourism is highly seasonal and relies disproportionately on tourists from a few countries: Russia and other Western Balkan countries account for two-thirds of overnight stays (Figure 6). Tourist overnight stays from June to September account for almost 75 percent of total annual overnight stays.

Figure 6: Tourism destination countries by overnight stays in 2019



In 2020, Montenegro suffered a complete halt in tourism, mostly due to the strong second wave of COVID-19 and the closed borders with the region. In 2020, the number of international tourist overnight stays collapsed by 86 percent (Figure 7), while the number of employed in the food service and accommodation sector declined by 27 percent on average (Figure 7). The tourism sector recovery depends largely on when the pandemic is contained and vaccine is available, but also on consumer behavior and preferences which might have changed permanently. Also, tourism is heavily reliant on SMEs, which might find it more challenging than their peers in other sectors to survive.

Figure 7: Employment in food service and accommodation

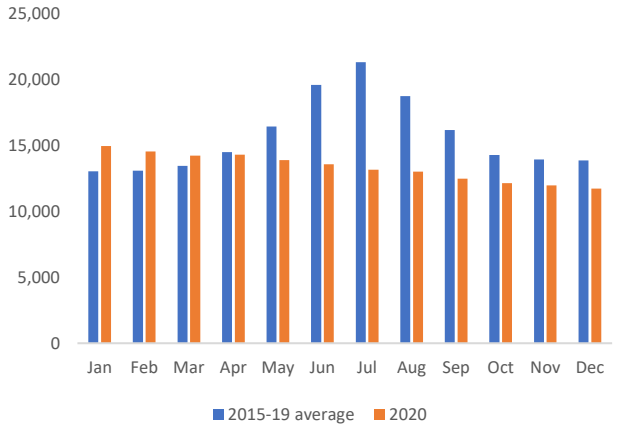
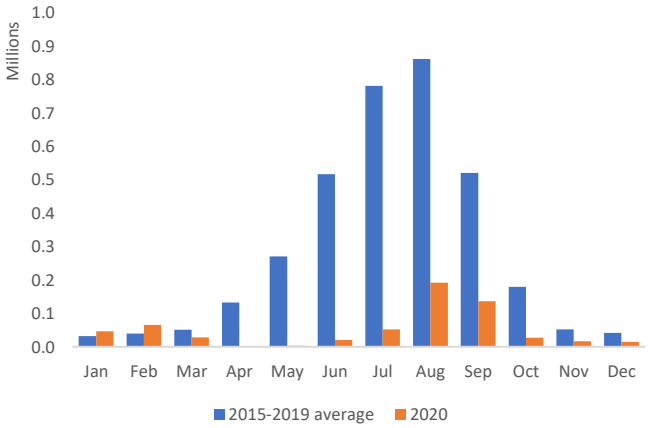


Figure 8: International tourists overnight stays



3. How to address the causes and consequences of Montenegro's boom-bust cycles: Improving economic resilience and reducing vulnerabilities

21. **Only by improving economic resilience and addressing the causes of homemade volatility can Montenegro sustain higher growth, inclusion, and poverty reduction.** Reducing volatility and strengthening resilience require a broader growth and tourism strategy focusing on domestic linkages and productivity, more equal and efficient social services and better work incentives, and sustainable natural resource and climate change policy. Addressing rising macroeconomic vulnerabilities is a critical pre-condition. Such policies can only be successfully implemented if Montenegro strengthens its institutions that enforce the rule of law to ensure fair market competition and environmental protection, provide checks and balances on spending and policies, and safeguard medium-term planning. This includes installing a merit-based public administration, an independent and efficient judiciary, transparent policymaking, and empowering the mandate of supervising agencies such as the competition authority and the state audit institution. And it requires overcoming short-term policy tradeoffs and enforcing transparent and accountable long-term plans in line with an inclusive social contract.

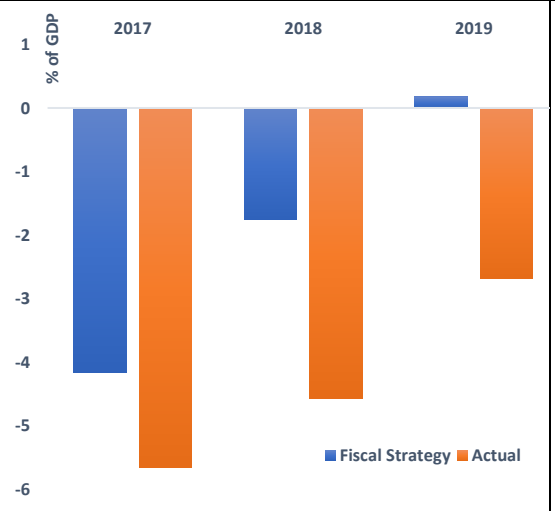
3.1 Addressing macro-financial vulnerabilities and constraints to private sector growth

22. **A more sustainable growth strategy post-COVID-19 should focus on sound macroeconomic policies paired with institutional reforms that guarantee a level playing field among all economic actors to unleash private sector productivity growth.** A prerequisite for a resilient recovery from the COVID-19 crisis is maintaining macro-financial stability and rebuilding fiscal buffers to reduce uncertainty and strengthen investor confidence. It also requires more well-paid formal private sector jobs that provide social insurance. These are created by young, productive, and innovative firms, and stronger linkages between foreign firms and domestic suppliers. Productivity growth thus requires tapping into the full potential of entrepreneurs by strengthening the state institutions ensuring that no one benefits from special treatment so that all have equal access to services and can reap the benefits of the risks they take. This will lead to diversification into new products and services leveraging Montenegro's comparative advantages in tourism, clean energy, and services. Reinforcing state institutions that enforce the consistent and non-selective application of rules and regulations will thus encourage entrepreneurs and businesses to compete by innovating instead of lobbying for or expecting government protection or subsidies. This includes rigorous policy monitoring and evaluation to channel state aid to the most productive firm support programs. The consistent enforcement of environmental legislation will further support the transition to clean energy production and more sustainable tourism development.
23. **After the deepest recession in decades, Montenegro needs to restore and maintain macroeconomic and financial stability in accelerating the recovery and improving citizens' wellbeing**. Addressing the long-standing issues and those that emerge from the pandemic will require turning firm commitments on vigilant fiscal management and structural reforms into actions. Thus, fiscal prudence through implementation of sound fiscal policies will be necessary to strengthen the macroeconomic sustainability of the country and to ensure Montenegro continues to maintain access to financial

markets. The years ahead will require a comprehensive fiscal consolidation program which must focus on reducing spending inefficiencies, while minimizing potential adverse short-term impacts on the poor and vulnerable and securing growth-enhancing investments that strengthen the resilience of the economy. Strong public financial management and efficient implementation of the public administration reform would increase the quality of public spending, make it more cost-efficient, and create fiscal space to weather future shocks.

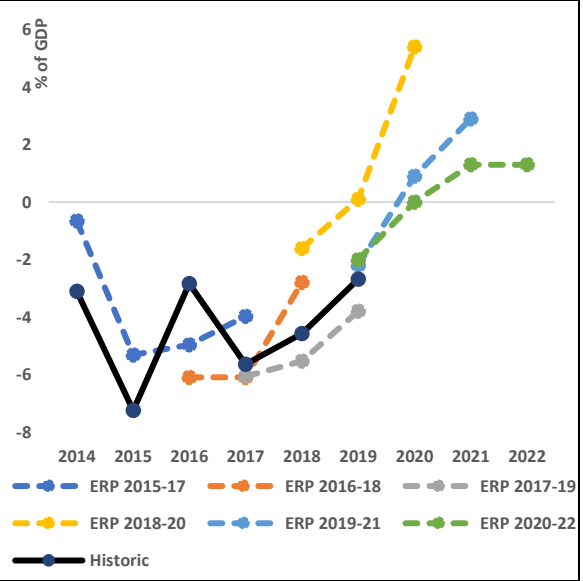
24. **Credible fiscal and debt strategies and their implementation are critical for fiscal sustainability.** Montenegro's first Fiscal Strategy 2017-2020 was aimed at maintaining fiscal sustainability by rolling out a comprehensive fiscal consolidation program. Much of it, however, relied on increasing revenues through higher VAT rates, excises, and a temporary rise in the otherwise flat personal income tax rate from 9 to 15 percent for above-average wages. While fiscal consolidation reduced the general government fiscal deficit, the ambitious initial Fiscal Strategy targets have been missed[9] (Figure 9). Paired with repeated overly optimistic fiscal projections, this has at times challenged the credibility of macroeconomic policy (Figure 10) and resulted in higher fiscal deficits (Figure 11) and public debt, making Montenegro the most indebted developing country in the region even before the COVID-19 pandemic (Figure 12). Better fiscal management also requires improving data collection and reporting. Official debt statistics, for example, do not include arrears or contingent liabilities (e.g. SOEs) which are not systematically collected and monitored, implying that total public debt is higher than reported.

Figure 9: Fiscal Strategy 2017-20 fiscal deficit have been missed…



Source: Ministry of Finance and WB staff calculation. Note: Fiscal Strategy fiscal deficit is expressed as percent of 2017 projected GDP per year

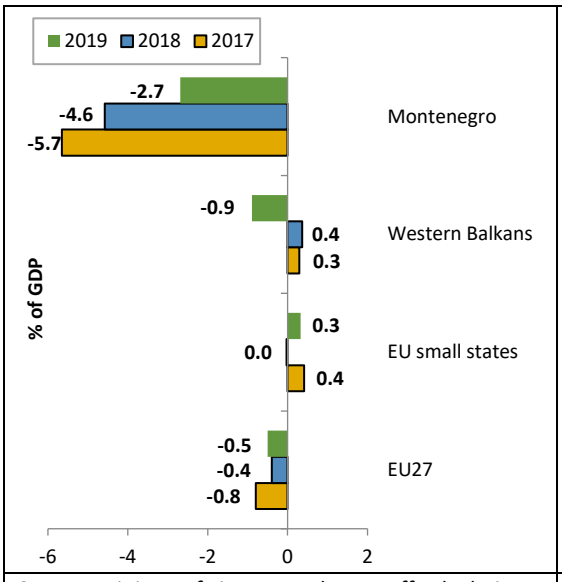
Figure 10: ...and the trend of overoptimistic fiscal projections continued until recently.



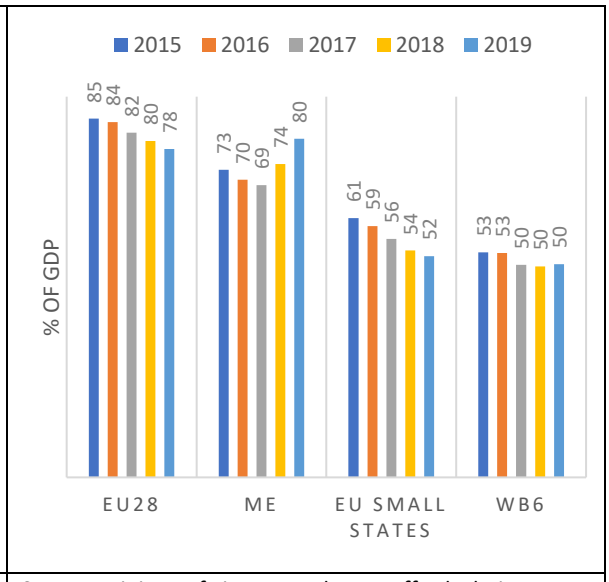
Source: Government of Montenegro and WB staff calculations

Figure 11: Fiscal deficit is the highest among regional and EU peers...

Figure 12: …as is Montenegro's public and publicly guaranteed debt



Source: Ministry of Finance and WB staff calculation.



Source: Ministry of Finance and WB staff calculation.

25. **To get debt down to prudent levels, Montenegro will need to achieve and maintain primary fiscal surpluses in post-crisis years and a strong commitment to comply with its fiscal rules** (Box 2). Fiscal rules are designed to support fiscal credibility and discipline by limiting government discretion over fiscal policy and therefore limiting the fiscal deficit and the growth of public debt. Montenegro has a broad array of fiscal rules but has generally not complied with them,[10] which resulted in episodes of procyclicality of fiscal policy during boom times[11]. For fiscal rules to promote more prudent and stabilizing fiscal policy, an effective public financial management system with reliable data management, reporting, monitoring, and enforcing mechanisms is needed. Montenegro is currently working on establishing a fiscal council, an independent public institution that has helped enforce prudent fiscal management in many countries. The independent analysis, assessment, and reporting on fiscal policy and macroeconomic projections would further strengthen transparency and compliance with fiscal rules.

Box 2: Montenegro public debt developments and outlook

Montenegro has the highest public debt, as a share of GDP, among the Western Balkan countries. Since its independence in 2006, Montenegro's public debt increased six-fold to reach 105 percent of GDP in 2020 (Figure 13). Almost entire public debt (over 97 percent) is owned by the central government, and over 85 percent of it is external. Since 2008, the country has been running a consistent fiscal deficit, the financing of which was mostly covered through borrowing. Over 2008-2020, the fiscal deficit averaged 6 percent of GDP and was impacted by the global financial crisis in 2009, the Euro area crisis in 2012, the construction of the priority section of the highway in 2015, but also because of many policy choices or a lack of implementation of reforms that have led to the widening fiscal deficit. Additionally, in the period from 2011 to 2020, the government paid a total of almost EUR220 million in activated guarantees (Figure 14), over half of which was paid for the Aluminum Plant (KAP), but also for several other private companies.

Figure 13: Montenegro's public and publicly guaranteed debt, 2006-2020

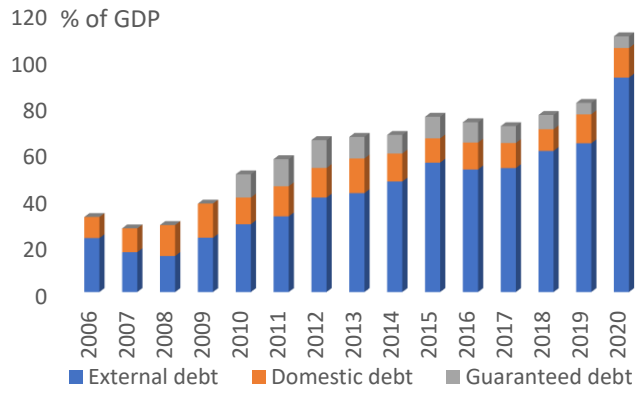
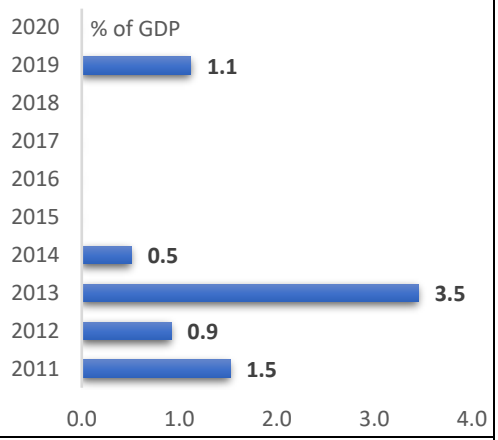


Figure 14: Activated guarantees, 2011-2020



Source: Ministry of Finance, World Bank calculations.

Montenegro's legal framework sets limits to public debt. In 2014, the Law on Budget and Fiscal Responsibility (LBFR) was adopted that introduced a set of fiscal rules, among others that the fiscal deficit should not exceed 3 percent of GDP, that public debt should not exceed 60 percent of GDP, and that state guarantees cannot exceed 15 percent of GDP. The Law also prescribes that in the case public debt reaches 60 percent of GDP, the government shall amend the law on budget to ensure that public debt remains below 60 percent of GDP and if public debt exceeds 60 percent of GDP, the government shall propose to the Parliament reducing multiannual spending and a set of measures to reduce public debt. In case the latter is due to capital investment projects, then the government must propose a recovery program that should be implemented in the framework of maximum five years. The LBFR prescribes that local governments and state-owned enterprises should have a government approval for long-term borrowing and issuing of guarantees. Furthermore, the law prescribes a tree-year debt management strategy.

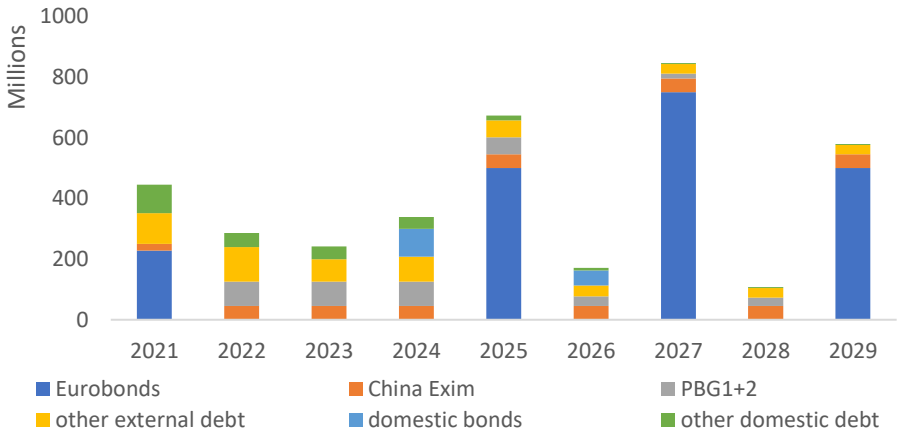
The Eurobonds account for the largest share of Montenegro's debt. Montenegro has been successfully tapping international markets since the first placement in 2011 (Table 2). The maturity of the Eurobonds placed ranged from 5 years until 2016 to 10 years in 2019, with interest rate falling from almost 8 percent in 2011 to below 3 percent in 2019 and 2020. The receipts have been used to rollover existing and more costly debt and to finance fiscal deficits. Following the adoption of the Debt Management Strategy 2018-20, the authorities have been successful in managing public debt – especially with regard to Eurobond placements in 2019 and 2020, as well as with two syndicated loans backed by the World Bank Policy Based Guarantees (PBGs) in 2018 and 2020. The 2019 and 2020 Eurobond placements were used to build up deposits to refinance liabilities in the next year, thus reducing the pressure on servicing debt liabilities. By end-2020, Eurobonds accounted for 45 percent of total public debt in Montenegro.

Table 2: Montenegro's Eurobond placements

EUROBONDS	AMOUNT (EUR MILLION)	INTEREST (PERCENT)	MATURITY (YEARS)
2010	200	7.875	5
2011	180	7.25	5
2014	280	5.375	5
2015	500	3.875	5
2016	300	5.75	5
2018	500	3.375	7
2019	500	2.55	10
2020	750	2.875	7

In 2020, gross public debt reached a record high, but is set to decline steeply by 2023. Due to new borrowing (including the Eurobond of EUR750 million, placed in December 2020, that will be used to finance 2021 financing needs) to finance widening fiscal deficit and a sharp contraction of GDP of 15.2 percent, public debt increased to over 105 percent of GDP. When looking at the currency composition of Montenegro's debt at end 2020 – 83 percent of it is denominated in euros, 15 percent in US dollars, and the remaining 2 percent in other currencies. An increasing share of Montenegro's debt denominated in US dollars is due to the loan taken from the China Exim bank to finance the construction of the first section of the motorway (see Annex 1: Bar Boljare Highway). Despite government plans to hedge against the exchange risk, to date no hedging has taken place. The Eurobond from 2016 of EUR227 million was already redeemed in March 2021 from the receipts of the 2020 Eurobond, and the remaining receipts should cover the entire 2021 and part of 2022 financing needs. While financing needs over 2022-24 remain sizable, averaging 5.8 percent of GDP, the largest repayments are due in 2025, 2027, and 2029, when a total of EUR 1.75 billion of Eurobonds is due (Figure 15). The debt service costs (both amortization and interest) for the first construction of the highway will average around 1 percent of GDP over 2021-2029, gradually falling to 0.3 percent of GDP in 2035 when the last instalment is due. Running consistent primary surpluses from 2022 onwards is needed for Montenegro to accelerate debt reduction and ensure debt sustainability.

Figure 15: Montenegro central government debt amortization, 2021-29

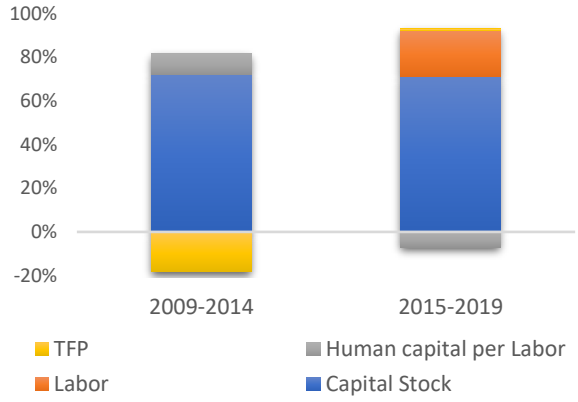
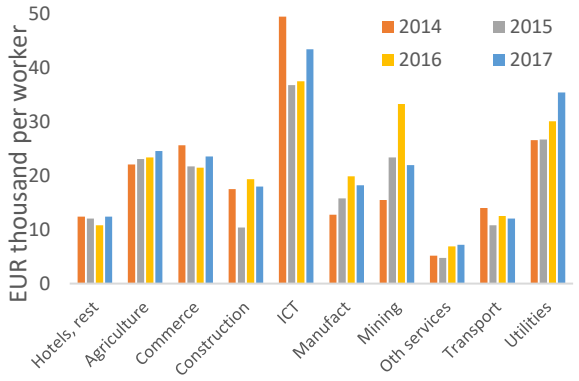


Source: Ministry of Finance, World Bank. *Note*: Central government debt stock as of 31/12/2020.

26. **Careful expenditure adjustment measures will be needed to improve a weak fiscal outlook**. Current inefficiencies in public spending leave room for expenditure adjustments that could create additional fiscal space by, for example, speeding up public administration reform, strengthening public

investment management including the framework for Public Private Partnerships, and continuing the public procurement reform (expanding centralized procurement and implementing the e-procurement platform making all contracts publicly available). The successful implementation of the fiscal consolidation program is critical to create more space over the medium term to direct public spending to areas that improve the quality of public services, such as infrastructure investments and social services. The pandemic and recovery will likely require additional support to those in need, and it is critical to ensure that the design of policies and programs maximizes the cost-efficiency, minimizes the potential negative fiscal and social impact, and is proactively and transparently communicated to the population and to the market.

27. **On the revenue side, more revenue could be mobilized through additional tax reforms.** Policy options to increase the efficiency of revenues include consider re-introducing a progressive personal income tax which was faded out in 2020 (potentially coupled with tax financing part of social security contributions to reduce the cost of formal hiring), identifying and reducing tax expenditures,[12] advancing the implementation of e-fiscalization, consider introducing a wealth tax on highest-net-worth individuals (contingent on better data collection), and carefully designing environmental taxation to reduce carbon emissions. Moreover, it is critical to continue improving tax administration, including data collection and reporting, to improve tax compliance and the revenue base and to be able to enforce some of these policy options.
28. **Maintaining stability of the financial sector remains important for a resilient private sector recovery.** While some of the vulnerabilities of the financial sector were addressed, challenges remain. These are reflected in a high share of short-term liabilities, weak profitability of some domestic and smaller banks, and some potential risks related to large exposures and exposures to related parties. An Asset Quality Review (AQR) is underway and, once completed, decisive actions by the Central Bank are needed to address the potential challenges revealed by the AQR. Additionally, robust banking regulation and supervision to ensure the proper identification of NPLs and provisioning for credit losses will be critical to weather any potential spillovers of the crisis to the financial sector**.**
29. **Boosting private sector-led growth requires stronger productivity gains which are also key to achieve a resilient economic recovery from the COVID-19 crisis.** The productivity challenge has been emphasized in the 2015 SCD and is confirmed by recent trends. During the boom period 2015-19, output per unit of labor input increased from a low base, but the 2011 levels were only recovered in 2019. Real wage growth closely followed labor productivity growth during this period. While Montenegro's aggregate labor productivity gains were above those in the Western Balkans, its level lags EU comparator countries.[13] Labor productivity increases were largely obtained through rapid accumulation of machinery and equipment, driven by a strong investment cycle in the recent years, instead of higher total factor productivity (Figure 16). Disaggregated firm census data show that labor productivity in Montenegro is the highest in ICT and utilities, including energy. Manufacturing, mining, and utilities had the highest labor productivity growth in the boom years 2014-17, while productivity was stagnant in tourism-related services such as hotels and restaurants and transport (Figure 17).

Figure 16: Capital formation drove growth, but total factor productivity was stagnant.	**Figure 17:** Labor productivity was stagnant in most service sectors.
	
Source: WDI, National authorities, WB staff calculation Note: The growth decomposition.	Source: Montenegro tax administration firm census data, WB staff calculations.

30. **Diversifying investments within tourism, as well as to other economic activities where Montenegro has a comparative advantage such as clean energy, can contribute to private sector productivity and strengthen economic resilience, as the COVID-19 crisis has shown.** Montenegro needs to encourage the development of innovative entrepreneurs if it is to expand its sources of growth. This includes diversifying investments within tourism, its main comparative advantage. Tourism investments have largely focused on high-end real estate which has shown to generate few linkages with local suppliers but in some sites created "overtourism" as arrivals are beyond the infrastructure capacity and in some cases have lasting negative impact on the environment (see Section 3.3). The post-crisis tourism should be transitioned towards a more sustainable model based on social inclusion and restoration and protection of the environment (see Sections 3.2 and 3.3). But sustainable development also requires diversification of the economy. In that regard, organic agriculture, forestry, and ICT provide opportunities to further diversify the economy and to enter international niche markets (Box 3). Moreover, investing in water, solar, and wind energy leverages Montenegro's comparative advantage in green energy and allows absorbing funds from the EU Green Deal. Due to declining costs, there is also substantial scope for private sector investment into green energy without government's support. The recently completed undersea cable with Italy further boosts the potential for clean energy exports to the EU.

Box 3: Opportunities for economic diversification

A continuous dialogue and close coordination with the private sector are a prerequisite for effective government interventions to support economic diversification. Successful diversification of the economy entails resource reallocation across and within sectors from low productivity activities to those with higher productivity. In many cases, government interventions are required for such resource reallocation. Engaging with the private sector through a public-private dialogue is key to identifying appropriate interventions. There are opportunities of within-sector and between-sector diversification.

Diversification within tourism and stronger linkages with other sectors would support more inclusive growth. Tourism sub-sectors with higher potential for domestic linkages include ecotourism, agritourism, and the rural hospitality sector, linking gastronomy, cultural heritage, and agriculture, thus creating job opportunities and infrastructure for the rural population and in the North. Policies strengthening the links between tourism and domestic agriculture and tourism-related services such as tour operators would further encourage the hospitality industry to source goods and services from domestic suppliers, including local and organic producers marketing domestic products to luxury hotels. This would help diversify the economy in sectors linked to Montenegro's comparative advantage such as restaurants, travel services, and agricultural producers (see also Section 3.2). The development of a green economy and sustainable tourism also requires the access to functional cadasters to facilitate adequate land use and management, urban planning, infrastructure, agriculture, and property taxation. Another opportunity are smart destinations, which are an extension of the idea of smart cities to tourism areas. Thus, a smart destination is a geographical space where tourism development is planned and implemented utilizing technological infrastructure.

Attracting FDI in higher value-added sectors can further support productivity growth by bringing know-how and skilled jobs to the country and help diversify the economy. Foreign firms bringing new knowledge and more productive processes, have the potential to transfer knowledge to domestic suppliers or competitors. Such knowledge spillovers have been a key driver of growth and jobs in several fast-growing Eastern European countries. Montenegro's high share of FDI—the highest in Eastern Europe—is concentrated in energy, hotels, and real estate which accounted for 90 percent of total FDI from 2011-18 (Figure 20). But especially the real estate sector has a limited potential to bring new knowledge (spillovers). To enhance the impact of FDI on productivity, Montenegro needs to better leverage investments in the tourism sector. This includes developing and adopting a linkages strategy to help increase spillovers to the local private sector. There is also room to strengthen the effectiveness of investment promotion efforts to attract additional investments in higher value-added sectors such as ICT and tourism-related services.

Tradeable services such as information and communications technologies (ICTs) and financial services could offer a way to diversify and add value to the economy. In 2019, ICT accounted for 3.7 percent of GDP compared to an average of 6 percent among OECD countries. The Global Innovation Index ranked Montenegro 36th in the world in ICT access and 54th in ICT use. This offers a solid base to further develop the sector. Montenegro has set an objective of digitalizing its economy in its Smart Specialization Strategy. The COVID-19 pandemic has not only highlighted the critical role of ICTs for continued functioning of societies, but also exhibited the sector's potential to grow. Technological innovations such as mobile communications, e-commerce, e-payments, access to cloud computing, and data storage allow small firms an easier access to global markets. Further, they can enhance the ability of small firms to supply new services by improving access to information and to deliver services to a wider range of consumers. A growing domestic ICT sector can also provide the backbone to develop better and more comprehensive e-government services that would strengthen transparency and citizen trust in public institutions (see Section 3.4).

31. **Fostering innovation and entrepreneurship plays a central role in improving private sector productivity and creating more and better jobs.** Most jobs in fast-growing countries are created by

high-growth firms (Figure 18), which tend to be younger, more productive, and more innovative, whereas innovation includes an adoption of a new (foreign) technology or organizational and managerial changes and not necessarily cutting-edge research. But Montenegro has very few of these firms (Figure 19) as there are few startups, and firms are trailing in adopting more productive services, ICT, and business models.[14] More well-paid private sector jobs thus require young, productive, and innovative firms, and stronger linkages between foreign firms and domestic suppliers. Encouraging innovation requires enforcing fair market competition ensuring that entrepreneurs have equal access to services and can reap the benefits of the risks they take (see below). But innovation activities typically require advisory or financial services—information about new markets, products, or organizational practices—which may not be readily available in markets, justifying policy intervention. Against this backdrop, Montenegro was the first non-EU country to adopt the Smart Specialization Strategy to foster innovation and integration with regional markets and the EU; it recently also adopted laws on innovation and on R&D incentives. But international experience has shown that developing the institutional capacity, including a strong governance structure, well-designed programs and targets, and rigorous monitoring and evaluations, is critical to develop successful firm support programs. The recently established Innovation Fund has the potential to provide such an institutional setting if implemented adequately. Enhancing regional economic integration such as through regional trade and transport facilitation is important to more effectively connect Montenegro's small open economy to larger regional and global markets.

Figure 18: High-growth firms create relatively few jobs in Montenegro

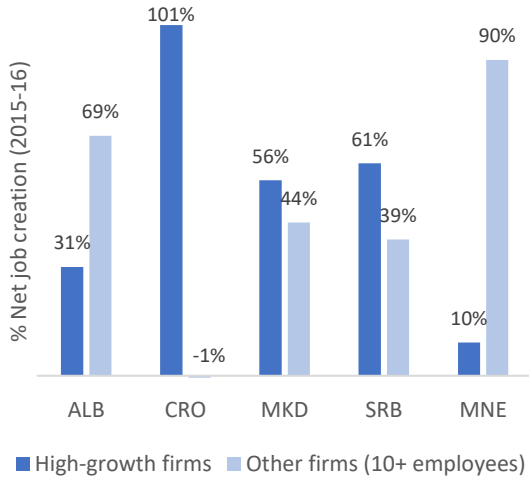
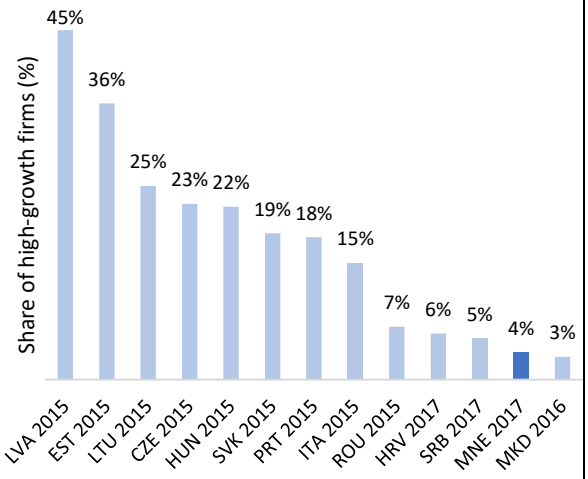


Figure 19: There are a few high growth firms in Montenegro



Source: Tax administration firm census data in Montenegro. For other countries, registry and SBS data, OECD Business Demographics; World Bank calculations. Note: High-growth firms are at least 4 years old, with 10 or more workers, and with growth of at least 20 percent a year for three consecutive years.

32. **Improving access to finance is critical for startups and innovators, especially in the post-COVID recovery when liquidity will be scarce.** Almost two out of three small and medium enterprises (SMEs) in Montenegro did not have a loan or line of credit in 2019. This share (60 percent) significantly increased from 43 percent in 2013.[15] And those firms that have a loan face high collateral requirements,[16] reflecting the continuing tight credit conditions of the banking sector. In 2017, the SME debt finance supply was estimated at US$530 million (19 percent of banks' outstanding loans)

while the demand for SME financing was estimated at US$1.2 billion, leaving a potential SME financing gap of US$632 million (16 percent of GDP).[17] SMEs' access to bank finance in Montenegro is restricted by high interest rates and the indebtedness of local companies. The small leasing and factoring sectors and non-existent corporate bond market limit SMEs' access to alternative financing sources. The Investment and Development Fund (IDF) directly lends to the private sector, aiming to fill the gap, but the targeting and effectiveness of its programs is unclear and at times not transparent.

33. **Reducing the high labor tax burden can help translate potential productivity growth into more and better jobs by encouraging the hiring of formal employees.** Montenegro has one of the highest labor tax wedges of 38 percent for an average worker among Western Balkan countries.[18] It is particularly high for low-wage workers, discouraging their formal employment. Reducing the labor tax burden requires financing part of the social security contributions through other sources, for example, a more progressive personal income tax (see above). Such a reform needs to be subject to a prior comprehensive feasibility analysis to avoid compromising the quality of essential public services (see also Section 3.2).
34. **The consistent implementation and enforcement of rules and regulations is a pre-condition for private sector productivity growth and job creation.** Countries with a weak and inconsistent enforcement of rules typically end up having a business environment that encourages firms to lobby for special policy treatment or state aid instead of competing based on innovation and productivity. Such an uneven playing field has been found to discourage firms to innovate, grow, and create jobs. Yet, many businesses and civil society report discretion and inconsistent implementation of regulations, which is frequently changing, while secondary legislation is either missing, adopted with significant delays, or not aligned with primary legislation.[19] The World Bank's Doing Business signals that getting electricity and construction permits requires cumbersome regulatory procedures in Montenegro. Potentially more problematic, Enterprise Survey data show that these regulations are enforced inconsistently across firms, with some benefitting from "fast-track" regulatory services but not others, undermining a level playing field. Specifically, 50 percent of Montenegrin firms obtain a construction permit within 25 days from their application while 25 percent must wait at least 150 days and 10 percent more than 400 days. These variations are larger in Montenegro than in other Western Balkan countries (Figure 21). And they persist among firms with the same activity, suggesting that the access to fast-track regulatory services depends at least in part on firms' ownership and connections (Pritchett et al., 2017). The discretion in implementation also includes a large system of various local non-tax fees and parafiscal charges—for example, for waste disposal, the use of municipal roads, or membership fees—which differ substantially across municipalities.[20] The recent creation of a public register of parafiscal charges is an important step and should be used to streamline these at times substantial regulatory costs. Moreover, a significant share of firms in Montenegro report having bribed a government official[21], more so than in other Western Balkan countries (Figure 22), reflecting institutional weaknesses (see Section 3.4). Ensuring consistent and non-selective application of laws and regulations would ensure predictability and give confidence to entrepreneurs and investors.

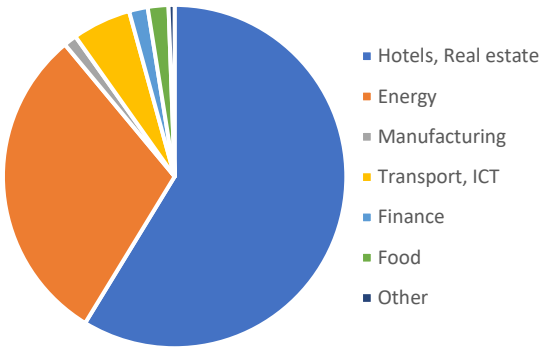
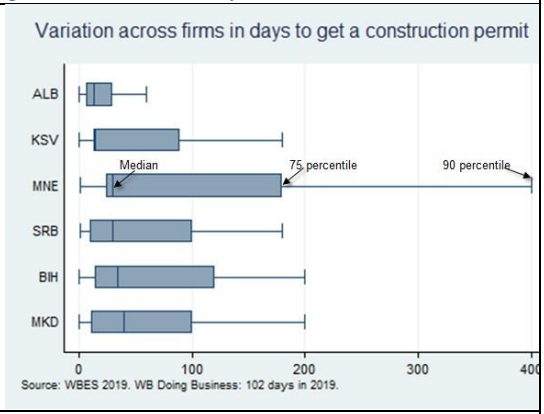
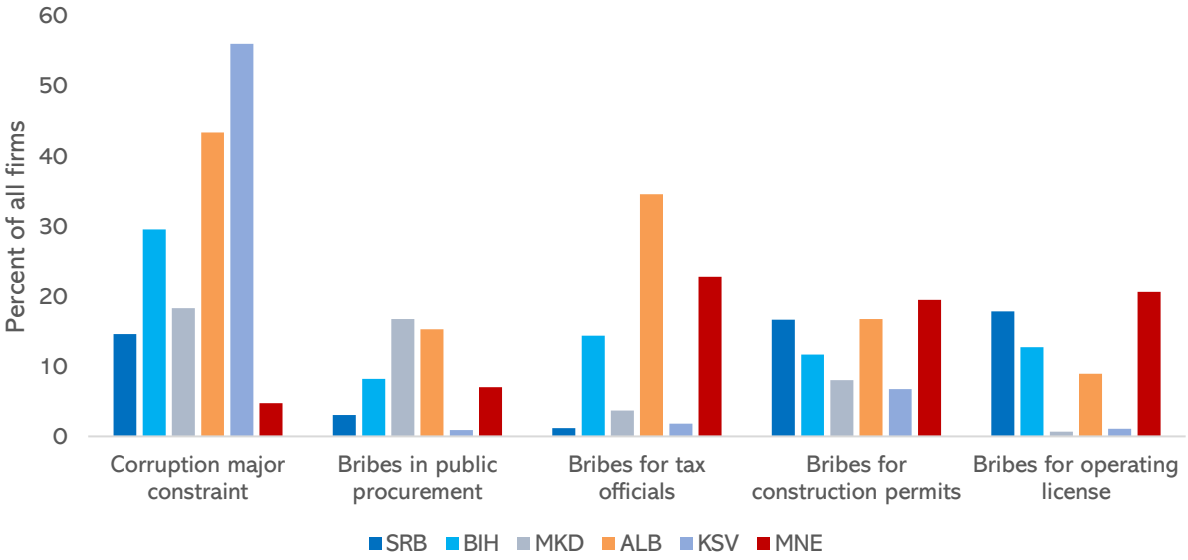
Figure 20: Foreign investments have focused on tourism and energy	**Figure 21:** Variation across firms in days to get a construction permit
	
Source: FDI Markets database. Note: FDI by sector, 2011-18 (US$ million).	Source: WB Enterprise Survey 2019, WB staff calculations. Note: The ends of a box show the 25th and 75th percentile days to wait for a permit across firms.

Figure 22: Bribery is a common practice in the Western Balkans, and more so in Montenegro



Source: 2019 World Bank Enterprise Survey findings, WB staff calculation

35. **Digitalization can be a powerful tool to minimize discretion in implementation of regulation, further made evident by the COVID-19 crisis.** Over 80 percent of surveyed households and 99 percent of companies had access to internet in 2020,[22] providing a solid basis for the digitalizing of services. In December 2019, Montenegro adopted the law on e-governance and amendments to the law on e-identification and signatures. In 2020, the government established a Council for E-Government. Currently, the provision of e-services is available through the e-portal which provides over 250 online services, but most of them are only informational. While submitting tax forms is conducted online, their complexity puts an administrative burden on businesses. The functionality of the e-service portal should thus be quickly boosted, which requires not only improvements in ICT infrastructure but also

close coordination across different government bodies and better communication to citizens. Digitalization is an important opportunity—both for digitalizing government services to improve the functioning of and trust in public institutions (see Section 3.4) and supporting companies to develop their digital capabilities and offerings. Addressing potential risks such as data privacy and cybersecurity and uneven access should be incorporated in the digitalization strategy from the early stage.[23]

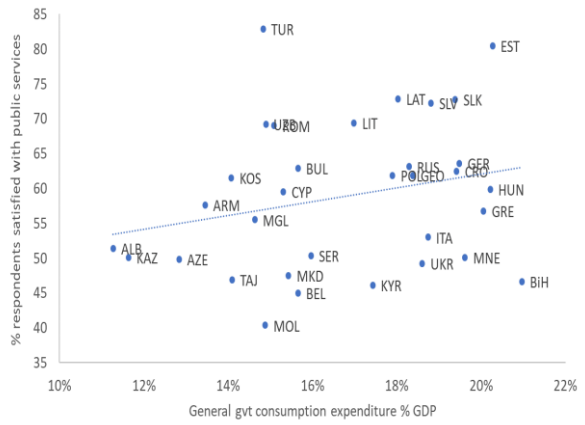
36. **Competitive markets are needed for a resilient recovery.** A dynamic and productive private sector requires a business environment where healthy competition is enforced, ensuring nobody benefits unfairly, including from informality, political connections, or other sources of influence. The practice of undeclared work[24] and underreported wages is widespread and costly, not only for the financing and quality of social services and the access to well-paid jobs (see Section 3.2), but also the private sector. In fact, unfair competition from the informal sector is perceived as a major obstacles by businesses.[25] It reflects weaknesses in the enforcement of rules and regulation, corruption, and high tolerance for tax-noncompliance.[26] Limited competition is also reflected in a very low average number of bidders submitted per tender in public procurement—only 2 in 2019. Montenegro's public procurement market reached 12.4 percent of GDP in 2019 and is an opportunity for domestic firms to compete, grow, and create jobs. While Montenegro has started to align its laws defining competition policy with EU standards, the implementation and required institutional changes are lagging. This includes boosting the mandate and capacity of the Agency for the Protection of Competition, for example, by allowing it to issue effective fines, review and influence critical legislation, and evaluate and publish the effectiveness of all state aid (in 2018, its state aid unit had 1 technical staff and a comprehensive state aid registry is still pending). Moreover, political connections are thought to be an impediment to a level playing field: six out of ten businesses believe that membership in political parties influences treatment by the court[27], with alleged vested interests exerting significant influence on the economy. Improving the rule of law and making public institutions more efficient, independent, accountable, and citizen- and business-centric are a foundation for creating a business environment conducive to growth, innovation, and entrepreneurship. It is thus necessary to reinforce the public institutions that enforce fair market competition to ensure that no one benefits from special treatment, which would force entrepreneurs to compete by innovating (see Section 3.4).

3.2 Enhancing service delivery, inclusion, and promoting work incentives

37. **Montenegro needs to strengthen investments in all its people for a resilient recovery and sustained prosperity.** Better opportunities for all to build human capital and participate in productive work are critical for rebuilding a stronger, more resilient economy and lifting more people out of poverty. Pursuing a development model that reduces Montenegro's vulnerabilities and enables more inclusive job creation, as discussed in section 3.1, is expected to lead to not only good jobs in the more developed coastal and central regions but also sustainable tourism opportunities with linkages to the local economy in the less developed northern regions. Policies to support inclusion will help poorer and disadvantaged groups to benefit. Those include service delivery and labor policy as well as targeted social protection and social inclusion policies. Strengthening human development, including for disadvantaged groups to equip themselves with the necessary skills to access jobs, would require enhancing service delivery. Despite high overall public spending, currently half of Montenegrins are

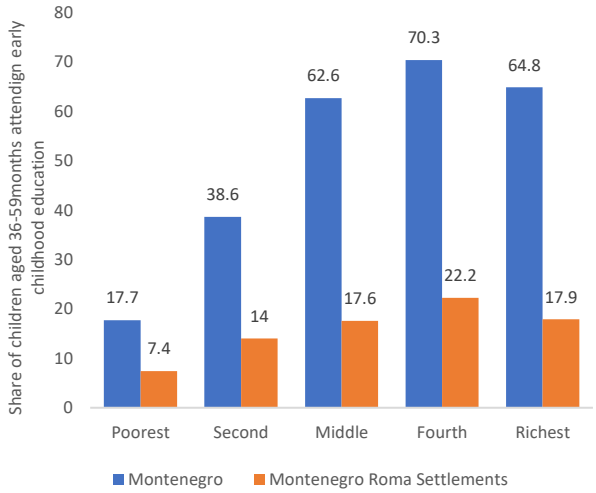
not satisfied with public services (Figure 23). Addressing constraints in the labor market and work disincentives, which currently disadvantage low-skill people, also remains important for increasing Montenegro's low labor force participation and employment rates. Service delivery and labor policy need to be complemented by effective social protection and targeted interventions to support specific disadvantaged groups such as the Roma and include them in the social dialogue.

Figure 23. Half of Montenegrins are not satisfied with public services



Source: LiTS Survey and World Development Indicators 2016.

Figure 24. Inequities start from a young age, especially for the poor and Roma population



Source: MICS 2018, UNICEF

38. **Reducing the barriers faced by youth, Roma, women, and poorer populations in Montenegro is necessary for sustained improvements in well-being for all citizens.** Youth, particularly disabled, lesbian, gay, bisexual, transgender, and intersex (LGBTI), and Roma youth, continue to face constraints to economic inclusion and lack voice.[28] The high unemployment rate among youth, 25.8 percent in 2019, constrains their long-term employment prospects. Around 17 percent of youth (aged 15-24) in 2019 remains not in employment, education, or training, which is high by international standards and above the EU average of around 10 percent. Scarring effects from periods of inactivity and unemployment prevent the accumulation of valuable skills and can have long-term effects on productivity and human capital.[29]
39. **Inequities in Montenegro start from a young age, with especially lower human development opportunities for the poor and Roma population (Figure 24**). COVID-19 will likely exacerbate existing gaps. As highlighted in the 2015 SCD, Roma people remain at a disadvantage and face multiple barriers to well-being. 21 percent of children under 5 in Roma and Egyptian settlements are stunted, compared to 7 percent in the general population (MICS 2018), and they face greater challenges in accessing the formal healthcare system. Although early childhood education has been increasing, gaps persist: the gross enrollment rate in preschool enrollment is 35 percent of rural children (62 percent in urban areas), 18 percent of the poorest children (65 percent of the richest), and 15 percent of Roma children.[30] The Regional Roma survey data also show that the employment gap between Roma (14 percent) and non-Roma living in same vicinity (37 percent) widened from 2011 to 2017.[31] Promoting Roma inclusion continues to require an integrated approach in several areas—education, labor

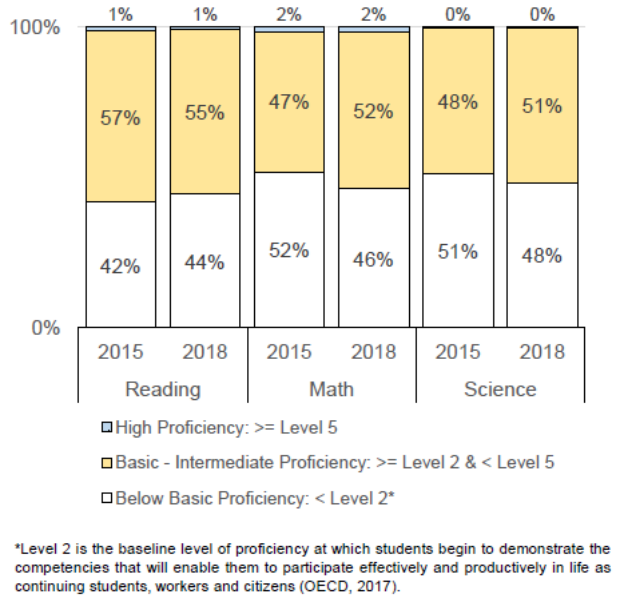
market, health, housing and access to essential services, and documentation—as well as building avenues for Roma voice and raising awareness about addressing any social stigma.

40. **Spatial inequalities further challenge inclusive development.** Sixty percent of all unemployed live in the less developed North, which hosts half of Montenegro's poor. Citizens in that region also have inferior access to social services and water, sewage, digital, and transportation infrastructure. This has led to continued strong migration from the North to the south in the past decades. Given the size of the country, access to services and job opportunities for people in lagging regions, especially for the youth, can be boosted by investing both in human capital and productive capacities and strengthening transport and communication infrastructure to better connect the North to the fast-growing coastal regions and Podgorica.[32] Moreover, the North, hosting the UN world heritage protected national park and other mountainous areas, provides opportunities to develop sustainable tourism such as ecotourism with strong linkages to the local economy's accommodation, agriculture, and travel service sectors, generating well-paid job opportunities and supporting inclusive economic development post-crisis (see Section 3.1 and 3.3). Improving public services and better connecting citizens in the North would also improve the engagement with all citizens and strengthen the trust in the government, a pre-condition for functioning public institutions (see Section 3.4).
41. **Although Montenegro has made progress in promoting gender equality, large gender gaps persist, particularly in access to economic opportunities.** With the Gender Equality Index value of 55 (out of maximum 100 points), Montenegro scored lower than the EU average of 67.4[33]. While the labor force participation rate among women aged 15 and above reached 49.9 percent in 2019, it remains substantially lower than 65.2 percent among men, and women's employment rate of 42.1 percent is still below 55.7 percent for men. Roma female labor participation rate is the lowest rate in the Western Balkans. In entrepreneurship, only 19.3 percent of firms had a woman as manager, and 10.5 percent of firms with female participation in ownership. In public administration, gender balanced representation in higher position is missing, as most of top positions are held by men.[34] In property ownership, Montenegro has almost three times more male property owners than female ones (74 vs. 25.9 percent).[35] Women earn less than men, with a gender wage gap of around 16 percent even after controlling for characteristics such as education and experience.[36] Limited access to affordable quality care, the structure of labor taxes and regulations, and social norms continue to constrain women's access to income-generating opportunities. Closing gender gaps in access to economic opportunities requires removing the barriers and disincentives to employment and entrepreneurship for women. These include: (i) improving access to assets and productive inputs, (ii) providing access to child and elder care and promoting workplace arrangements and flexibility to facilitate care duties, (iii) removing disincentives and barriers embedded in labor taxation and regulation, and (iv) increasing employability of women through effective active labor market policies and adequate skills and training. Gender-based violence remains a concern. Cross-cutting policies around social norms and discrimination; access to information; and monitoring and evaluation systems are also important.[37]
42. **Economic resilience and better opportunities for all require a more inclusive and effective education system.** Montenegro's Human Capital Index has improved over the past decade (from 0.59 to 0.63 between 2010 and 2020, driven by increases in expected years of schooling and harmonized test scores). However, it underperforms compared to countries in Central and Eastern Europe and the Baltics; for example, years of schooling after adjusting for quality is 8.9 in Montenegro compared to 9.8 in Serbia, 10.4 in Croatia, and 11.4 in Slovenia. Traditional teaching methods and the structure of vocational education and training hinder the quality and relevance of skills for the labor market.

Montenegro has among the lowest amount of recommended instructional time in Europe, with a gap to the EU28 average equivalent to nearly 7 weeks of schooling per year. Teaching and learning remain geared toward knowledge acquisition rather than critical thinking, despite a movement toward competency-based curricula.[38] Foundational skills are inadequate for nearly half of the students: about 44-48 percent of 15-year-old students still perform below basic proficiency for reading, science, and mathematics, compared to 31 percent for ECA region (Figure 25). The structure of secondary VET profiles and stratified enrollment patterns create mismatch with the labor market, while perpetuating inequities, though recent efforts to promote dual education shows promise.[39] Learning losses due to the COVID-19 pandemic will exacerbate existing deficiencies and could have long-term impact on human capital: The share of students performing below functional literacy may increase from 44 to 54 percent, and the reading achievement gap between the top and bottom quintiles is expected to increase.[40]

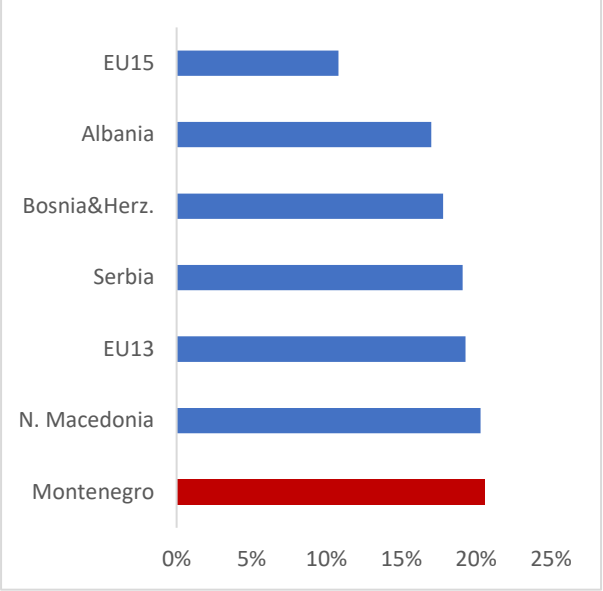
43. **How can Montenegro strengthen inclusive education and skills?** This would include: (i) extend coverage and quality of early childhood education; (ii) strengthen quality of basic education to equip students with necessary foundational skills; (iii) improve the supply, quality, and management of vocational and technical programs to improve transition to higher education and labor market; (iv) promote mitigation and learning recovery measures for all students after the unanticipated break due to the pandemic through diagnostic student assessments, catch-up sessions, and training on remedial approaches for weak students; and (v) continue efforts to develop reskilling and upskilling programs for adults. Targeted interventions may be needed to address specific issues for vulnerable groups. Improving teaching and learning outcomes continues to require stronger monitoring and quality assurance mechanisms, for example, consistency between school-level assessments and the new curricula and better alignment between pre-service teacher training and Standards of Competencies for Teachers and Principals. Smart use of digital technologies, including digital learning materials and assessments and building on the solutions introduced because of the pandemic, would also strengthen the quality, equity, effectiveness, and resilience of the education system.

Figure 25. Close to half of 15-year-olds perform below basic proficiency
(Share of Montenegrin students by proficiency level)



Source: OECD PISA 2018

Figure 26. Montenegro has high premature mortality from NCDs
(Mortality from NCDs, %)



Source: World Bank.

44. **Montenegro's health service delivery model needs to be more efficient given the pressure of an aging population and pandemic risks.** Public health spending (5 percent of GDP compared to the EU average of 7 percent of GDP) does not catch up with the rising cost of health care due to an aging population[41] and increasing non-communicable diseases, which imposes a financial burden on the population. The level of private out-of-pocket payment was almost 40 percent of total health expenditure in 2018, almost 3 times the EU average of 15 percent. While Montenegro has initiated recent efforts such as pharmaceutical regulation to contain expenditures and payment reforms, the service delivery model is not suitable for the disease burden and not sufficiently geared toward health promotion and disease prevention. The burden of non-communicable diseases (NCDs) is high and increasing due to high prevalence of behavioral risk factors and accounts for an estimated 95 percent of all deaths. Premature mortality from NCDs is high (Figure 26). Smoking prevalence, the main preventable risk factor, increased from 31 percent in 2012 to 46 percent in 2016.[42] The health system is hospital-centric and requires a different service mix that would give priority to primary care prevention and management of chronic conditions. Primary care can have a pivotal role in NCDs prevention, risk management, and early detection, but requires enhancing its diagnostic and prescribing capacity and investing more in its preventive role. The Covid-19 experience exacerbates long-standing financing and service delivery challenges and highlights the need to build a resilient health system. Moreover, the low coverage rate for the first dose of MMR vaccine in Montenegro, 42 percent in 2018 and falling in recent years, adds further public health risks to an already difficult pandemic situation.[43]
45. **Increasing efficiency and resilience to future shocks in the health sector is critical.** This will involve investing in critical pandemic preparedness gaps; increasing resilience and sustainability in health financing; reviewing options for improving service delivery by investing in primary health care; and containing pharmaceutical costs and improving rational drug use. Strengthening primary health care

and management of chronic conditions and emerging infectious diseases is key for building a resilient healthcare system. Continuing efforts to reform health financing would help to ensure that people have access to services through a financing scheme that provides incentives to reduce out-of-pocket payments and improve health. More use of technology such as telemedicine and other digital tools, building on the comprehensive Integrated Health Information System (IHIS), could make health and social care more easily available to more people during and after the Covid-19 pandemic.

46. **Improving road safety in Montenegro, the worst in the Western Balkans and well below the EU average, is also important for citizen's health.** Montenegro had 7.7 road crash fatalities per 100,000 population in 2018, compared to the best performing countries in Europe of 3 fatalities per 100,000. The high social and economic cost of crash incidents and fatalities is estimated to translate into 3.6 percent of the country's GDP, almost double the cost in comparator countries.[44]
47. **Improving resilience also requires stronger social protection services that are fiscally and socially sustainable to protect citizens against extreme poverty and against shocks.** Since 2015, Montenegro has been implementing a comprehensive social welfare information system called the Social Card, which has helped to minimize inclusion and exclusion errors and facilitated adaptation of social benefits, including payouts of additional cash support to the poorest during the COVID-19 pandemic. However, the effectiveness of social assistance is still hampered by the low coverage of poverty-targeted programs and inadequate integration with employment policies to activate beneficiaries. Design restrictions and resource allocation of social benefits as well as inadequate coordination between social assistance and employment policies reflect institutional weaknesses.[45] All social assistance programs covered only 4.7 percent of the total population and 15.7 percent of the poorest quintile (based on 2015 household budget survey data, the latest analysis available), low compared to other Europe and Central Asia countries. Only 15.6 percent of people in the poorest income quintile are covered by the country's main poverty-targeted programs—Family Material Support (FMS) and child allowances. Following the ongoing comprehensive social protection system review, Montenegro can improve efficiency and adaptivity of social assistance by considering a re-balance of resources across social assistance programs to increase the spending in poverty-targeted programs, improving program design to increase its coverage and ability to respond to shocks, and strengthening activation policies.
48. **As raised in the 2015 SCD, pension reforms are needed to further improve pension adequacy in a fiscally sustainable manner.** In 2020, Montenegro adopted the amendments to the Pension Law by which, among others, the minimum pensions increased from EUR128 to EUR145[46], the pension calculation period excluded a quarter of least favorable years of service, the retirement age was reduced from 67 for all to 66 for men and 64 for women, and a more generous "rotating indexation formula" (75% of wage or price inflation, whichever is higher, and 25% of the lower) introduced. Given the consistent deficits of the Pension Fund and the constrained fiscal space, Montenegro's pension system intervention would worsen its short run fiscal sustainability, decelerate the future erosion of adequacy but also raise future costs. Expanded costs would need to be adjusted to the fiscal capacities of the country, primarily by faster and decisive tightening of early retirement options. Ultimately, the retirement age, pension contribution rate and voluntary savings for retirement would need to be addressed again.
49. **Addressing constraints in the labor market and work disincentives remains important for increasing employment and economic inclusion.** Higher labor income was the biggest contributor to poverty reduction in Montenegro in 2013-17, and efforts to maximize job opportunities remain the most

important and sustained way to reduce poverty in the long term. Yet many Montenegrins are not working or searching for a job. Among people aged 15+, Montenegro's activity rate (57.4 percent in 2019) and employment rate (48.7 percent) remain far below those of neighboring EU countries. Inactivity and unemployment are even worse among poor households. Public-sector and informal employment represents 33 percent and 23 percent, respectively, of total employment. Only about 20 percent of Montenegro's workers aged 15 and above are employed in the formal private sector (Section 3.1 discusses the constraints to more formal private sector job creation).[47] Private sector employment is constrained by a clear preference for working in the public sector, as shown in the 2019 Balkan Barometer data. High labor taxes and contributions, particularly for low-wage and low-skilled workers, create high costs for employing them formally. The design of social assistance also reinforces barriers and work disincentives (e.g., by taking away one euro in benefits for each euro earned), and activation of social assistance beneficiaries remains limited. Introducing in-work benefit could provide a transition-to-work buffer for beneficiaries of family material assistance to motivate them to take on formal jobs without immediately losing social benefits. During the COVID-19 crisis and recovery, support programs and policies need to ensure targeting to those most in need, with flexibility of scaling back after the pandemic, as opposed to universal programs that might disincentivize work, create entitlements, and jeopardize fiscal sustainability. A recent example was the lifetime mothers' benefits introduced in 2016, which became fiscally unsustainable, incentivized women to leave the workforce, and had to be withdrawn in 2018.

50. **Continued efforts to strengthen job-matching interventions and equip the workforce with skills that match evolving labor demand are important**. Improving labor market policy would include continued implementation of the Labor Law adopted in 2019, considering options to lower the effective marginal tax rate for low-wage earners to increase incentives for formal jobs, and continued efforts to improve Active Labor Market Programs and labor intermediation services. The government can improve job matching by enhancing monitoring and evaluation and the effectiveness of active labor market programs implemented by the Employment Agency, including reducing barriers to productive youth employment.
51. **Enhancing service delivery and economic inclusion would require strengthening institutions** (see Section 3.4), such as a well-functioning public administration, greater accountability, and transparency. Continuing system reforms aimed at improving service delivery efficiency will be important for promoting economic resilience and inclusion in a fiscally sustainable way. Strengthening policy coordination and governance effectiveness is necessary to increase the cost-effectiveness of service delivery and implement unfinished reforms. In doing so, designing and implementing advanced digital transformation programs would increase government efficiency and quality of service delivery, enhance government-citizen communication, and improve governance and oversight.

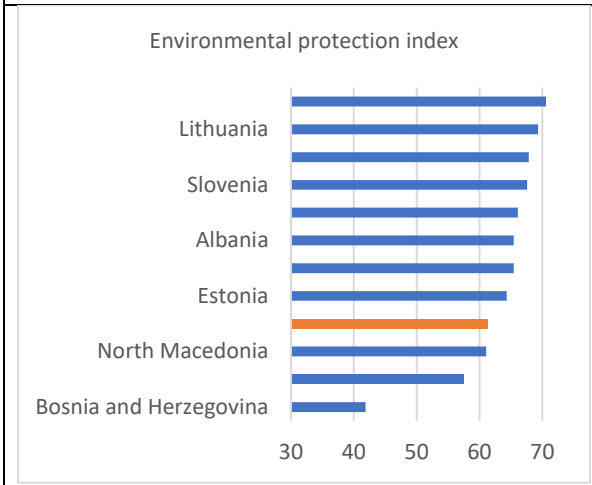
3.3 Improving natural resource management and climate resilience

52. **Montenegro faces an urgent need to ensure more sustainable management of the environment and natural resources, the basis of its comparative advantage in tourism and clean energy.** Montenegro is by constitution an ecological state, yet the protection of its environment and ecosystems continues to lag comparators in the EU (Figure 27). Environmental degradation and climate change typically have the strongest negative impact on the income and health of the poor and vulnerable. They also involve high economic costs by undermining tourism, Montenegro's growth and jobs engine.

Sustainable management of Montenegro's natural assets is therefore critical to ensure delivery of basic services and adequate infrastructure, such as waste and water waste management, to support tourism activities. Sustainable tourism potential not only in the coastal regions but also in mountain areas could spur job creation and inclusive economic development (see Section 3.1 and 3.2).

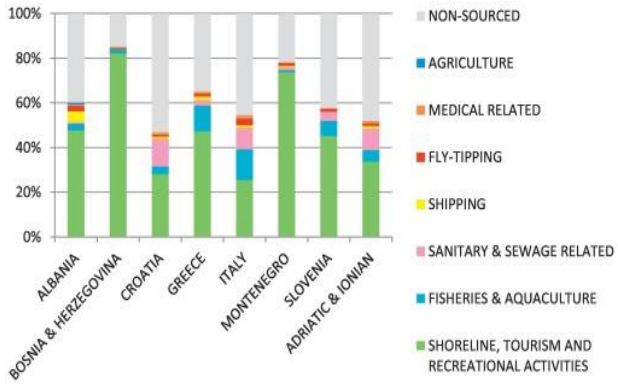
53. **Institutional strengthening and enforcement are necessary to strengthen natural resource management and climate resilience.** This includes a well-functioning public administration and translating strategic and legal commitments into actions (see also Section 3.4). Montenegro has modified its policy and legal framework in recent years, for example, the adoption of the National Strategy for Sustainable Development, the establishment of the Fund for Environmental Protection, the adoption of the Law on Environmental Impact Assessment, the National Climate Change Strategy, and adoption of the Law on Ratification of the Paris Agreement. In EU accession negotiations, Montenegro opened Chapter 27: Environment and Climate Change and adopted the National Action Plan for meeting the closing benchmarks for Chapter 27 in 2020. However, significant further steps are necessary for implementation and enforcement of reforms needed to achieve this, particularly on waste management, water quality, nature protection, and climate change.[48]

Figure 27. Montenegro lags peer countries on environmental protection.



Source: Environment Protection Index 2018 ranks 180 countries on 24 performance indicators across ten issue categories covering environmental health and ecosystem vitality

Figure 28. Montenegro's tourism sector is a main contributor to the pollution of the Adriatic coastline



Source: L. Gjyli et a., 2019.

54. **More effective marine litter management is needed to sustain tourism activity.** Most tourists are attracted to Montenegro by its pristine natural beauty. Yet Montenegro's tourism sector is a main contributor to the pollution of the Adriatic coastline (Figure 28). Most of Montenegro's tourism is concentrated in the coastal region, and during the peak season, the number of tourists in certain towns is as high as three-times the number of residents. Cruise tourism (with a higher negative impact on marine environment) has been increasing in recent years. Montenegro has the highest per-capita plastic leakage into the Mediterranean Sea (Figure 29). This plastic leakage, however, comes not only from tourism activity in the coastal region but also via rivers and streams carrying plastics into the sea. Solid and water waste management in the coastal area remains a significant issue. Podgorica ranks third among the localities contributing the most waste leakage. Pollution and the environmental

degradation of its coast, rivers, and lakes thus pose a substantial threat to the sustainability of Montenegro's growth and jobs. In 2019, Montenegro adopted the Law on Marine Environment Protection, and by 2022, a new monitoring program should be developed that would allow for better quality and more frequent data on marine environment protection.

Figure 29: Montenegro has the highest per-capita plastic leakage into the Mediterranean Sea

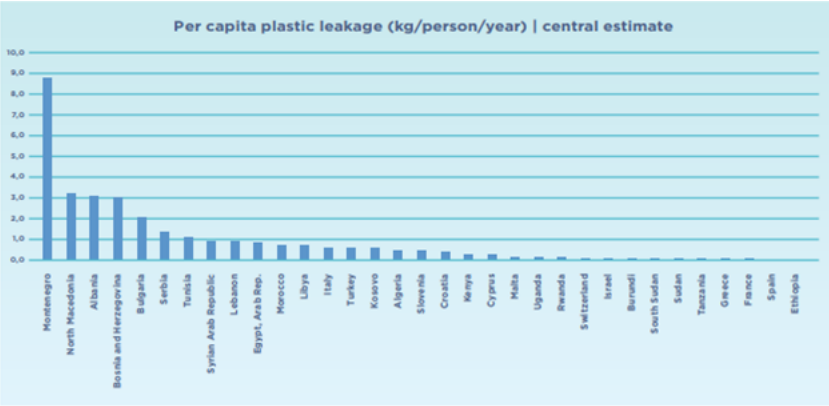


Figure 4.3: Overview of the plastic leakage in the Mediterranean basin for macroplastics and microplastics.

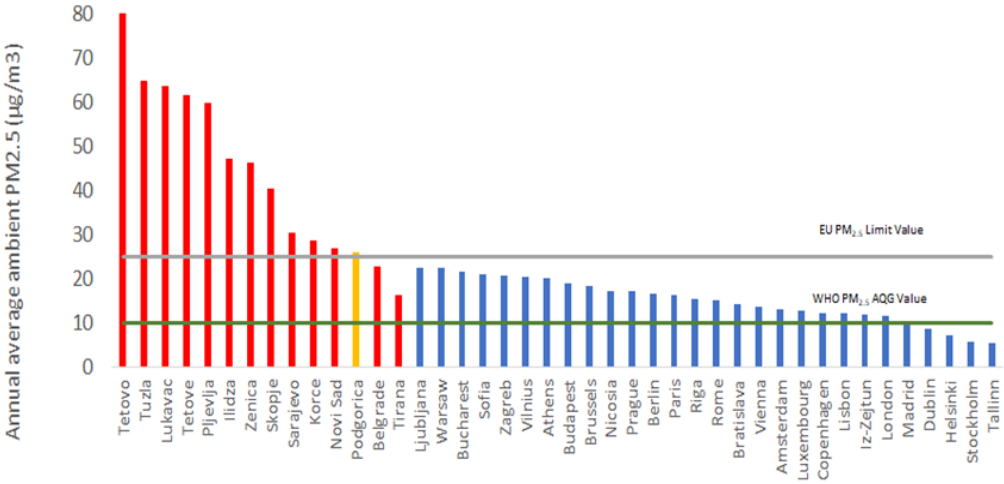
Source: Boucher, J. & Bilard, G. (2020). The Mediterranean: Mare plasticum. Gland, Switzerland: IUCN. https://portals.iucn.org/library/sites/library/files/documents/2020-030-En.pdf

55. **Solid and water waste management weaknesses remain and must be urgently addressed.** Inefficient management of solid waste, including industrial waste, remains a problem as previously analyzed in the 2015 SCD. Industrial waste sites are still posing a significant problem for the environment, tourism development, and public health of surrounding communities. The 2015-2020 national waste management plan does not clarify the country's basic waste management model, and insufficient cooperation between municipalities and poor engagement of the public in the separation of waste continues. In 2019, 518kg of municipal waste was generated per capita, much higher than the regional countries and most of the EU small states[49]. Moreover, almost no recycling takes place (only 1 percent of the municipal waste and 2 percent of the industrial waste was recycled in 2019) and infrastructure for separate waste collection and recycling relies on a few recycling centers in four municipalities. By comparison, 30 percent and 29 percent of municipal waste in Croatia and Estonia, respectively, was recycled. Moreover, a large proportion of fishing gear is dumped or lost at sea, due to high costs of disposal and to limited port collection facilities.[50] There is also an urgent need to remedy illegal waste disposal and the use of temporary waste disposal in all municipalities[51]. The 2019 EU Progress Report highlighted the absence of well-functioning management authorities, a not yet operational water monitoring system, and wastewater as a major source of pollution. The municipal wastewater disposal into the sea is a major contributor to the marine pollution, while in the northern region, wastewater is discharged into rivers or infiltrated into the ground. While there are some improvements in service coverage and quality in the past few years, water service provision sustainability (including collection rate and customer satisfaction) has decreased during this period.[52] The performance and financial sustainability of water and sewage utilities remain a challenge. Infrastructure investments for both water and sanitation would have to be scaled up to move toward EU standards. The compliance rate for the quality of drinking water is only 85 percent, and that for

effective level of wastewater collection is 28 percent. What is more, only 8 percent of wastewater is treated as collected wastewater might often be discharged untreated or not sufficiently treated.

56. **Apart from waste, the rivers are also affected by the construction of small hydro plants, which is facing vested interest problems and strong opposition from the public.** The concerns relate to rivers and streams being dammed and put into derivation pipes, and deforestation for the construction of access roads and pipelines can lead to erosion and habitat destruction. The costs of the subsidized price are being transferred to beneficiaries. The civil society has been vocal about the vested interests among the small hydropower plants owners and the political elite[53]. The new government decided to suspend the procedure of approving the construction of new small hydropower plants until the contracts concluded so far are reviewed. Going forward, an environmental and social impact assessment for all new hydropower projects should be carried out to inform investment decisions and environmental and social safeguard actions. Regional cooperation to improve mechanisms and capacity to plan and manage the transboundary Drina River Basin, incorporating climate change adaptation, is also important to manage natural resource against flooding and for tourism and hydro power.
57. **Preserving the natural environment requires sustainable management of Montenegro's biodiversity overall and the implementation of existing legal frameworks.** While Montenegro has the legal framework in place[54], weaknesses in monitoring and implementation remain. Biodiversity is threatened by fires, illegal deforestation, landfill, and wastewater discharge. Better management of Montenegro's abundant forests (which cover 60 percent of the country territory) would not only safeguard CO2 absorption but also provide opportunities to grow sustainable wood production and related industries (see Section 3.1). To preserve Montenegro's biodiversity, the country needs to continue tangible measures to preserve and improve the ecological value of protected areas and Natura 2000 sites for protected habitat, as well as to designate marine protected areas. Seasonal tourism increases the pressure on local infrastructure and ecosystems, especially in the coastal region. Some of the coastal areas are overly developed (Budva, now Boka Bay), threatening the unique biodiversity value of this area and its UNESCO status. Thus, the need for integrated sustainable coastal management remains key, together with strengthening the monitoring mechanisms, improving the enforcement capacities of the relevant authorities, and increasing awareness among the general population of the importance of biodiversity preservation.
58. **Elevated levels of air pollution harm people's health and livelihoods as well as the economy.** The most affected places, Pljevlja and Podgorica, are among highly polluted cities in Europe (Figure 30). In 2019, Pljevlja experienced 140 days of particulate matter (PM10) levels exceeding the daily limit, and the average annual concentration was very high at 58µg/m3.[55] Almost 6 percent of all mortality cases in Podgorica, 12 percent in Niksic, and 22 percent in Pljevlja could be attributed to the current level of air pollution in these cities. In more than half of these cases, the effects were related to increased levels of air pollution in winter as a result of the use of fossil fuels[56]. The main sources of air pollution in Montenegro are in energy (heating use of firewood and coal for heating), traffic, and industry, and from the neighboring countries[57]. While some of the legislation has been harmonized with the EU requirements, in practice, not much is being done to improve the air quality, and there's an urgent need to establish monitoring. Sustainable energy development is critical to support GHG emissions reduction and air quality improvement in Montenegro, including, for example, an accelerated phasing out from coal generation of electricity and possible incentives to the local population in Pljevlja to use alternative sources of energy.

Figure 30: PM2.5 levels are higher than the levels the WHO considers safe



Source: WHO Ambient Air Quality Database.

59. **As raised in the 2015 SCD, Montenegro is vulnerable to natural disasters**, especially floods and earthquakes, which can cause significant damage to infrastructure, the economy, and people's livelihoods, especially among vulnerable groups. The country ranks seventh among ECA countries in output affected by a 100-year flood.[58] Strengthening the resilience of infrastructure requires explicit resilience considerations in road management planning and maintenance and prioritize investment needs in the most crucial transport links.
60. **Resilience requires climate policy and translating climate commitments into actions.** Climate change results in a wide range of significant economic and fiscal risks for countries as it threatens existing and new economic assets (natural and built such as infrastructure), changes the existing profile of health risks, and, as a result, can require costly mitigation and adaptation measures that accumulate over the medium and long term. It also results in the loss of biodiversity and coastal erosion, threatening Montenegro's pristine natural resources and the sustainability of tourism and agriculture. In 2015, Montenegro adopted its National Strategy on Climate Change until 2030, but considerable efforts are still needed to harmonize with the EU 2030 climate and energy policy framework. In 2017, Montenegro submitted its first Nationally Determined Contribution (NDC) for climate action, focused on mitigation[59], but adaptation measures are also important to sustain tourism activities. In December 2019, Montenegro adopted the Law on Protection from the Negative Impacts of Climate Change (PNICC), which, together with the secondary regulation establishing an emission trading scheme from February 2020, is a significant milestone for the country's decarbonization path. The corresponding secondary regulation specifies the operators participating in emissions trading, determines the total amount of emission credits to be auctioned, and sets a minimum price of EUR24 per tons of CO2. The funds raised from the scheme are prescribed to be transferred into the Environment Protection (Eco) Fund and used for environmental protection measures and support for renewables and innovation. However, although established in 2018, the Eco Fund is still not operational. Despite progress made, Montenegro needs to develop and adopt the remaining secondary legislation to implement the Law on PNICC, and considerable effort is still needed to align with the EU acquis.[60]
61. **Investing in green energy will help to leverage Montenegro's comparative advantage.** Cleaner sources of energy such as water, solar, wind energy should remain Montenegro's energy priority while leveraging the EU Green Deal and Western Balkan Economic and Investment plan.[61] Montenegro's

energy intensity was 2.3 times higher than EU average in 2017. Montenegro has made a strategic shift to increase the supply of renewable energy sources which in 2019 accounted for almost 60 percent of electricity production. Since 2017, two wind farms Krnovo and Mozura have been installed and are currently operational. In 2019, wind and solar constituted almost 9 percent of the energy mix compared to 0 percent in 2015. During ten consecutive days in May 2019, Montenegro managed to meet the entire electricity demand from renewable sources. In 2019, the undersea cable interconnector (capacity of 600MW) between Montenegro and Italy became operational, creating significant opportunities for Montenegro's renewables energy sector as it becomes a regional energy hub connecting the Western Balkans energy market to the EU. Due to decreasing solar and wind energy costs, there has been increased private sector participation in the provision of renewable energy without government's support. The Government has started implementing the Energy Development Strategy of Montenegro by 2030 with a more explicit emphasis on sustainable energy development, which is organized around three pillars: energy efficiency, decarbonization of the energy sector, and renewable energy. However, there are significant constraints to expanding energy efficiency investments into the residential and commercial sector, in part due to limited laws, institutions, and mechanism to support improvements. A broader decarbonization of the economy will require assessments, coal transition planning, and actions on government systems; people and communities; and repurposing land and assets.

3.4 Strengthening resilience requires stronger public institutions and rule of law

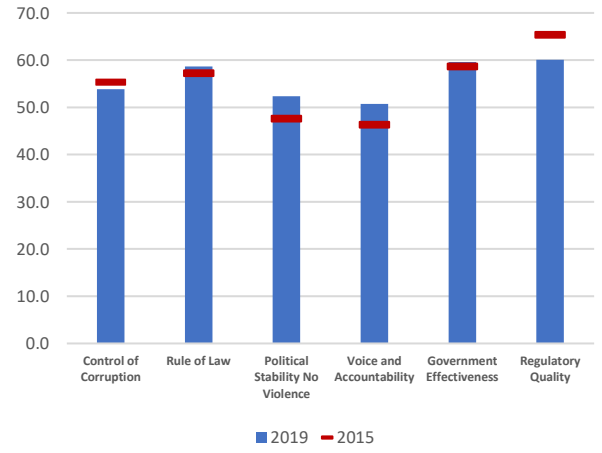
62. **Strengthening the quality of public institutions—including the public administration, the judiciary, and independent public agencies—is critical to enforce more resilient macroeconomic, social, and environmental policies.** The development impact of a reform depends on the quality of the primary law providing the framework, its bylaws and rulebooks implementing it, and the enforcement of this legislation. The analysis in Sections 3.1-3.3 has shown that the success of policies aiming improve macroeconomic stability and private sector productivity, inclusive and efficient social services, and natural resource management, all hinge on the mandates and effectiveness of the public institutions enforcing them (Figure 31). For example, many of the legal frameworks in all these 3 areas have been harmonized with the EU standards, but the implementation of major framework laws is pending, including the Labor Law, Banking Laws, or Laws on Environmental Impact Assessment and Climate Change. Other critical reforms have been delayed or only partially implemented, including the public administration reform or new platforms for e-government services and e-procurement. In many cases, however, the existing legislation safeguarding the functioning of markets and medium-term policy planning fails to be effective due to weaknesses in the mandate or capacity of the public administration, independent public agencies, or the judiciary enforcing them. Weaknesses in the public administration resulting in a lack of enforcement range from solid and water waste management, legislation preserving biodiversity, road safety, or reporting wages, to medium-term budget plans and countercyclical macroeconomic policy, the use of cost-effective treatment and drugs in the health sector, the quality of education linking funding to learning outcomes, better coordination between social assistance and employment agencies, or the control of corruption. The limited mandate or capacity of public agencies can further undermine the rule of law as exemplified by the lack of antitrust enforcement and penalties and monitoring of state aid policy. Finally, political economy constraints can hinder the enforcement and consistent application of existing legislation as illustrated by inefficiencies in the judiciary or the dealing with potential private sector vested interests

such as the small hydro power plants. In the following, we briefly review institutional progress since 2015 and present options to strengthen the quality of public institutions that enforce more resilient policies.

Figure 31: Reform progress in Montenegro is primarily limited by the quality of public institutions enforcing new laws and regulations

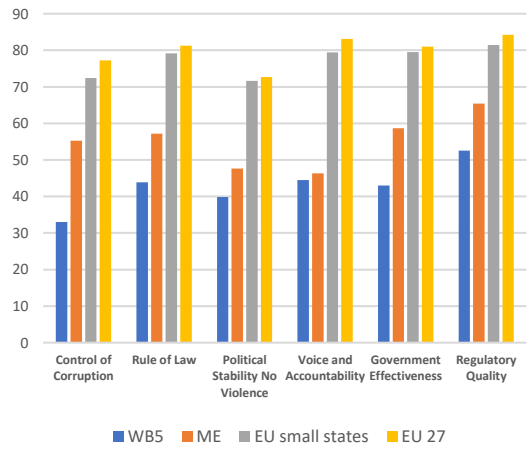
63. **Improvements in governance and strengthening institutions have largely stalled in recent years.** The 2015 SCD recognized strengthening governance institutions as pivotal for reducing poverty and increasing opportunities for shared growth in Montenegro. It included a detailed institutional analysis covering the state legitimacy, transparency, voice and accountability, trust and informality, corruption, justice and rule of law, regulatory barriers, and public service delivery. The World Bank's Worldwide Governance Indicators (WGI) continue to show a stagnation in governance improvements, reflecting the rule of law issues as a major impediment to economic, social and political progress. Since 2015, there were incremental improvements in political stability and voice and accountability, while backsliding was observed in control of corruption and regulatory quality (Figure 32). And while Montenegro is, on average, doing better in terms of governance than the other Western Balkan countries, it continues to lag well behind the EU small states and the EU (Figure 33). Promoting simple, efficient, and transparent government with the citizen at the center of reforms is critical for making public sector and its services efficient and conducive to economic and social wellbeing.

Figure 32: Montenegro has made mixed progress in improving governance since 2015.



Source: WBGI, WB staff calculations

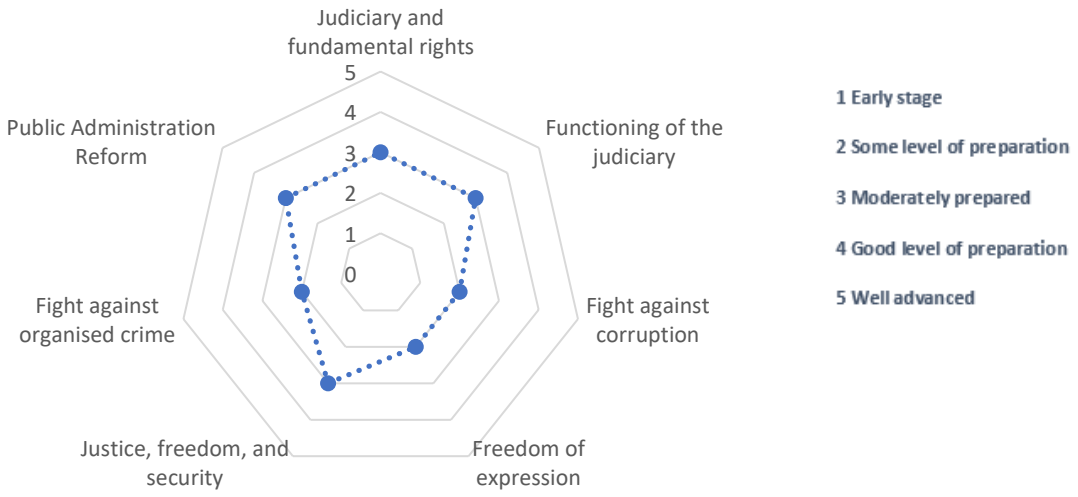
Figure 33: Montenegro's governance lags EU member states.



Source: WBGI, WB staff calculations

64. **Montenegro's institutional building is strongly anchored in the EU accession process.** Montenegro started the accession negotiation with the EU in 2012 and has so far opened all 33 negotiation chapters but has provisionally closed only 3. After more than 8 years of accession process, the rule of law issues remains a major impediment to Montenegro's speedier integration in the EU: the country has only *some level of preparation* in the areas of fight against corruption, fight against organized crime, and freedom of expression (Figure 34). Although Montenegro has aligned much of its legislation with EU standards, the implementation gaps have reduced the effectiveness of well-conceptualized policies, and some required institutional changes are lagging. To close the negotiation with the EU, Montenegro needs to demonstrate a solid track record of judicial reforms and existence of an independent judiciary with capacities to efficiently perform its tasks of maintaining and safeguarding the rule of law is a cornerstone of these policies.[62]

Figure 34: EU Political criteria - level of preparation

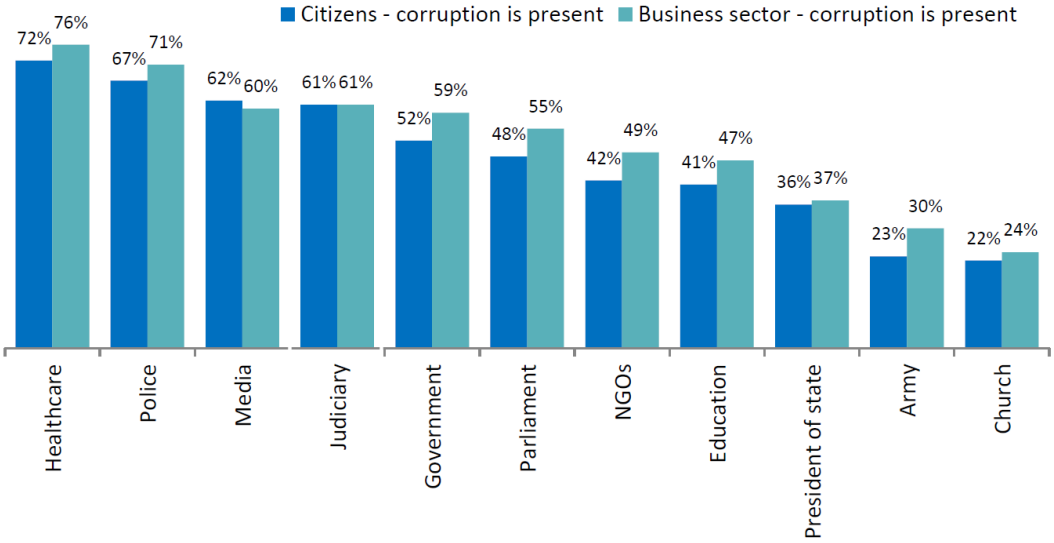


Source: European Commission Report on Montenegro (2020).

65. **Corruption due to state capture and the perception of corruption are significant problems in the Montenegrin public and private sectors.** Citizens are significantly concerned about corruption, and corruption is often cited as a risk by foreign investors[63]. An improved legal framework to help combat corruption and organized crime has been in force since the adoption of the Law on Prevention of Corruption in 2014 and the Law on the Special State Prosecution in 2015. Despite legal improvements, corruption remains Montenegro's major problem. A recent survey showed that one in four citizens thinks that corruption is prevalent in public administration.[64] A 2016 survey conducted for the World Bank indicated more than 60 percent of citizens and businesses believed that corruption was present in the judiciary (Figure 35)[65]. In 2020, the Freedom House downgraded Montenegro from a "semi-consolidated democracy" to a "hybrid regime", indicating judicial independence, media freedoms, and corruption as serious issues. The effective action in response to high-level corruption cases was almost absent, with evident reluctance to counteract corruption effectively. In 2020, the Transparency International Corruption Perception Index list placed Montenegro 67th out of 180 countries. Corruption weakens confidence in public institutions, privileges rent-seeking[66] and lobbying for special treatment over entrepreneurship and innovation, undermines investors' confidence, and

weakens poverty alleviation programs or public services such as health and education. Fighting corruption by strengthening the independence of the judiciary and the integrity of public authorities and their enforcement capacities would level the playing field for businesses and encourage investors.

Figure 35: Citizens and businesses find corruption prevalent across sectors

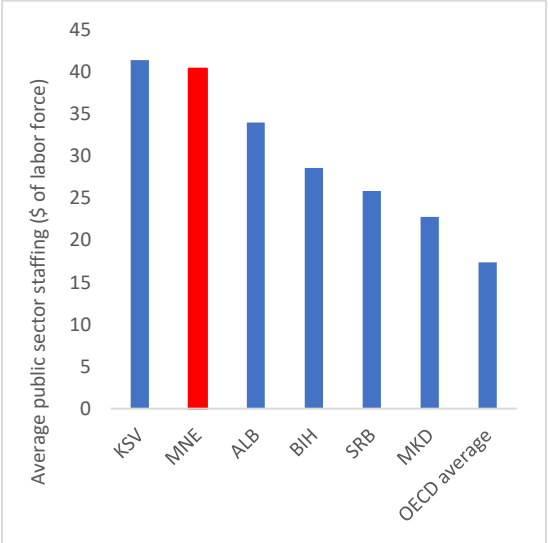


What does it take to strengthen the quality of institutions and enforcement and thus economic resilience in Montenegro?

66. **Strengthening Parliament's legislative and oversight role and improving its communication and cooperation with citizens is essential for strengthening accountability and public policy effectiveness.** Parliament's role in exercising oversight has been limited, while policy debate remained weak reflected in unanimous voting by ruling MPs and opposition MPs boycotting the Parliament. During coronavirus outbreak and government's policy responses to the pandemic, the Parliament itself was in the lockdown, reflecting its weak oversight over the government. The practice of boycotting the work of Parliament by opposition MPs, which started in 2016, has continued into 2021 as well, undermining Parliament's role of running political and policy dialogue. The European Commission assessed that "limited progress was made in improving parliamentary accountability, the oversight of the executive and democratic scrutiny, and the legislative-making process"[67].
67. **Optimizing Montenegro's large public sector would reduce inefficiencies and strengthen service delivery and accountability.** Despite continuous commitments to public sector staff optimization[68], the public sector wage bill has been growing by 4.4 percent on average over the last five years . The high public sector wage bill primarily originates from the large number of public sector employees. While gross wages adjusted for workers' education and characteristics are on par with private sector averages, Montenegro's employment share in the general government (which includes the SOEs) is 40 percent, one of the highest in Europe and the second highest in the Western Balkans (Figure 36). Moreover, the public employment and wage bill do not include temporary service contracts, the planning, managing, and monitoring of which is very weak and lacks a clear framework. Spending on temporary service contracts has been above the planned amounts by 30 percent on average in the last 7 years, while actual spending is larger, as it is often reported under different budget lines.[69] In

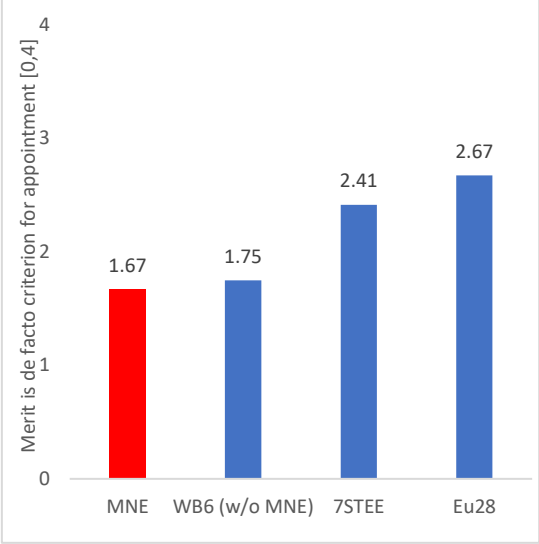
2018, the authorities adopted the Public Sector Optimization plan which was supposed to result in reduction of the number of employees at both central and local levels, but the implementation was weak and progress difficult to follow as Montenegro does not have a central register of public sector employees. Politicization of the public service is also considered a major challenge.[70] Recruitment practices in Montenegro are not perceived to be based on merits which discourages and can even prevent skilled graduates from working in the public sector (Figure 37). The efficiency and capacity of the public administration can be strengthened by adhering to merit-based recruitment and promotion practices and introducing control mechanisms and accountability for staffing. In order to identify redundancies and overlapping of responsibilities, a functional review must be performed that would also be used as a starting point for the optimization going forward.

Figure 36: Montenegro's high public sector wage bill is driven by the large number of public sector employees...



Source: latest LFS data, 2018 for MNE, World Bank estimates. Note: Public sector employees in MNE include central and local government and SOEs.

Figure 37: ...while inefficient recruitment practices appear to undermine government effectiveness..



Source: VDEM, World Bank 2018

68. **Improving public financial management (PFM) is critical to address existing spending inefficiencies and would signify savings and scope for improving public services quality.** Since 2016, Montenegro has undertaken an ambitious PFM reform program, but implementation has been moderate with significant delays across different areas. The 2019 PEFA report found that fundamentals of the PFM system are in place and core functions are performing well, but more advanced elements of PFM system require further improvement. Identified challenges include a lack of robust and binding medium-term budgetary planning; insufficient commitment to fiscal targets and rules; weak management of public investment, assets, and fiscal risks; poor performance measurement and evaluation; and a lack of an assessment of expenditure effectiveness. Addressing these challenges would significantly improve the efficiency and equity of government operations and increase participation, transparency, and accountability.
69. **Improving State-owned Enterprises (SOEs) and state aid governance can reduce market distortions, rebalance jobs to private sector, and reduce fiscal costs or generate extra revenues.** SOEs have often

been used as employment hubs, and those in the transport sector have been unlawfully receiving state aid for years. The data on employment in all SOEs is not available, reflecting weaknesses in government's monitoring and SOE governance. The European Commission has been flagging that transport SOEs are not competitive and that their losses have been transferred to the state.[71] The State Audit Institution has found that state aid was often paid from different budget lines and without a legally-binding opinion of the Agency for Competition. In 2019 alone, almost EUR16 million was paid out to SOEs in this manner[72], while in December 2019, the Parliament adopted a Law on providing EUR155 million to Montenegro Airlines, which in September 2020 the Agency for Competition found incompliant with the Law on State Aid and requested any further financial support from the budget to stop. In December 2020, the government announced to wind up chronically loss-making Montenegro Airlines. SOEs top the Tax Administration list of companies with the highest amounts of tax arrears.[73] The insolvent SOES are to a large extent a consequence of poor SOE governance and decisive actions are needed to strengthen it. At the same time, a central registry of all state aid would allow for greater transparency and accountability, also providing data for much needed monitoring and evaluation of the efficiency of state aid.[74]

70. **Transparency and digitalization are critical to combat corruption and enhance the effectiveness and accountability of public administration.** While Montenegro's key aggregate fiscal documents are available to public in an appropriate and timely manner[75], more detailed information is often missing. The civil society has been vocal about the availability of more auxiliary information and the recent increasing trend of classifying information as confidential. Some important data and information regarding the construction of the largest public investment costing over EUR1 billion have been classified as confidential, including the feasibility study. The European Commission assessed that "the implementation of the current law on free access to information has not helped to increase the accountability and transparency of the public service". While Montenegro established the open data portal, more targeted and well-systematized data would increase its usage by businesses, citizens, and research and CSO community. Increasing digitalization of government and its services is a powerful tool to increase transparency, cost-effectiveness, and accountability of the public sector, while at the same time reducing administrative costs for businesses and citizens and improving their relationship with the government.

71. **Strengthening the rule of law is often quoted as the main priority for boosting private sector development**.[76] According to the World Bank Perception Survey on Judiciary, a high percentage of users of judicial services and lawyers believe that the judiciary does not treat all citizens equally. As much as 63 percent of the citizens think that membership in political parties has an effect on treatment by the court, while 57 percent think that differences in the treatment exist also depending on different economic status. Strengthening judiciary and institutions that enforce fair market competition and prevent corruption are critical for improving the business environment. As public procurement is one of the government activities most prone to anti-competitive practices and corruption, the relevant framework should ensure the most efficient use of public funds through an open, transparent, fair, and compliant public procurement process. A significant step towards increased transparency and competition is the introduction of e-procurement, which became operational in January 2021[77]. The authorities need to do more to improve the predictability of the regulatory framework and implement it consistently. Substantive improvements will require a concerted effort with strong leadership from the government, and good coordination among various agencies and institutions. In 2020, only 35 percent of surveyed businesses reported to have been

included in the legislation process, while less than 19 percent responded to have participated in public consultation process.[78] The reforms need to be informed by the views of the private sector on where the real problems are. At the same time, reforms leveling the playing field need to overcome the resistance from private sector firms that stand to lose specific policy protection or benefits.

4. Priorities for improving economic resilience to achieve more sustainable growth and poverty reduction

72. **The SCD Update revisits the priority areas for Montenegro today, with a focus on the need to improve economic resilience and enable a sustainable and inclusive recovery**. Recent developments since the first SCD illustrate the recurring challenge of Montenegro's strong boom-bust cycles, with remaining structural challenges in the economy, labor market, social service delivery, natural resource management, and the strength of public institutions. Many of the same constraints still reinforce Montenegro's vulnerabilities and prevent sustained progress on shared prosperity and poverty reduction. The COVID-19 crisis has further exemplified these vulnerabilities and made the policy priority of strengthening economic resilience more urgent.
73. **Reducing Montenegro's vulnerabilities and strengthening resilience requires a different development model:** one with a broader growth and tourism strategy based on stronger domestic linkages and productivity, more equal and efficient social services and better work incentives, and sustainable natural resource and climate policy. To have an impact, this development model needs to be underpinned by stronger institutions that enforce the rule of law, market competition, and safeguard medium-term planning. This model is expected to lead to not only good jobs in the more developed coastal and central regions but also sustainable economic opportunities with linkages to the local economy in the less developed northern regions. Policies to support inclusion—such as service delivery and labor policy as well as targeted social protection and social inclusion policies—will help poorer and disadvantaged groups to benefit. They enable disadvantaged groups to build critical human development to access jobs and relieve constraints such as labor tax and work disincentives that disadvantage them. Complementary policies such as effective social protection and targeted interventions to support specific disadvantaged groups are important.
74. **The Update identifies 9 priority areas, shown in Table 3**. Prioritization in the SCD Update takes the list of priorities in the 2015 SCD and puts emphasis on the most critical ones for strengthening resilience. Prioritization is informed by new knowledge from recent analytical work and takes stock of the latest key data and knowledge gaps (see Annex 4). The SCD Update is also informed by internal team discussions and external consultations with stakeholders. The Update's priority areas are similar to those identified in the 2015 SCD, with two adjustments (Annex 2 shows the matching). First, while the previous SCD does not group priorities, the Update presents them in three tiers—precondition/foundational, high, and supporting priorities—to highlight the policies that are essential to strengthen economic resilience, including a resilient and inclusive recovery from the COVID-19 crisis. Second, the formulations in the previous SCD have been updated for three priorities. Specifically, the previous priorities on equal economic opportunities and on human capital are slightly reformulated and embedded in "*Provide equal access to quality social services and opportunities to boost human capital*" and "*Reduce the cost to create formal jobs and strengthen incentives for work*" in the Update, due to the need for equal opportunities to start early and how they link closely with human development and job access. The previous priority on EU integration is now reflected in "*Align the quality of public institutions with the EU to strengthen the enforcement of laws and regulation*."

Table 3: Summary of priority areas

Priorities	
Ensure sound fiscal policy	
Ensure financial stability by strengthening bank regulation and supervision	
Strengthen the social protection system to safeguard against shocks	
Strengthen natural resources management, adaptation, and environmental risk mitigation	
Provide equal access to quality social services and opportunities to boost human capital	
Reduce the cost to create formal jobs and strengthen incentives for work	
Improve connectivity and infrastructure integration	
Level the playing field among private sector to encourage entrepreneurship, innovation, and productivity growth	
Align the quality of public institutions with the EU to strengthen the enforcement of laws and regulation	

Note: Italics denote where the text has been updated from the formulation in the previous SCD. Red, orange, and yellow show tiers of priorities from precondition/most critical to high and supporting priorities.

75. **Ensure sound fiscal policy to accelerate debt reduction**: The implementation of prudent fiscal policy and management is critical to sustain fiscal sustainability, a bedrock for resilient and inclusive growth. Periods of procyclical spending and the lack of fiscal space have exacerbated boom-bust cycles and the social vulnerabilities to these macroeconomic fluctuations. To get debt down to prudent levels, Montenegro will need to achieve and maintain primary fiscal surpluses in post-crisis years. The fiscal adjustment must focus on identifying and reducing inefficient spending. These could include implementing a public administration reform focused on rationalizing the number of public sector employees, improving tax policy and administration, while minimizing potential adverse social impacts in the short-term. To the end, Montenegro must start to comply with and enforce its fiscal rules which requires an effective public financial management system with reliable and transparent data management, reporting, monitoring, and enforcement mechanisms. Stronger public financial management includes strengthening public investment management and continuing the public procurement reform. The more efficient public spending would boost growth and create the fiscal space to support the recovery from the pandemic. The strengthening of fiscal institutions (including the establishing of the independent fiscal council) would allow to sustain higher quality spending and reduce debt to levels consistent with Montenegro's fiscal rules, a prerequisite to weather future shocks.
76. **Ensure financial stability by strengthening bank regulation and supervision**: Financial sector resilience is also a prerequisite for macroeconomic stability. Enforcement of financial sector regulation has led to the liquidation of two smaller domestic banks in early 2019, supporting a consolidation process in the sector. Addressing remaining pockets of vulnerabilities and strengthening the regulation and supervision of the quality of loan portfolios following the Basel Core Principles to

prevent the build-up of new ones, are key priorities to strengthen resilience. The COVID-19 crisis further tests the resilience of the financial sector. So far, key financial sector indicators have been stable, but the full crisis impact on asset quality will only show once the government crisis response program, including the loan moratorium, phase out. Moreover, access to finance remains a major constraint to growth for SMEs in Montenegro. Improving access typically requires stronger non-bank financial institutions, including leasing, factoring, and micro finance activities, but it also requires reducing the importance of vested interests in lending.

77. **Strengthen the social protection system to safeguard against shocks:** Effective and adaptive social protection remains crucial to protect the poor and vulnerable given Montenegro's strong vulnerabilities to excessive boom-bust cycles. The COVID-19 pandemic has shown gaps in the system's resilience and flexibility to extend protection to vulnerable citizens during the crisis. Following the ongoing comprehensive social protection system review, Montenegro can improve efficiency and adaptivity of social assistance by considering a re-balance of resources across social assistance programs to increase the spending in poverty-targeted programs and improving program design to increase its coverage and ability to respond to shocks.
78. **Strengthen natural resources management, adaptation, and environmental risk mitigation:** Sustainable management of Montenegro's natural assets is not only critical to ensure delivery of basic services but also the backbone of its comparative advantage in tourism and clean energy. But the enforcement of laws that protect nature and biodiversity is weak, and difficulties in solid and water waste management need to be addressed urgently. Only 8 percent of wastewater is treated. Municipal wastewater disposal into the sea or into rivers in Podgorica and the North is a major contributor to the Adriatic marine, lakes, and rivers pollution. Moreover, climate change is projected to lead to the loss of biodiversity and coastal erosion, threatening Montenegro's pristine natural resources. While Montenegro developed strategies for climate change mitigation, adaptation measures needed to sustain tourism activities are lagging, including those related to disaster risk management, sustainable management of natural resources, and resilient infrastructure. Further investing in green energy provides growth opportunities for the country. Montenegro has modernized its legal framework in recent years to align it with EU legislation, but strategies and frameworks must start to translate into actions. This requires strengthening the public institutions that implement and enforce waste management, the protection of natural resources and biodiversity, and climate change mitigation and adaptation measures.
79. **Provide equal access to quality social services and opportunities to boost human capital:** This agenda, including a focus on poor and disadvantaged groups, remains important for resilient economic growth and more equitable opportunities for all citizens to benefit. Foundational skills are inadequate for nearly half of the students. Strengthening education and skills would require strong institutions and investment to enhance early childhood education, quality of basic education for all, vocational and technical programs to improve transition to higher education and labor market, and reskilling and upskilling for adults. Increasing efficiency and resilience to future shocks in the health sector is critical, as made evident by the COVID-19 pandemic, the high NCD burden, and the pressure of an aging population. This would require strengthening primary health care and management of chronic conditions and emerging infectious diseases, as well as continuing efforts to reform health financing to ensure access to services through a financing scheme that provides incentives to reduce out-of-pocket payments and improve health. Smart use of digital technologies can help to strengthen the quality, equity, and resilience of the health and education systems. Inclusion of the Roma

population would require continued efforts to address the multiple barriers they face. Addressing potential losses due to health and education service disruptions during COVID-19 is important to avoid exacerbating gaps in the future.

80. **Reduce the cost to create formal jobs and strengthen incentives for work**: Close to half of Montenegrins aged 15 and above are outside of the labor force, and only one in five people is employed in the formal private sector. Challenges with an aging population and outmigration mean that Montenegro needs to use its available workers effectively. Reducing the high labor tax and contribution burden (particularly for low-wage, low-skill workers and those with dependents), strengthening the effectiveness of job matching through improved employment services, and improving labor market activation in the design and implementation of social assistance remain important to lower disincentives and barriers to work, including for disadvantaged groups. Promoting women's access to economic opportunities—through improved child-care access and reforming labor tax and regulation, for example—can help narrow gender gaps in employment.
81. **Improve connectivity and infrastructure integration:** As argued in the previous SCD, investments in energy, ICT, and upgrading of transport infrastructure while encouraging private sector investment opportunities remain important for physical connectivity and expanded trade in services. This would further support economic opportunities in the northern region and reduce spatial inequalities, but also increase overall benefits from Montenegro's comparative advantage in tourism, clean energy, and potential tradable services like ICT. However, decisions on large investments in transport infrastructure should be informed by comprehensive feasibility studies (financial, economic, and environmental). Regional trade and transport facilitation can also help to deepen regional economic integration with other Western Balkan countries and with the EU.
82. **Level the playing field among private sector to encourage entrepreneurship, innovation, and productivity growth**: Higher, more inclusive, and resilient economic growth requires a business environment where healthy competition is enforced, ensuring nobody benefits unfairly, including from informality, political connections, or other sources of influence. While Montenegro has started to align its laws defining competition policy with EU standards, the uneven implementation and enforcement of rules and regulation becomes apparent in this policy area. This has raised the uncertainty for business, undermining riskier, more productive investments. Leveling the playing field requires institutional changes boosting the mandate of the Agency for the Protection of Competition, reducing the discretion of public officials—for example in implementing public procurement and imposing parafiscal charges—and increasing transparency and the efficiency of the judiciary to lower the payoffs from vested interests. Ensuring that no one benefits from special treatment would encourage entrepreneurs to compete based on their productivity, a prerequisite for a resilient economic recovery from the COVID-19 crisis.
83. **Align the quality of public institutions with the EU to strengthen the enforcement of laws and regulation**: Montenegro has adopted new, comprehensive legal frameworks for more resilient macroeconomic, social, and environmental policies in recent years. But their implementation has been slow and new rules and regulations have often not been enforced, undermining more tangible progress. In Montenegro, strengthening public institutions that enforce the rule of law and prioritize medium-term planning is thus the foundation for successfully implementing and sustaining more resilient macroeconomic, social, and environmental policies. What does it take? It includes a more efficient, merit-based public administration that upholds medium-term planning in public finance and social sectors, an independent and impartial judiciary, and a strong mandate for public agencies that

enforce pro-market regulation, anticorruption, and environmental protection. Building and sustaining such stronger public institutions requires a stronger role for the Parliament in legislation and oversight and better communication and participation of citizens in these processes. And it requires transparency in policymaking, including access to information and policy evaluations, which is essential to achieve policy effectiveness and accountability—the key to gain citizens' trust which is in turn needed to build and maintain strong public institution. Digitalization can play an important role in boosting access to information and policy participation, but, in the end, it requires the accountability of the public officials. This focus on strengthening public institutions to uphold more resilient policies is aligned with the government program. The time is ripe.

Annex 1: Bar Boljare Highway

The largest investment in Montenegrin history, the Bar-Boljare Highway, is a three-phase project to connect the port of Bar to the Serbian road network to the North, passing through the underdeveloped northern region. The 160-kilometer highway would also provide a link to Pan-European Corridor XI.

In October 2014, the Government and the China EXIM Bank signed the financing contract for construction of a 41 km section of the highway valued at $944 million or €688 million (the loan is in USD without the exchange rate hedge). This followed the February signing of a construction contract with the China Roads and Bridges Corporation (CRBC) amounting to €809.6 million—23 percent of that year's GDP, for which a feasibility study was prepared by the company implementing the project and was classified internal. The loan carries a 2 percent interest rate and a 20-year repayment period (with a 6-year grace period), starting in 2021. Montenegro agreed to waive immunity on the grounds of sovereign for itself and its property in connection to any arbitration proceedings, which, if arise, would be carried out by China International Economic and Trade Arbitration Commission in Beijing. The IMF estimated that, had the first phase not been built, Montenegro's debt-to-GDP ratio would have been at 59 percent of GDP in 2019, instead of rising to 76.5 percent of GDP, implying that the fiscal adjustment strategy adopted in 2017 would not have been necessary to return debt to sustainable levels.

The Law on Highway enacted by the Parliament in November 2014 allows for a full tax exemption of civil works, labor, and highway-related imports for the construction companies, which increases the highway cost. The government has so far approved additional EUR 49.5 million[1] which would be financed from the 10-percent of the contract value anticipated for additional works. In addition to that, the government approved the state-owned road company Monteput to borrow extra EUR 38.2 million from the state-owned Investment Development Fund to finance the electric energy supply for the motorway. The total cost is expected to be over EUR1 billion when accounting for around 250 million of foregone revenues through tax exemptions and subsidies[2], but not accounting for environmental costs, especially in the UNESCO protected Tara basin (activists raised concerns of the destruction of wildlife in the Tara and suggested construction material is being discharged into the river during the highway construction). This would make it one of the most expensive motorways per kilometer in the world.

Works began in 2015 and were initially scheduled to end in May 2019 but were postponed to September 2020, and then further delayed due to COVID-19. Around 92 percent of total works has been completed so far, with almost a half of total value subcontracted to domestic companies, with one company contracting over €240 million (the amount initially agreed for all domestic companies to contract). On average, around 2,000 workers were engaged per year, of which two-thirds were Chinese workers, with scarce data on the number of locally employed workers. The lack of transparency of data around the construction of the first phase of the highway has been an issue since the very beginning of works.

The authorities recently commissioned a new, comprehensive cost-benefit and feasibility study for the entire highway, funded under the EC- and EBRD-supported Western Balkans Investment Fund. The government committed to base its decisions on further highway construction on the results of that feasibility study which is expected to be finalized in mid-2021.[3] After the finalization of the feasibility study, the authorities plan to develop adequate and transparent financing modalities in collaboration with international financial institutions. However, the impact of the crisis on public finance will inevitably further delay construction in the medium-term.

---

[1] EUR4.8 million for electric power supply, EUR14 for water supply, and EUR30.5 for works on the Smokovac loop.

[2] NGO MANS report on highway, https://www.mans.co.me/cetvrti-izvjestaj-o-izgradnji-auto-puta-put-bez-kraja/#

[3] The IMF underlined that caution is needed in implementing the next phases of the Bar-Boljare highway project until feasibility, cost-benefit analyses, and financing issues are fully addressed, and has underscored that private-public partnership (PPP) arrangements should be approached with caution to reduce the risk of resuming significant contingent fiscal liabilities (IMF, Montenegro 2019 Article IV).

Annex 2: Comparison of priorities with the 2015 SCD

Priorities in the SCD Update	**Priorities in the 2015 SCD (approximate matching)**
Ensure sound fiscal policy	Ensure sound fiscal policy
Ensure financial stability by strengthening bank regulation and supervision	Ensure financial stability through strengthened bank regulation and supervision and NPL resolution
Strengthen the social protection system to safeguard against shocks	Strengthen the social protection system to safeguard against shocks
Strengthen natural resources management, adaptation, and environmental risk mitigation	Safeguard against environmental risks and protect natural resources
Provide equal access to quality social services and opportunities to boost human capital	Increase access to economic opportunities, including for vulnerable groups (youth, rural population). Increase quality of human capital, including through strengthened education and skill acquisition
Reduce the cost to create formal jobs and strengthen incentives for work	Facilitate activation and strengthen incentives for work
Improve connectivity and infrastructure integration	Improve connectivity and infrastructure integration
Level the playing field among private sector to encourage entrepreneurship, innovation, and productivity growth	Level the product and labor market playing field to foster private sector development
Align the quality of public institutions with the EU to strengthen the enforcement of laws and regulation	Improve commercial and institutional integration with the EU Strengthen governance, public service delivery and the rule of law

Annex 3: Montenegro's EU accession path

Since its independence in 2006, Montenegro's key strategic priority has been the EU membership. In 2010, the country was granted the official EU candidate country status, and in 2012 the accession negotiations between the EU and Montenegro started (Figure 38). Since then, the country has been aligning its legislation and practices with the EU acquis and to date has opened all 33 negotiation chapters, three of which have been provisionally closed (Science and Research, Education and culture, External Relations). In 2021, to renew the vigor, the EU and Montenegro agreed on the application of the revised enlargement methodology to the accession negotiations, which should increase dynamism of the process and strengthen even further a political dialogue. The new methodology will have a stronger focus on the rule of law, fundamental rights, the functioning of democratic institutions and public administration reform, as well as on economic criteria.

Figure 38: Key milestones in Montenegro's EU accession process

The prospect of joining the EU has been a driving force for many of Montenegro's legal and structural reforms in recent years, yet there was uneven progress across different areas and challenges remain. These challenges are mostly in the areas of the rule of law, fight against corruption and organized crime, governance issues, and freedom of expression. In its 2018 Enlargement Strategy for the Western Balkans, the Commission highlighted that *"the [Western Balkan] countries show clear elements of state capture, including links with organised crime and corruption at all levels of government and administration, as well as a strong entanglement of public and private interests. All this feeds a sentiment of impunity and inequality."* In the 2020 Report on Montenegro, the European Commission assessed that no progress was made on freedom of expression, and that only limited progress was made in judiciary and the fight against corruption. While the judiciary is nominally independent, in practice this sector is still politicized and its

independence, professionalism, efficiency, and accountability remain a challenge.[4] For example, there were no judicial follow ups on the alleged misuse of public funds for party political purposes in the two affairs, "recording" and "envelope". The EU has been repeatedly expressing high concerns over media freedom and has called on Montenegro to prioritize investigate cases of attacks against journalists.

The EU has been the largest provider of financial assistance to Montenegro. Over 2014-2020, the country received almost EUR270 million[5] in grants in support of key sectors (competitiveness, agriculture, democracy and governance, rule of law, etc.). In addition to that, EUR173 million was provided since 2009 in Western Balkans Investment Framework grants[6], to leverage investments of estimated EUR1.7 billion.[7] In the wake of the COVID-19 crisis, the EU provided macro financial assistance of EUR60 million, and reallocated EUR50 million in the grants, while at the same time providing vaccines. As another commitment to the Western Balkans, the EU adopted a comprehensive Economic and Investment Plan for the Western Balkans, which aims to spur the long-term recovery of the region, a green and digital transition, foster economic regional cooperation, boost economic growth and support reforms required to move forward on the EU path. The Plan identifies 10 investment flagships and is expected to be supported by up to EUR9 billion of EU funding, with a potential to mobilize up to EUR20 billion.

There are commitments on both sides for the EU accession process. But translating the commitments into actions will require strong reform process and a political will for enlargement on both sides. In its 2018 Enlargement Strategy, the EU indicated that Serbia and Montenegro could potentially be ready for membership in a 2025 perspective, subject to the strong political will and the delivery of real and sustained reforms. In 2021, the Montenegrin government expressed strong commitment to implement reforms needed to finish the negotiations by 2025. Nevertheless, turning commitments into actions and delivering sustained reforms will be required for Montenegro to clearing its path to the EU membership. On the other side, the political developments in the Union itself will also be determinant for it to happen.

[4] European Commission, Montenegro 2020 report
[5] European Commission, www.ec.europa.eu/neighbourhood-enlargement
[6] The Western Balkans Investment Framework joint initiative of the EU, financial institutions, bilateral donors and the governments of the Western Balkans that supports socio-economic development and EU accession across the Western Balkans through the provision of finance and technical assistance for strategic investments.
[7] European Commission, www.ec.europa.eu/neighbourhood-enlargement

Annex 4: Knowledge and data gaps

This SCD update identifies the following key knowledge gaps in Montenegro:

- Education: teacher policies, connectivity and availability of digital devices, education spending adequacy and equity, adult education and lifelong learning, governance and integrity issues in education
- Political Economy: Understanding the underlining political economy drivers requires further analysis, including how the close state-business linkages affect the implementation of policies.
- Health: up-to-date officially published and internationally comparable data on health outcomes, health care financing (public and private out-of-pocket expenditures), accessibility and quality of care, and health system performance. The latest data available are from 2014-15.
- Deeper data and analytics on natural resource management, environmental sustainability and climate resilience.
- Energy: understanding of the Energy Efficiency industry in the residential and commercial sectors, mapping of various renewable resources, the design of a program for coal transition and decarbonization of the Energy sector
- Migration patterns and drivers both within and outside the country (profiles and behavior of migrants, host country activities)
- Fiscal: how large and efficient are tax expenditures and which ones should be removed?
- Fiscal policy and labor informality: should part of social security contributions be taxed finance to reduce the high labor taxes? If so, what would be the right source of tax financing? Would there be potential (temporary) adverse impacts on the quality of social services and how could they be avoided?
- Fiscal: What are the major inefficiencies in public spending? What are the redundancies in the public sector administration and how to increase its efficiency?
- Fiscal: the performance of SOEs (including data on employment, wage spending, debt, and contingent liabilities)
- State aid: did state aid support firm growth or undermine competition?
- Access to finance and growth: did the IDF loan program alleviate SME's credit constraints?
- Productivity: to which extent does regulatory uncertainty such as the system of parafiscal charges reduce productivity?
- Product market competition: are regulatory barriers in service sectors restricting market access? How can be ensured that the competition authority can more effectively contest anti-competitive practices?

Annex 5: Key economic indicators

	2015	2016	2017	2018	2019	2020
Real economy	*percent change, unless otherwise indicated*					
GDP (Nominal, EUR)	3,655	3,954	4,299	4,663	4,951	4,193
Real GDP	3.4	2.9	4.7	5.1	4.1	-15.2
GDP per capita (EUR, nominal)	5,874	6,354	6,908	7,494	7,959	6,741
Contributions to Real GDP Growth						
Consumption (percentage points)	2.3	4.8	3.2	5.2	2.9	-4.8
Investment (percentage points)	1.7	7.2	8.0	4.9	0.8	-3.7
Net exports (percentage points)	-0.6	-9.1	-6.5	-5.0	0.4	-6.7
Exports	5.7	5.9	1.8	6.9	5.4	-48.9
Imports	4.4	15.3	8.4	9.2	2.4	-19.5
Unemployment Rate (ILO Definition)	17.6	17.7	16.1	15.2	15.1	18.0
Poverty headcount ratio at US$5.5 a day (PPP) (% of population)	19.4	16.0	16.0	..	..	..
At risk of poverty rate (% of population)	..	24	23.6	23.8	24.5	..
CPI (year-average)	1.5	-0.3	2.4	2.6	0.4	-0.3
Fiscal Accounts	*percent of GDP*					
Expenditures	48.8	45.3	47.0	46.6	46.0	55.4
Revenues	41.5	42.5	41.4	42.0	43.3	44.4
General Government Balance	-7.3	-2.8	-5.7	-4.6	-2.7	-11.0
General Government Primary Balance	-4.9	-0.7	-3.3	-2.4	-0.5	-8.3
General Government Debt	66.2	64.4	64.2	70.1	76.5	105.1
Balance of Payments	*percent of GDP*					
Current Account Balance	-11.0	-16.2	-16.1	-17.0	-15.0	-26.0
Imports, Goods and Services	60.7	63.1	64.5	66.7	64.8	60.6
Exports, Goods and Services	42.3	40.6	41.1	42.9	43.7	25.8
Net Foreign Direct Investment	16.9	9.4	11.3	6.9	6.2	11.2
Other memo items						
GDP nominal in US$ (millions)	4,053	4,374	4,845	5,504	5,543	4,843
External debt (percent of GDP)	170.6	161.8	159.9	162.6	167.2	..

Endnotes

[1] World Bank (2016). *Montenegro - Achieving Sustainable and Inclusive Growth Amidst High Volatility: systematic country diagnostic*. Washington, D.C.: World Bank Group. https://openknowledge.worldbank.org/handle/10986/24589

[2] World Bank (2020). "Western Balkans Regular Economic Report: The Economic and Social Impact of COVID-19: Poverty and Household Welfare"; United Nations Montenegro (2020). "Rapid Social Impact Assessment of COVID-19 outbreak in Montenegro".

[3] The 2015 SCD highlights the consequences of the earlier cycles on economic, social, and poverty indicators.

[4] As reflected in the rate of migration balance, which was negative in all but two northern municipalities. The rate of migration balance is the ratio of annual net migration on the estimated mid-year population. The rate of migration balance can be obtained as the difference between immigration rates and emigration rates (per 1 000 inhabitants)

[5] The mother benefits provide life-time cash transfers to mothers of three or more children on the condition of not being employed.

[6] World Bank (2020), COVID-19 and Non-Performing Loan Resolution in the Europe and Central Asia region

[7] That is, a domestic restaurant or tour operator had to pay the full rate while services onsite the luxury resorts where tax exempted. In 2019, Montenegro eliminated these discrepancies to harmonize their VAT laws in the EU acquis process.

[8] European Commission (2020), Montenegro Report

[9] State Audit Institution of Montenegro, Assessment of Fiscal Responsibility Criteria in 2019 Report (2020), available at Izvještaj o ocjeni kriterijuma fiskalne odgovornosti za 2019. godinu (dri.co.me)

[10] World Bank (2019) Fiscal Rules for the Western Balkans, Policy Research Working Paper 8990

[11] World Bank (2020), Regional Economic Report No.17, Fiscal policy to flatten the curves: Crisis containment and mitigation

[12] Montenegro's tax system allows for a number of tax expenditures, which are costly and raise concerns about effectiveness and equity. To date, no comprehensive overview of all tax expenditures nor an analysis of their economic and social impact has been prepared. Tax exemptions from PIT, social contributions, CIT, VAT, and excise duties have been used to attract investment in luxury tourism sector, while the construction of the highway has been fully exempt from taxes, contributions and duties by a special law, further increasing its cost. Tax expenditures are a concern, not only because of their cost but also because they disproportionately benefit the well-off and can favor some (privileged) firms over others leading to resource misallocations and reducing productivity growth. At the same time, the lack of progressivity of income taxation is disproportionately affecting those with lowest incomes.

[13] The true labor productivity gap to the EU countries is likely higher since labor informality is higher in Montenegro. The administrative labor data in the WDI likely do not include all informal workers, implying that the total number of workers in Montenegro is underestimated and thus the true GDP per worker is lower.

[14] World Bank (2019), Growth and Jobs Summary Report

[15] World Bank Enterprise Surveys

[16] The value of collateral needed to access bank credit is still above 200 percent on average, much higher than compared to its 2009 level of 152 percent.

[17] IFC (2017), MSME Finance Gap. World Bank Group. Washington D.C.

[18] World Bank (2019), Growth and Jobs Report

[19] World Bank (2019), Growth and Jobs Summary Report

[20] World Bank (2019), Growth and Jobs Report

[21] For example, in 2019, the Minister of Tourism and Sustainable Development resigned following the dissemination of a video of two construction inspectors

[22] MONSTAT (2020) ICT Usage of ICT in households and ICT Usage of ICT in enterprises

[23] Uneven access to and adoption of digital technologies can exacerbate rather than mitigate inequality and social exclusion. Adoption of digital technologies also introduces new risks related to personal data protection,

cybersecurity, and cybercrime. Digital infrastructure expansion may lead to increased energy consumption and waste of electrical and electronic equipment. Such an expansion in countries with weak competition frameworks and institutions may be subject to anti-competitive practices. Automation and digitization could create disruptions for the labor market.

[24] The difference between the number of employed according to the administrative data and the LFS survey indicate a high level of informality (17 percent in 2019). Moreover, the data on the number of paid taxes and contributions by the Tax Administration is lower than the administrative data, while reporting the minimum wage and paying the reminder under the table is a common practice in the private sector.

[25] World Bank Enterprise Survey 2019

[26] The Government formed a Commission for fighting informality, but concrete steps are pending.

[27] World Bank (2018), Montenegro – Experiences and Perceptions of Judicial Performance

[28] Youth are poorly informed of economic opportunities and rely primarily on family and friend networks. They believe they cannot contribute to their own society (88% indicate they have no knowledge and skills to share). Stiftung, Friedrich Ebert (2019). "Montenegro Youth Study 2018/9"

[29] World Bank (2018): Life on the Margins: Survey Results of the Experiences of LGBTI People in Southeastern Europe

[30] UNICEF MICS6 (2018) and Montenegro Roma Settlements Report; WB (2018) – Montenegro ECD Country Profile

[31] EC-WB-UNDP Regional Roma Survey (2017)

[32] World Bank (2009), "Reshaping Economic Geography", World Development Report.

[33] UNDP (2020) Gender Equality Index for Montenegro for 2019

[34] Institut Alternativa (2020) Where are women in public administration, available at https://institut-alternativa.org/infografik-gdje-su-zene-u-javnoj-upravi/

[35] BEEPS 2013

[36] World Bank (2016). Montenegro: Promoting Women's Access to Economic Opportunities: Policy Note.

[37] World Bank (2016). Montenegro: Promoting Women's Access to Economic Opportunities: Policy Note.

[38] European Commission – Recommended Annual Instruction Time in FT Compulsory Education in Europe 2018/19. Eurydice. UNICEF (2019) – PISA 2015 Results and Education Policy Recommendations

[39] World Bank Skills and Growth VET Study (2019)

[40] World Bank (2020) COVID-19 Learning Loss Estimates; PISA 2018

[41] According to the UN forecast, the share of the population aged 65+ is projected to increase from 13.6% in 2015 to 15.8% in 2020 and to 30% by 2050

[42] WHO

[43] WHO, UNICEF study

[44] (World Bank, Road Safety Country Profile, 2019)

[45] World Bank (2019) Public Finance Review.

[46] The minimum pension was increased from 44 percent of the average pension (or 25 percent of the average net wage) to 50 percent of the average pension (and 28 percent of the average net wage) in 2019.

[47] World Bank (2019), Growth and Jobs Report

[48] Coalition 27 (2020). "Progress of Montenegro 2020: Long Travel to the EU." http://koalicija27.me/2020/10/11/shadow-report-of-the-coalition-27-for-the-chapter-27-environment-and-climate-change-for-2020/

[49] In the countries of the region: Serbia (338kg), Albania (381kg), BiH (356kg in 2018), North Macedonia (301kg in 2018); in the EU small states: Estonia (394kg), Croatia (445kg), Latvia (439kg), Lithuania (472kg), Slovenia (504kg). However, the recycling rates of municipal waste in the EU countries are considerably higher.

[50] Dalberg Advisors, WWF Mediterranean Marine Initiative, 2019 "Stop the Flood of Plastic: How Mediterranean countries can save their sea"

[51] European Commission (2020) Montenegro Report

[52] Lopez Martinez, Patricia; Broeks Motta, Elvira Cusiqoyllor; Salvetti, Maria Silvia Giovanna. 2019. *Water and Wastewater Services in the Danube Region: A State of the Sector 2018 Update* . Washington, D.C. : World Bank Group.
https://hubs.worldbank.org/docs/imagebank/Pages/docProfile.aspx?nodeid=31194475

[53] CEE Bankwatch Network (2019) Western Balkans Hydropower: Who Pays, Who Profits?
[54] The Law on natural environment (Official Gazette 52/16) and the Law on environment protection (54/16), but Montenegro remains only partially aligned with the EU acquis
[55] Agency for Environment Protection (2020) Information on the state of natural environment for 2019
[56] Source: WHO, 2016
[57] Ibid
[58] Global Facility for Disaster Reduction and Recovery (GFDFR) "Europe and Central Asia: Country Risk Profiles for Floods and Earthquakes."
[59] Montenegro's NDC commits to a 30 % emission reduction by 2030 compared to the 1990 base year. https://www4.unfccc.int/sites/ndcstaging/PublishedDocuments/Montenegro%20First/INDCSubmission_%20Montenegro.pdf
[60] European Commission (2020) Montenegro Report
[61] The EU's European Green Deal, presented in December 2019, commits member states to invest in clean energy. Aligning with the Green Deal framework could become an important agenda for Montenegro in the EU accession process. Additionally, the EU Economic and Investment Plan for the Western Balkans identifies flagship projects to accelerate the green and digital transition and to foster regional cooperation and convergence of the Western Balkans with the EU.
[62] World Bank (2019) Result Oriented Review of Delivery of Justice in Montenegro
[63] U.S. Department of State (2019), 2020 Investment Climate Statements: Montenegro
[64] Agency for Preventing Corruption (2020), Survey on corruption perceptions and understanding of Agency's mandate, available at https://www.antikorupcija.me/documents/5596/ASK_2020_-_rezultati_za_2020._godinu.pdf
[65] World Bank (2019) Result Oriented Review of Delivery of Justice in Montenegro
[66] Rent-seeking is a practice of manipulating public policy to increase profits for a selected group. There is a anecdotal evidence on rent-seeking in Montenegro, while there are no confirmed court cases. The anecdotal evidence largely refers to construction of small hydropower plants, whose owners benefit from a subsidised price. Montenegro has also provided tax exemptions for constructions of luxury hotels and high-end resorts, whose owners are reportedly linked to the political elite. The construction of the highway was exempt from paying taxes, social contributions, and excises, and the NGO sector has raised concerns over domestic companies disproportionately benefiting from the contract.
[67] European Commission, Montenegro Report (2020)
[68] Public Administration Reform Strategies 2011-2015 and 2016-2020
[69] State Audit Institution of Montenegro, Report on management of temporary and supplementary work contracts in the state administration bodies (2019), available at: Uspješnost upravljanja ugovorima o djelu, ugovorima o dopunskom radu i ugovorima o privremenim i povremenim poslovima u organima državne uprave (dri.co.me)
[70] European Commission, Montenegro Report (2020)
[71] European Commission, Montenegro Report (2020)
[72] State Audit Institution, Audit Report of the Final Budget Account for 2019, available at: http://www.dri.co.me/1/doc/Izvje%C5%A1taj%20o%20reviziji%20Predloga%20zakona%20o%20zavr%C5%A1nom%20ra%C4%8Dunu%20bud%C5%BEeta%20Crne%20Gore%20za%202019.%20godinu.pdf
[73] By October 2020, five SOEs topped the Tax Administration list of the 100 companies with the highest amount of tax and social contribution arrears, with five of them owing more than the rest 95 companies combined, available at https://poreskauprava.gov.me/vijesti/235212/AzURIRANA-CRNA-LISTA-PORESKIH-OBVEZNIKA.html
[74] The Agency for Competition started preparing a register of all state aid provided by central and local governments. However, significant challenges remain around the scope and preciseness of the data. Improving the framework for state aid through establishing a single platform for all state aid providers would be a significant step forward to increasing efficiency and reducing administrative costs, but also allowing for real-time monitoring of state aid provided. The Agency publishes a central register of companies benefiting from COVID19 support, while a public register of de-minimis state aid is incomplete and further efforts are needed to capture all beneficiaries.
[75] World Bank (2019), PEFA Report
[76] Montenegrin Foreign Investors Council (2019), White book

[77] In December 2019, Montenegro adopted the Law on Public Procurement which is in a large degree aligned with the EU Acquis and provides a basis for introduction of an electronic public procurement system (e-procurement). The Ministry of Finance and Social Welfare launched the e-procurement on 1 January 2021, but capacities to manage public procurement processes must be significantly strengthened.

[78] Council for Competitiveness (2021) Annual Report on the involvement of the private sector in the law-making process in 2020.