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COMMISSION STAFF WORKING DOCUMENT

ECONOMIC REFORM PROGRAMME

OF

MONTENEGRO
(2024-2026)

COMMISSION ASSESSMENT

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1. EXECUTIVE SUMMARY

Montenegro continued to record high economic growth in 2023, which is set to slow down in 2024-2026. A successful tourism season and strong private consumption, supported by a large inflow of foreign nationals, were the key drivers of economic growth in 2023, estimated at 5.8%. The main headwind came from high albeit moderating inflation, while tighter financing conditions weighed on investment. The baseline scenario set out in Montenegro's economic reform programme (ERP) projects real GDP growth to slow to an annual average of 3.2% in 2024-2026, driven by domestic demand on the back of rising private and public consumption and recovering investment. Net exports are projected to provide only a marginal contribution to GDP growth as tourism services, which exceeded their 2019 level already in 2023, are expected to decelerate from double-digit growth. The balance of risks is tilted to the downside as inflation might fall less than projected, eroding disposable income, while higher financing costs could negatively affect investment. Imports may increase by more than expected if investment plans, in particular the construction of the Bar - Bojare highway, are realised.

The ERP's fiscal scenario projects a sizeable deterioration of the budget balance in 2024 and a gradual deficit reduction in the following 2 years, which is set to lead to a modest pace of debt reduction. The 2023 budget performed much better than expected and recorded a surplus, estimated at 0.5% of GDP, driven by strong growth in indirect taxes, one-off revenues and lower-than-budgeted spending. The 2024 deficit is largely driven by strong increases in social transfers and capital spending. Budgetary adjustment in 2025-2026 is expected to rely on a sharp deceleration in public spending, which is projected to lead to a drop of 2.3 percentage points (pps) in the spending ratio and a small primary surplus in 2026. However, the envisaged spending restraint appears overly optimistic and is not underpinned by concrete measures. The public debt ratio, which has fallen very substantially in recent years, is set to continue declining but only slowly, to 61% of GDP in 2026. Debt refinancing needs remain large, peaking at 11% of GDP in 2025.

The main challenges facing Montenegro are the following.

- **High mandatory spending and a limited revenue base, together with upcoming large debt repayment needs call for a stronger fiscal consolidation than envisaged in the ERP.** Amid external and internal risks, the economic outlook is positive with decelerating but stable growth in Montenegro. However, debt repayment needs are set to increase sharply, first in 2025 and later in 2027 and 2029, which, coupled with tight financing conditions, raise vulnerabilities. Given Montenegro's monetary framework, fiscal policy is the main tool to manage aggregate demand and support further disinflation. This calls for a comprehensive medium-term fiscal plan with conrete consolidation measures and a commitment to bring the debt ratio below 60% of GDP as prescribed by the fiscal rule. Broadening the tax base, streamlining tax exemptions and incorporating new budget revenue initiatives would contribute to rebuilding fiscal buffers and reducing public debt. Further fiscal space could be gained by reviewing and reforming mandatory spending on the public wage bill, social and health expenditure.

- **Improving the long-term sustainability of public finances requires strenghening fiscal governance and the management of public investment.** While fiscal rules are in place, they are weak and lack a strong enforcement mechanism. Major new spending initiatives have not been adequately costed, resulting in high mandatory expenditure. Large infrastructure projects need better management and prioritisation given the limited fiscal space available. Setting up an independent fiscal institution would help strengthen the costing of new initiatives and help improve fiscal discipline. Improving the oversight and risk management of state-owned enterprises (SOEs) would over time alleviate their burden to the budget.

- **Improving the business environment, fostering private sector development, advancing the green and digital transition, and developing human capital are the key structural challenges Montenegro is facing.** There is a need to address, among others, weaknesses in the regulatory environment, informality, difficulties in access to finance and challenges in monitoring and managing SOEs. Montenegro's energy transition plans are in line with the European Green Deal, implying further development of the energy sector through investements in green energy and decarbonisation. Digitalisation focuses on developing digital services and improving cyber security. Structural labour market challenges, including persistently low rates of labour market activity and high unemployment, especially among women, young people and the low-skilled, continue to undermine potential growth and improvements in living standards. These challenges are expected to be addressed through key structural reforms identified in the country's reform agenda under the new Growth Plan for the Western Balkans.

The implementation of the policy guidance set out in the conclusions of the Economic and Financial Dialogue of May 2023 has been partial. In 2023, the fiscal outcome was better than envisaged in the revised budget due to very good performance of indirect tax revenue and one-off revenue items. No new medium-term fiscal strategy has been adopted. Nor has progress been made on public investment management and the review of tax expenditures. Although a legal basis has been created to set up a Fiscal Council, the call for appointing Council members was unsuccessful due to an insufficient number of applicants. Montenegro has made limited progress on preparations to roll out the Youth Guarantee implementation plan, on preparing a clear timeline and financial planning for the reform of the social and child protection system, and on developing a mechanism to continuously monitor active labour market measures. The government adopted a programme and action plan for 2024-2026 on supressing the informal economy. Progress was made on digitalisation, but was limited on reforms related to the green agenda and to SOEs.

2. ECONOMIC OUTLOOK AND RISKS

Montenegro's economy continued to grow strongly in 2023, exceeding expectations. Based on quarterly data, full-year real GDP increased by 6.0% year on year (y-o-y) in 2023, on the back of strong growth in private consumption and service exports. Growth in private consumption was supported by rising wages and pensions as well as a high inflow of foreign nationals (in particular Turks, Russians and Ukrainians). Exports were boosted by the continued strong growth in tourism. The main headwind came from high albeit moderating inflationary pressures reflecting both international and domestic factors. Tight monetary conditions weighed on investment. The ERP estimates annual growth at 5.8% in 2023 which is well above 4.4% as projected in the ERP for 2022-2025[1]. Supported by a significant number of foreign workers, labour market conditions improved substantially with the average unemployment rate falling to a new historical low of 12.2% by the end of 2023, down from 15.1% in the previous year.

The ERP's baseline scenario projects GDP growth to average around 3.2% in 2024-2026 with a mildly decelerating trend. The ERP expects domestic demand to be the key driver of growth with a positive albeit decelerating profile of private and public consumption as well as investment. Higher employment and wages together with increased pensions are set to support private consumption while the recovery of investment is expected to be driven by new investment projects in energy, tourism and road infrastructure, notably a continuation of the construction of the Bar - Bojare highway. Further marginal support for GDP growth is projected to come from net exports, mainly tourism services, which exceeded their pre-pandemic level already in 2023, and are forecast to decelerate from double-digit growth. Import growth is also set to slow down from 10.6% in 2023 to an average of 4.8% in 2024-2026. The ERP estimates a positive output gap of 2.7% in 2023 which is projected to decline mildly to 2.2% in 2026. Compared to the previous year, the ERP revises GDP growth downwards by 0.2 pps and 0.5 pps for 2024 and 2025 respectively. The ERP also contains an alternative downside scenario which assumes a deterioration in external environment and in particular a slower growth in the EU. The resulting fallout on investment and trade - including lower tourism activity - together with higher inflation and interest rates, would result in significantly lower GDP growth, ranging from 1.4% in 2024 to 1.7% in 2026.

The baseline ERP scenario of moderating growth is plausible though somewhat optimistic and subject to external and domestic risks. The baseline growth scenario for 2024 is more positive than the Commission's autumn forecast but the divergence narrows in 2025. The key difference in 2024 stems from a higher growth of private consumption, which is subject to a risk of inflation that is higher than the 5% assumed in the ERP. The downside scenario assumes inflation of 7% in 2024 which would lead to private consumptuion growing by only 1.4%. Further differences relate to the programme's assumption on capital investment which is based on the implementation of a new investment cycle. The deceleration in import growth forecast for 2024 in the baseline scenario seems somewhat sharp given the projected consumption and investment dynamics, and Montenegro's reliance on imports as a very small and open economy. The ERP rightly refers to external risks related to higher inflation, tight monetary conditions and slower global growth, including in the EU countries. Domestic

[1] Macroeconomic and fiscal estimates and forecasts covering 2023-2026 have been taken from the ERPs themselves; if available, preliminary macroeconomic and fiscal outturn data for 2023 have been taken from the relevant national sources (statistical office of Montenegro (MONSTAT), Ministry of Finance, central bank of Montenegro).

risks stem from limited fiscal space, which constraints the response to unexpected adverse shocks to the economy. Positive risks relate to improvements in the domestic regulatory environment and progress on EU-related reforms.

Table 1:

Montenegro - comparison of macroeconomic developments and forecasts

	2022		2023		2024		2025		2026	
	COM	ERP	COM	ERP	COM	ERP	COM	ERP	COM	ERP
Real GDP (% change)	6.1	**6.4**	4.9	**5.8**	2.7	**3.8**	2.3	**3.0**	n.a.	**2.9**
Contributions:										
- final domestic demand	7.6	**7.4**	6.8	**7.1**	3.1	**4.9**	2.7	**2.7**	n.a.	**3.0**
- change in inventories	2.5	**2.6**	0.0	**0.0**	0.0	**0.0**	0.0	**0.0**	n.a.	**0.0**
- external balance of goods and services	-3.5	**-3.6**	-1.9	**-1.3**	-0.5	**-1.1**	-0.4	**0.2**	n.a.	**0.0**
Employment (% change)	17.2	**18.2**	5.4	**9.5**	2.2	**2.2**	0.8	**1.8**	n.a.	**1.7**
Unemployment rate (%)	15.0	**14.7**	13.6	**13.2**	13.2	**12.6**	13.0	**12.0**	n.a.	**11.6**
GDP deflator (% change)	n.a.	**12.4**	n.a.	**5.7**	n.a.	**2.3**	n.a.	**2.5**	n.a.	**1.8**
CPI inflation (%)	11.9	**13.0**	9.0	**9.0**	5.7	**5.0**	3.8	**3.4**	n.a.	**2.5**
Current account balance (% of GDP)	-13.3	**-12.9**	-12.6	**-12.7**	-12.3	**-13.1**	-12.1	**-12.0**	n.a.	**-10.9**
General government balance (% of GDP)	-5.2	**-3.7**	-2.3	**0.5**	-3.4	**-3.4**	-3.5	**-2.9**	n.a.	**-2.4**
Government gross debt (% of GDP)	69.5	**69.3**	61.0	**62.2**	63.5	**61.6**	61.2	**61.3**	n.a.	**61.0**

Sources: Economic Reform Programme (ERP) 2024, Commission Autumn 2023 forecast.

Inflation eased in 2023 and is projected to decline further in 2024-2026. Following record growth in 2022, inflation steadily declined throughout 2023 from 16.2% y-o-y in January to 4.3% in December[2] and averaged 8.6% for the year as a whole. The ERP estimates a cumulative increase of prices in 2022-2023 of over 23% as compared to 2021. Inflation has been driven by surging global commodity prices, such as food and fuel, as well as domestic policy-induced increases of wages and pensions. The ERP expects the average inflation rate to ease further, from 5% in 2024 to 2.5% in 2026, due to the high base in 2023 and stabilising import prices, in particular for food and fuels. Average wage growth is expected to be 5% in 2024 before levelling out to 4% in 2025-2026. The ERP rightly acknowledges external risks which could lead to a resurgence of inflation while it offers little discussion on the domestic risks related to further fiscal stimulus measures such as a major increase in the minimum pension rate (52%) from January 2024 and other social transfers included in the 2024 budget.

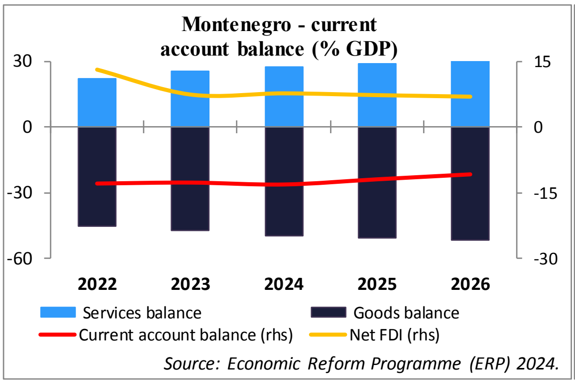
The ERP projects a gradual decrease in the current account deficit. In 2023, the current account deficit is estimated to have narrowed to 11.4% of GDP from 12.9% in 2022 as very high growth in services exports (21%) mitigated a decline in merchandise exports caused by weaker performance in metal exports. In near future, the ERP assumes stable growth in merchandise exports (6% in 2024-2026) combined with a slowdown in merchandise imports (from 11% in 2024 to 6.5% in 2026). These dynamics are set to result in a widening deficit of goods trade which is projected to be mitigated by a growing surplus of services trade. Growth in services exports and imports are also set to slow down from 12% and 8% in 2024 to 9% and 6% in 2026, respectively. The secondary account surplus declined to 6.4% of GDP in 2023 and is projected to recover to 7.9% in 2026. Overall, the ERP projects the current account deficit to narrow from 13.1% in 2024 to 10.9% in 2026. This is a more cautious scenario than in the previous year's ERP, which assumed a decline to 8.9% of GDP in 2025. A high import

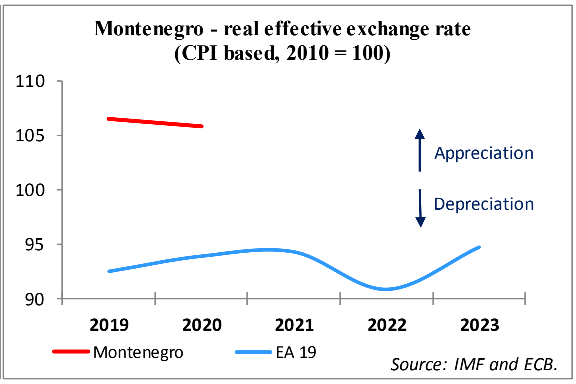
[2] In February 2024 inflation remained unchanged at 4.3% y-o-y.

dependency and poor diversification of the production base remain key structural weaknesses of the Montenegrin economy. The assumption of higher imports growth in 2024 is in line with the projected investment profile.

Though set to decline, foreign direct investment (FDI) inflows are expected to finance two thirds of the current account deficit. Net FDI inflows declined by 47% y-o-y in January-September 2023, due to a combination of lower inflows of equity investment and inter-company debt (by 26% y-o-y) and higher outflows (25%). The latter was mainly driven by the withdrawal of funds by non-residents. More than a half of FDI inflows (53%) went into real estate. As a share of GDP, full-year net FDI inflows are estimated to have declined to 6.3% in 2023 from 13.2% the previous year. They are projected to increase to 7.8% of GDP in 2024 and to decline gradually to 7.1% of GDP in 2026. This profile implies that around two thirds of the current account deficit would be covered by FDI in 2024-2026. The ERP attributes this dynamic to a ‘base effect’ without providing a more substantial explanation. At the end of 2023, Montenegro’s net international investment position was negative at 109% of GDP as compared to 130.4% by end-2024. The external debt declined to 140.8% of GDP in 2023 (supported by the denominator effect, as GDP increased by 11.8% in nominal terms in 2022) from 165.8% in 2022.

Graphs: external competitiveness and current account





The banking system remains stable with adquate levels of liquidity and profitability. Most temporary measures aimed at preserving the liquidity and solvency of domestic banks, adopted in the context of the spill-over effects of Russia’s invasion of Ukraine, expired during 2023. The central bank of Montenegro (CBM) strengthened the supervisory process in November by requiring credit institutions to pass the conformity check before paying dividends. As a precautionary measure, the central bank kept a repo line from the European Central Bank to address exceptional liquidity needs in the event of unforeseen circumstance. Banks continued to fund themselves mainly through domestic deposits which increased by 15.5% in 2023. Credit growth rose to 10.8% from 6.6% in the previous year. Borrowing costs increased with the nominal weighted average lending rate reaching 6.5% by the end of 2023 as compared to 5.3% at the beginning of the year. The widening spread between lending and deposit rates, reaching 623 basis points in Q3-2023 from 566 at the end of 2022, supported the profitability of the banking sector: The return on assets increased to 2.6% from 1.7% over the same period. The non-performing loan ratio declined moderately to 5.0% of total loans at the end of 2023, as compared to 5.7% in 2022.

Table 2:

Montenegro - financial sector indicators

	2019	2020	2021	2022	2023
Total assets of the banking system (EUR million)	4 604	4 587	5 329	6 407	6 735
Foreign ownership of banking system (%)	67.9	80.3	80.0	82.0	83.7
Credit growth (%, average)	4.2	5.0	6.6	6.1	10.8
Deposit growth (%, average)	1.8	-2.5	12.8	23.3	15.5
Loan-to-deposit ratio (end of period)	88.1	93.7	80.0	70.1	74.8
Financial soundness indicators (%, end of period)					
- non-performing loans to total loans	4.7	5.5	6.2	5.7	5.0
- regulatory capital to risk-weighted assets	17.7	18.5	18.5	19.3	20.3
- liquid assets to total assets	20.8	22.2	26.4	31.0	23.7
- return on equity	9.0	4.1	4.6	14.4	19.8
- foreign exchange loans to total loans	0.4	0.2	0.2	0.2	0.1

Source: Central Bank of Montenegro.

3. PUBLIC FINANCE[3]

Supported by extraordinary revenue growth, the 2023 budget outcome substantially exceeded the target envisaged in the revised budget. The initial budget set the general government deficit target at 5.9% of GDP, compared to the 2022 outcome of 4.3% , due to higher mandatory social spending and cautious assumptions on the revenue side. Following the amendment of the 2023 budget in November to accommodate much stronger growth in public revenue and allocate additional funds for energy, social and health transfers and public wages, the overall deficit target was reduced significantly to 3.4% of GDP. The actual budget outcome is estimated to have been in surplus, at 0.5% of GDP, due to a combination of much higher revenue (44.3% of GDP versus 37.6% predicted in the revised budget) and less pronounced increase in spending (43.8% versus 40.9% of GDP). Public revenue growth was supported by high consumer spending fuelled by a large inflow of foreign nationals, high inflation, a successful tourism season and improved tax discipline. Revenues also benefited from an increase in social contributions following public sector wage increases as well as one-off revenues related to the economic citizenship programme, the termination of a hedging arrangement[4] and the energy-related budget support from the EU. Overall, total revenues increased by 26.3% y-o-y or by 5.1 pps of GDP, while total spending rose by 12.8% or 0.9 pps of GDP. Current expenditure increased by 17.2% y-o-y, driven by higher social transfers (23.6%), an increased wage bill (19.3%) and a surge in interest payments (34.9%). In parallel, capital spending declined by 9%, raising a question mark on the composition and quality of public spending.

[3] The assessment of the fiscal framework is based on a revised fiscal scenario provided to the Commission after the official ERP submission, and not on the fiscal tables presented in the ERP. The revision is mainly explained by: (i) the budget outcome of 2023; and (ii) revised projections for the local government sub-sector, which led to a significant revision of general government finances.

[4] The hedging transaction in the form of cross-currency swap was concluded in the amount of USD 818 million covering a loan provided by Exim China Bank with a maturity of 14 years. The cross-currency swap operates on the principle of exchanging euro and dollar cash flows between the contracting parties, in accordance with the agreed terms and in accordance with the loan repayment plan to which the hedging arrangement is linked. The Ministry of Finance decided to keep the hedging arrangement until all four repayment instalments have been repaid and closest to the date of mandatory termination i.e. July 2023. The transaction was terminated (by the outgoing government) in early June 2023 when the market gain reached around USD 64 million.

While fiscal consolidation remains a priority, the ERP projects a worsening budget balance in 2024 (compared to the actual 2023 outcome) and gradual adjustment in the next 2 years. A number of ad hoc measures in previous years[5] weakened the tax base and resulted in higher mandatory spending. The ERP sets out some fiscal consolidation measures which contain reduced discretionary spending, applying stricter criteria for the selection of mature investment projects and better collection of revenue as well as the expansion of the tax base. All new spending measures are required to be fiscally neutral, i.e. financed from current revenue but not from new borrowing. This concept excludes capital expenditure and therefore does not limit the extent of the deficit. Public revenue is set to level out from the record 44.3% of GDP in 2023 to 44.1% in 2024 and then decline to 42.8% in 2026. Other (non-tax) revenue, which was supported by one-off items in 2023, is set to decline from 7.1% to 5.4% of GDP in 2024 and to 4.6% in 2026. Key items supporting public revenue will remain VAT and excise duties, which are projected to account for around 74% of tax revenue in 2024-2026. The share of social contributions is set at nearly 20% of budget revenue for this period. Public spending is set to increase from 43.8% of GDP in 2023 to 47.5% in 2024 before declining to 45.2 % in 2026. The main items driving higher spending relate to growing social transfers and capital investment. This projected path would result in a sharp widening of a headline deficit to 3.4% in 2024 and a gradual fall by 0.5 pps per year thereafter. The primary balance is projected to achieve a surplus of 0.2% of GDP in 2026. The projected fiscal adjustment is backloaded, but more ambitious than last year's programme which did not envisage any reduction of the primary deficit. The debt ratio is assumed to be on a declining path from 62.2% of GDP in 2023 to 61% in 2026 which is well below the projections of the previous ERP. Overall, the assumed fiscal path of a substantial widening deficit in 2024 and a gradual adjustment in the subsequent years would result in exceeding the limits prescribed by the rules of fiscal responsibility[6] in 2024, but partially complying with them in 2025-2026.

[5] These included abolishing the mandatory health contributions, introducing a non-taxable share of wages, introducing additional allowances for all children and for mothers of three or more children, large increases in minimum pensions and wage increases in the public sector.

[6] Numerical fiscal rules limit the general government deficit and debt to below 3% and 60% of GDP, respectively.

Table 3:

Montenegro - composition of the budgetary adjustment (% of GDP)

	2022	2023	2024	2025	2026	Change: 2023-26
Revenues	39.2	44.3	44.1	43.3	42.8	-1.5
- Taxes and social security contributions	34.1	37.2	38.7	38.5	38.2	1.0
- Other (residual)	5.1	7.1	5.4	4.8	4.6	-2.5
Expenditure	42.9	43.8	47.5	46.2	45.2	1.3
- Primary expenditure	41.2	41.9	45.5	43.9	42.7	0.7
of which:						
Gross fixed capital formation	5.3	4.3	5.2	5.0	5.1	0.7
Consumption	13.0	13.7	13.6	12.8	12.3	-1.4
Transfers & subsidies	19.7	20.8	22.7	22.4	22.1	1.3
Other (residual)	3.2	3.1	4.1	3.7	3.2	0.1
- Interest payments	1.6	1.9	2.0	2.2	2.5	0.6
Budget balance	-3.7	0.5	-3.4	-2.9	-2.4	-2.8
- Cyclically adjusted	-3.4	-0.1	-4.3	-3.8	-3.1	-3.0
Primary balance	-2.1	2.4	-1.4	-0.7	0.2	-2.2
- Cyclically adjusted	-1.8	1.8	-2.3	-1.6	-0.6	-2.4
Gross debt level	69.3	62.2	61.6	61.3	61.0	-1.3

Sources: Economic Reform Programme (ERP) 2024, Commission calculations.

Driven by strong growth in social transfers and capital spending, the general government deficit is set to widen in 2024. Compared to the 2023 output, government revenue is set to decrease marginally, by 0.2 pps to 44.1% of GDP, although the ‘other’ (non-tax) revenue category is set to decline by 1.7 pps to 5.4% of GDP due to expiring one-off items. Tax revenue is set to increase by 1.5 pps to 38.7% of GDP, which seems rather optimistic given an exceptional performance in 2023. Nearly half of government revenue is projected to come from VAT and excise duties, which would increase by 13% each and account together for 22.2% of GDP. While pension increases should support household consumption and VAT income, further additional revenues are expected thanks to higher legal trade in tobacco products, changes in the excise calendar and new excise duties on products with added sugar. Revenues from labour and corporate income taxation are projected to rise by 12% and 9%, respectively, as compared to 2023, in line with economic trends, the narrowing of the informal economy and the ongoing adjustment of public wages. Revenues from social security contributions are expected to remain stable at 8.6% of GDP. Public spending is projected to increase by 3.7 pps to 47.5% of GDP, due to a strong increase in mandatory current spending, mainly driven by social transfers, and higher allocation for capital investment. Social benefit spending is planned to increase by 22.6% y-o-y, or by 2 pps to 14.4% of GDP, reflecting the increase in the minimum pension (52%) and the regular pension indexation. The gross wage bill is assumed to remain roughly unchanged at 10.7% of GDP, but it will increase by 5% y-o-y in nominal terms, due to a new collective bargaining agreement and a higher number of workers employed. The capital budget is set at 5.2% of GDP, which is 1.1 pps higher than in 2023 due to the planned start of the second phase of the Bar-Boljare highway.

The budget for 2024

* On 28 December, Parliament of Montenegro adopted the 2024 Budget Law, which targets a deficit of 3.4% of projected GDP, assuming real growth of 3.8% and inflation levelling out to 5%.

Table: **Main measures in the budget for 2024**

Revenue measures*	Expenditure measures**
• Increase in indirect revenues due to higher consumption supported by an increase in minimum pension to EUR 450 *(Estimated impact: 0.4% of GDP)* • Implementation of excise increase through regular excise calendar, and introducing the new excise product and suppressing the grey economy on tobacco market *(Estimated impact: 0.6%)* • One-off change in non-tax revenue due the implementation of the economic citizenship programme *(Estimated impact: 0.4% of GDP)* • Implementation of the new Law on Games of Chance *(Estimated impact: 0.3% of GDP)* • Returning the VAT rate on the pre-crises level from 7% to 21%, in the field of tourism and hospitality as of 1 January 2024 *(Estimated impact: 0.2% of GDP)*	• Increasing the minimum pension to EUR 450 *(Estimated impact: 1.5% of GDP)* • Regular adjustment of pensions *(Estimated impact: 0.8% of GDP)*

* Estimated impact on general government revenues.
** Estimated impact on general government expenditure.

Source: ERP

In the medium term, the ERP projects that budget deficits will decline as a result of the rapidly decelerating growth of public spending. The budget revenue as share of GDP is set to decrease from a high level due to decelerating growth of tax revenue and shrinking other revenues. Tax revenue is forecast to grow at some 4% in nominal terms in 2025-2026, supported by lower tax debt, an accelerating excise calender, the revision of the taxation of games of chance and measures to tackle informality. The budgetary adjustment should mainly be driven by a sharp deceleration of public spending, from an annual increase of 15% in 2024 to 2.7% in 2025 and 2.5% in 2026, leading to a 2.3 pps drop in the spending ratio in 2025-2026. The ERP refers to the principle of controlled growth of current spending and a reduction in non-productive spending, but the assumptions on the main spending items raise some concerns. Notably, the projection of an almost stable wage bill in nominal terms, leading to a 0.5 of GDP reduction per year might prove overly optimistic and not in line with historical wage trends and the inflation outlook in 2025-2026 which is likely to generate at least some wage adjustments. Social transfers are projected to grow by 5% in 2025 and 4% in 2026, after a major increase (22.6%) in 2024. This assumption seems rather optimistic, as an average pension is indexed three times a year, resulting in a 39% increase by the end of 2024[7]. The capital budget is set to remain roughly stable at some 5% of GDP, which is above the level achieved in 2023, but in line with historical trends.

After significant declines in recent years, the ERP projects the public debt ratio to decrease only moderately, to 61% of GDP in 2026, while financing needs are set to rise sharply. The ERP estimates that total public debt decreased sharply, to 62.2% of GDP at the end of 2023 from 69.3% in the previous year. Total financing needs amounted to 6.1% of GDP, which were mainly covered by new borrowing (4.6%), government deposits (0.9% of GDP) and privatisation revenues (0.3%). Despite a widening primary deficit in 2024, the ERP expects the public debt to level out to 61.6% of GDP, helped by GDP growth, inflation and negative stock-flow adjustments, the latter partly related to the continued use of government deposits to meet financing needs. In 2025-2026, rising interest expenditure is set to be the main debt ratio-increasing factor while an offseting impact is expected from GDP growth and inflation. The ERP projects a small primary deficit in 2025 which should turn into a surplus in 2026, contributing to a continued modest debt reduction. Debt repayment needs are set to rise sharply, from 4.8% of GDP in 2023 to 7.6% in 2024 and 11% of GDP in 2025, bringing gross public financing needs to a record 14.1% of GDP in 2025. The surge in 2025 is driven by a maturing Eurobond (EUR 500 million or 6.7% of projected GDP) which needs to be refinanced. Government deposits, which stood at 3.6% of GDP in September 2023, are planned to help debt repayment by 1% of GDP in 2025-2026.

A new hedging arrangement covers currency exchange and interest rate risks. While the average debt maturity shortened by 2 years in 2020-2022, the termination of hedging arrangement for a US dollar denominated loan from China in 2023 resulted in a significant increase in the average weighted interest rate and in the share of non-euro-denominated debt (to around 20% of the total).While the share of debt with a fixed interest rate remained practically unchanged from previous year at 77.8% of the total, the share with a variable interest rate (22.2%), is mainly linked to Euribor, which was expected to result in higher borrowing costs due to tightening global financial conditions. This, along with currency exchange risks, has been addressed by concluding a new hedging arrangement after the submission of the ERP.

[7] Following the 52% hike in the minimum pension rate to EUR 450 as of 2024, the government announced that there will be no regular adjustments of the minimum pension for the next 2 years.

Montenegro

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

	2022	2023	2024	2025	2026
Gross debt ratio [1]	69.3	62.2	61.6	61.3	61.0
Change in the ratio	-14.7	-7.1	-0.6	-0.3	-0.3
Contributions [2]:					
1. Primary balance	**2.1**	**-2.4**	**1.4**	**0.7**	**-0.2**
2. 'Snowball effect'	**-11.6**	**-5.2**	**-1.6**	**-1.0**	**-0.3**
Of which:					
Interest expenditure	1.6	1.9	2.0	2.2	2.5
Growth effect	-4.5	-3.6	-2.2	-1.8	-1.7
Inflation effect	-8.7	-3.5	-1.3	-1.4	-1.1
3. Stock-flow adjustment	**-5.2**	**0.5**	**-0.4**	**-0.1**	**0.1**

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

Source: Economic Reform Programme (ERP) 2024, Commission calculations.

Debt dynamics

The favourable snowball effect is set to moderate sharply, as nominal GDP and inflation are set to slow down while interest costs rise. A continued moderate debt reduction is set to be ensured by the improving primary balance, which is projected to turn positive in 2026. Using government cash deposits to repay maturing debt is projected to generate some downward stock-flow adjustments in 2024 that will decline in the following 2 years.

While the ERP presents a broad balance of risks to the baseline scenario, some risks deserve deeper consideration. Political risks relate to geopolitical tensions and the internal environment, which could lead to new spending pressures, undermining the sustainability of public finance and credit conditions for the forthcoming borrowing. The lack of a comprehensive fiscal strategy creates a risk of further ad hoc measures, as shown by the ongoing discussion to raise the minimum wage up to EUR 700 and increase net wages, potentially by reducing the pension contribution rate. Such decisions would constitute a major risk and have heavy consequences for Montenegro's fiscal sustainability, requiring a substantial increase in indirect taxes to offset the costs. Given the 2023 output, public revenue is revised significantly upwards as compared the previous ERP, resulting in lower government deficits. Spending projections signal consolidation attempts, but the underlying assumption, such as freezing the public wage bill, lacks credibility. The ERP indicates positive risks to the baseline scenario, related to the implementation of the Growth Plan for the Western Balkans, the reform of the Revenue and Customs Administration, strengthened measures against the informal economy, the concession of Montenegro's airports and the growth impact of the highway construction. Negative risks stem from possible delays in the implementation of structural reforms, adverse external trends, in particular inflation, and delays in the implementation of revenue-supporting measures. Further negative risks relate to possible cost overruns in highway construction projects and contingent liabilities related to SOEs. There is also a specific issue concerning the revision of future statistical data, namely that alignment with the European System of Accounts (ESA 2010) methodology would require reclassifying some operations of public companies into the general government sector, potentially increasing deficit and debt levels.

Sensitivity analysis

The ERP includes a detailed analysis of the deficit, with a comparison between baseline and low growth scenarios as well as with the previous ERP. The comparison of scenarios includes a detailed risk matrix identifying potential positive and negative events (see above). However, a detailed impact of each single risk is not quantified; only their total effect on the budget balance, as reflected in the alternative scenario. Under the low growth scenario, the general government deficit would widen from 1.2% of GDP in 2023 to 8.4% in 2024 and adjust to 6.4% in 2025. In addition, the public debt-to-GDP ratio would reach 76% of GDP by 2026 implying higher fiscal sustainability risks.

Shortcomings in the composition of public finance include a narrow tax base and high mandatory spending. Abolishing mandatory health contributions and introducing a non-taxable part of wages has substantially weakened the tax base[8], while growing public spending is mainly driven by current expenditure (86% of the total) leaving little space for capital investment. Public investment would also benefit from more efficient capital budgeting and implementation. While the ERP mentions the need to strengthen the tax base with a comprehensive tax reform, there is a risk that lowering the tax wedge on labour would deliver the opposite result and further weaken public revenue. Higher taxation of illegal assets, raising excise rates for goods with adverse health effects, reducing the informal economy and tax debt are all steps in the right direction, but it is unclear whether their impact would be sufficient to compensate for continuous growth of mandatory spending. The reforms of the pension and healthcare systems, renumeration of public employees, together with the reform of SOEs, are essential for limiting the increase of current spending and freeing the resources for investment projects (e.g. on education, infrastructure and digitalisation), aimed at increasing productivity and the competitiveness of the economy.

Compliance with existing fiscal rules requires tighter fiscal consolidation than that envisaged in the current ERP. The current medium-term fiscal planning breaches the numerical rules for general government debt for the entire period, while the general government deficit is projected to fall below the limit of 3% of GDP in 2025-2026, partly due to overoptimstic assumptions on containing public spending. The ERP confirms the urgent need for reforms in the areas of health, social benefits, pensions and public sector wages, which are indispensable for achieving the fiscal consolidation and medium-term sustainability of public finance. The ERP also suggests considering a revision of existing fiscal rules, as they are too weak to anchor fiscal policy, and possibly introducing additional rules or reinforcing the current budgetary planning process. A requirement for fiscal neutrality, which was applied for the 2024-2026 fiscal planning, could be institutionalised while respecting the current limit for budget deficit and the need to achieve a primary surplus. A commitment to anchor public debt to 60% of GDP could be a useful tool in strengthening fiscal sustainability. Further support for monitoring the implementation of fiscal policy could come from the Fiscal Council, which would be tasked with evaluating new measures prior to their adoption. Montenegro adopted the Law on budget and fiscal responsibility, creating the legal basis for setting up the Fiscal

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[8] Given the importance of the tourism industry, Montenegro's tax mix is very dependent on revenues from taxes on goods and services, accounting for 62.6% of total tax revenues in 2021. For comparison, taxes on goods and services average to 49.2% and 32.1% in WB6 economies and OECD countries, respectively. As a share of GDP, VAT revenues account for 19.9% in Montenegro, which is almost twice as much as the OECD average of 10.6%. OECD (2022).

Council. However, the public call for Council members has so far failed and the government plans to relaunch a call in 2024.

4. MAIN MACRO-RELEVANT STRUCTURAL CHALLENGES

In November 2023, the Commission proposed a New Growth Plan for the Western Balkans[9] with the aim of supporting the region's economic convergence and accelerating the accession process. The plan involves a Reform and Growth Facility (EUR 2 billion in grants, EUR 4 billion in loans) that is to be disbursed in 2024-2027 as investment[10] and budget support in exchange for implementing reforms that are to be set out in reform agendas prepared by the Western Balkan partners. The New Growth Plan is therefore an important tool to increase reform incentives to boost growth and convergence. In this context, with a view to ensuring an integrated surveillance of Montenegro's economy, this chapter briefly outlines the main structural challenges facing the country.

Montenegro's comparative advantage is due to its geographical location, climate and landscape. Its small and open economy is service-oriented and largely focused on tourism as the principle source of income. Services account for nearly 80% of all exports, while foreign tourists directly generate over 20% of the country's GDP. Given the country's reliance on one sector and its small size, the economy remains vulnerable to external shocks and the challenges of climate change.

An improved business-oriented institutional and regulatory environment would facilitate private sector development. A burdensome regulatory and institutional environment hinders private sector dynamism as well as domestic and foreign investment and provides incentives, specifically to micro and small enterprises, to engage in undeclared work and transactions. This is compounded by the excessively complex legal framework, weak law enforcement[11], a lack of transparency in administrative decision making and financial burden from local taxation and para-fiscal charges.

Pushing forward reforms and privatising SOEs and improving their governance and profitability remain a challenge. Insufficient performance of SOEs translates into fiscal risks and a potential increase in public spending within limited fiscal space. The caretaker government stepped back from previous plans to formulate the State's ownership strategy and set out a portfolio of key companies that should remain in state possession, as well as to improve the management practices and financial performance of SOEs. As there was no political agreement on the direction and scope of such reforms, the government also stepped back from its plans for setting up a holding company to

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9 https://neighbourhood-enlargement.ec.europa.eu/enlargement-policy/new-growth-plan-western-balkans_en

10 Infrastructure investments need to comply with the EU environmental acquis, national and international nature protection and water management obligations, ensure public participation and consultation, and guarantee high quality environmental impact assessment reports that include cumulative impacts on nature and biodiversity.

11 There are considerable challenges in dispute settlement in Montenegro, despite progress in implementing reforms. The time to resolve a commercial dispute has been consistently increasing and the commercial court is still challenged by weak enforcement and limited implementation capacity. Similarly, the Constitutional court spent 6 months without a quorum and there is still one vacancy to be filled, which could increase the backlog of cases.

manage and reform SOEs[12], and limited the scope of its 2022 measures to set up a small unit in the Ministry of Finance to monitor fiscal risks related to SOEs. The performance of Montenegro's SOEs, including those at the local level, could be enhanced by establishing a legal SOE framework, which would incorporate principles of good corporate governance, and transforming SOE management structures, eliminating political patronage and improving financial performance to reduce fiscal risks.

The informal economy is a major obstacle to the inclusive, sustainable growth and the competitiveness of Montenegro. The informal sector is fuelled by deficiencies in the institutional and regulatory environment, labour market weaknesses, insufficient enforcement capacity of the public authorities, corruption and tax non-compliance. The impact of the informal economy is particularly harmful for SMEs that operate legally and microenterprises in the services sector, which dominate the economy. These smallest companies perceive informal competition as the most costly obstacle to doing business. The costs of the informal economy and corruption are also higher for innovative companies, which particularly hinders the development of sectors of the economy that are based on knowledge and skills. Effective policies to reduce informality would help create a supportive environment for the SME sector, enabling it to also benefit from the presence of skilled migrant labour in the country. The ERP sets out measures aimed at strengthening the business environment and supressing the informal economy, such as introducing a new integrated IT system for public revenue management and streamlining trade in goods and services.

Montenegro's green transition remains at an early stage. The national energy and climate plan is under development and expected to be adopted in 2024. The plan is expected to align with the 2030 energy and climate targets approved by the Energy Community Ministerial Council in 2022. As EU Member States move towards greener economies, Montenegro would benefit from aligning its policies with those of the EU. This would strengthen its competitiveness during the accession process (for example on the Carbon Border Adjustment Mechanism), and ultimately help it cope with increased market pressures. It should notably implement the Energy Community's Decarbonisation Roadmap and put in place a carbon pricing instrument compatible with the EU ETS, along with a reliable and transparent framework for monitoring, reporting and verifying greenhouse gas emissions. While the use of renewable energy sources is high (some 43% of the electricity production in 2020 came from renewable sources, mostly hydropower and biomass) Montenegro could leverage its natural endowments in hydro, solar and wind power, increasing energy production and exports, while also helping to achieve the country's climate goals, and supporting the achievement of coal phase out.

The pace of investment in digital infrastructure is slow. The telecoms operator auctioned 5G spectrum and awarded it to three major operators in December 2022, but a framework for 5G cybersecurity requirements is still pending. All three operators are obliged to activate 5G in every municipality by the end of 2024, providing 5G coverage to 50% of population by 2026. Access to broadband networks is key to digitalising the economy and public services, and to implementing Montenegro's smart specialisation strategy in the ICT sector. By May 2022, some 82% of Montenegrin households were located in areas with high-speed broadband connection available (defined as 30 Mbit/s), but actual take-up was much lower at only around 48% of households. Meanwhile, 19% of households were still without internet access in 2021, despite it being technically

[12] The SOE Montenegro Works, which was created in August 2021 and tasked with monitoring SOEs' financial performance, was liquidated in July 2022.

available. In rural areas, 37% of households were without internet access. The main goal of the national broadband plan is to provide a higher percentage of household coverage by fixed broadband internet access at a speed of 100Mbps.

The digitalisation of the public sector, and the development of transactional e-government services for the public and for businesses feature prominently among the government's priority reforms, as set out in a series of important strategic documents[13]. Although digitalisation gained additional momentum during the COVID-19 pandemic[14], state authorities failed to produce tangible improvements. The cyberattacks during in the second half of 2022 seriously disrupted the government's digital services and brought the issue of cybersecurity to the forefront, but it consequently left little space for improvements to e-governance. The ERP refers to digitalisation and cyber security measures, which are expected to result in the digitalisation of the public administration and to strengthen cyber security and broadband infrastructure through a multidisciplinary approach. This reform measure should improve confidence in digital services, increase the efficiency of public services and contribute to productivity growth.

With the economic recovery, labour market indicators also continued to improve and surpassed pre-crisis levels, but structural challenges remain. According to the labour force survey (LFS), the average unemployment rate fell to 12.2% in Q4-2023, down from 13.4% a year earlier, while the employment rate also increased to 63.8%, up from 59.6%, the previous year. Despite these improvements, the 2023 LFS results once again confirmed large regional disparities, with the unemployment rate standing at 3.5% in the tourism-heavy coastal region, at 7.7% in the central region, and at 29.2% in the poorer northern region. The gender gap narrowed somewhat, but the activity rate of women (63.6%) remained significantly below that of men (77.5%). Remaining major structural challenges are youth unemployment, standing at 23.7% for the population aged 15-24, and long-term unemployment, as 76.1% of all unemployed have been looking for a job for more than 12 months. The most vulnerable groups on the labour market remain women, young people, Roma and low-skilled workers, with Roma and people with disabilities facing particular challenges in accessing the labour market. While some support is available for these groups by way of employment and education programmes, these do not seem effective in supporting these groups to better prepare for or integrate into the labour market. Despite ongoing reform efforts, the public employment service's capacity for job mediation remains weak and lacks a continuous monitoring of active labour market policies, which in turn prevents the design of quality, targeted and effective employment activation measures. The Employment Agency of Montenegro's reform and readiness remain key challenges and are important for not only implementing the Youth Guarantee, but also for ensuring a healthy, well-functioning labour market in the long term.

A mismatch of skills remains a significant challenge, particularly for graduates of vocational education and training (VET) or higher education, despite some recent efforts to improve the transition from education and training to the labour market. The quality and relevance of the entire education system and the lack of practical experience of VET

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[13] 2022-2026 digital transformation strategy, 2022-2026 strategy for the digitalisation of the education system, 2022-2026 cybersecurity strategy and the Law on electronic documents.

[14] In 2022 Montenegro implemented the new customs law, requiring electronic data processing for information exchange among customs authorities and economic entities. This improves efficiency in customs procedures, leading to a more secure and digitally streamlined trade environment for both businesses and the government agencies.

and higher education graduates are long-standing challenges. A high share of people transitioning from VET programmes to higher education and other programmes are less suited to market needs. Occupational mismatches (i.e. over-qualification) are highest for people with tertiary education (around 14%). Although tertiary educational attainment is still lower than the EU average, the labour market cannot absorb the numbers of tertiary graduates in certain areas, such as business and humanities. However, there is still a shortage of medical and STEM graduates (ETF, 2019), demonstrating the need to step up the smart specialisation strategy. Montenegro's entrepreneurial lifelong learning strategy for 2020-2024, the National Partnership and the Innovation Fund are expected to help address these skills shortages. Furthermore, the strategy for the development of vocational education in Montenegro (2020-2024), along with its action plans, outlines measures to overcome workforce skills shortages and to improve the efficiency and the effectiveness of the VET system and lifelong learning. The reform of career guidance services at all levels leave further space for development (ETF, 2022). Montenegro has committed to the Western Balkans agenda on innovation, research, education, culture, youth and sport, which is expected to guide its reform efforts. Lifelong learning and adult education with up- and re-skilling has not yet played a sufficiently prominent role, including in facilitating the green and digital transitions. Given the very high share of long-term unemployment, developing and implementing these measures remains essential.

Annex 1: Overview of the implementation of the policy guidance adopted at the Economic and Financial Dialogue in 2023

Every year since 2015, the Economic and Financial Dialogue between the EU and the Western Balkans and Turkey has adopted targeted policy guidance for all partners in the region. The guidance represents the participants' shared view on the policy measures that should be implemented to address macro-fiscal vulnerabilities and structural obstacles to growth. The underlying rationale of the guidance is similar to that of the country-specific recommendations usually adopted under the European Semester for EU Member States. Implementation of the guidance is evaluated by the Commission in the following year's ERP assessments.

The following table presents the Commission's assessment of the implementation of the 2023 policy guidance jointly adopted by the EU and the Western Balkans and Turkey at their Economic and Financial Dialogue at ministerial level on 16 May 2023.

Overall: partial implementation (38.9%) [15]	
2023 policy guidance (PG)	**Summary assessment**
PG 1:	There was **limited implementation** of PG 1:
Adopt an appropriately tight fiscal stance in 2023 to help disinflation, while providing targeted support to vulnerable households and firms, if needed.	1) **Substantial implementation**: In early 2023 the caretaker government adopted some structural measures to support budget revenue. Good economic performance, supported partly by the inflow of foreign nationals, resulted in a strong increase in budget revenue making it possible to achieve a small surplus - a much better outcome than planned in the revised budget. The decision to increase minimum pensions supports the most vulnerable households.
Adopt a new medium-term fiscal strategy with the 2024 budget, including concrete consolidation measures supporting the achievement of a non negative primary balance from 2025, and a reduction of the public debt ratio over the medium-term.	2) **Limited implementation**: A medium-term fiscal strategy, including concrete consolidation measures, has not been adopted. Fiscal projections set out in the 2024 budget foresee the continued moderate reduction of the public debt-to-GDP ratio, while the primary balance is projected to become positive in 2026. But the unerlying measures to achieve the required speding restraint are not well developed.
Ensure proper costing of new fiscal initiatives before considering them for adoption.	3) **No implementation**: Important initiaves, such as the 52% increase in minimum pension, were not accompanied by a proper cost assessment.

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

PG 2: Implement the public investment management assessment (PIMA) recommendations, prioritising key public infrastructure works within the available fiscal space while avoiding exceptions regarding project selection. Adopt amendments to the Law on Budget and Fiscal Responsibility and take concrete steps towards setting up a fiscal council. Based on an analysis of the economic and fiscal impact of all tax expenditures to be shared with the Commission, prepare concrete budgetary recommendations to reduce tax expenditure (such as exemptions, deductions, credits, deferrals).	There was **limited implementation** of PG2. 1) **Limited implementation:** In cooperation with the IMF, the Ministry of Finance set key priorities and agreed technical assisstance to improve the capital budget planning. 2) **Substantial implementation:** Amendments to the Law on budget and fiscal responsibility were adopted. The government launched a public call for members of the Fiscal Council, but it was unsuccessful due to an insufficient number of applicants. A new call is expected in Q1-2024 and the Fiscal Council should be set up by the end of 2024. 3) **No implementation:** With technical support from the IMF, a review of Montenegro's tax exemptions was carried out in 2021. However, no concrete steps were taken to prepare an economic impact analysis/quantification of the scale of tax exemptions.
PG 3: Continue to carefully assess and analyse price developments, stand ready to use the limited tools available under the chosen monetary framework to ensure price stability Strengthen further the reporting and risk management frameworks across the banking system to ensure an accurate reporting of asset quality and continue to reduce data gaps in particular as regards the real estate sector. Continue to improve and implement legislation to further align with the EU framework on regulation and supervision, including on deposit insurance, and accelerate efforts to provide viable and timely solutions for swift and effective NPL resolution.	There was **substantial implementation of PG 3**: 1) **Partial implementation**: The central bank carefully monitored developments in price dynamics and observed some increases in lending rates and slowing credit growth. Fiscal policy that led to large net wage increases added to underlying inflationary pressures. So far the central bank has not used macroprudential tools, which are among the few tools it has at its disposal to influence lending activity and therefore also inflation. 2) **Substantial implementation**: Following the completion of all Asset Quality Review follow-ups, on-site checks were conducted to determine the correctness of capital adequacy calculations. Non-performing loans (NPLs) continued to decline. On the real estate sector, the central bank created an indicator on the departure of real estate prices from its fundamentals to monitor financial system risk. Some data gaps remain. 3) **Substantial implementation**: Progress was made on key legislation that further aligns Montenegro's regulation and supervision with the current EU framework, including on enabling regulations to implement the Law on credit institutions. The coverage ratio of insured deposits has been raised incrementally. Following the adoption of the Law on resolution of credit institutions, the CBM prepared resolution plans, determined the minimum

	requirement for own funds and eligible liabilities (MREL), and set up a Resolution Fund which it manages. However, progress on legislation and actions to strengthen the broad institutional framework for efficient insolvency has been limited, with an inter-agency working group set up by the CBM needing to be actively resumed.
PG 4: Improve the institutional and regulatory environment and enhance energy resilience and transition to implement the Green Agenda. Further digitalise and simplify administrative procedures for micro, small and medium enterprises and prioritise cybersecurity, data protection and business continuity for e-government services. Prepare a roadmap for reforming state-owned enterprises (SOEs), prepare a framework for the monitoring and management of SOEs and develop objective criteria for the selection of their management bodies.	There was **limited implementation** of PG 4. 1) **Limited implementation:** Preparation of the National Energy and Climate Plan (NECP) is significantly delayed. Preparatory work on two climate-related laws is underway. Some activities have been undertaken to facilitate preparation of laws on energy and cross border exchange of electricity and gas. Several secondary legislation acts on energy efficiency were adopted, but implementation is still lagging. The energy projects, Montenegro Energy Efficiency Project and Promotion of Energy Efficiency in Public Buildings are underway. 2) **Limited implementation**: Montenegro joined Digital Europe programme in June 2023, but the government support for SMEs participating in the calls for proposals is not specified. The launch of a new government e-portal has been postponed to the end of 2024. Initial activities to establish a new cybersecurity architecture, including a cybersecurity agency and a secure data centre are underway. 3) **Limited implementation**: Initial activities for development of a new regulatory framework for SOEs have been carried out. The analysis of a current legal framework remains to be completed. Adoption of the strategy on state ownership, the roadmap for reforms of SOE governance and the related legislative proposals are yet to be drafted.
PG 5: Based on the results of the informal economy survey, establish an action plan to reduce informality. Ensure cooperation between central and local authorities to implement the plan, including prevention and incentives to legalise informal businesses and employees. Develop an analysis of the inspection services and of the relevant legal framework to optimise the inspector's work, minimising discretionary decisions and inconsistences in the inspection	There was **partial implementation** of PG 5. 1) **Full implementation:** In December 2023, the government adopted a programme for supressing the informal economy for 2024-2026, with an accompanying action plan. 2) **Limited implementation:** While some forms of cooperation between central and local authorities have been announced within the newly adopted programme for supressing the informal economy, the implementation is yet to take place. 3) **Limited implementation:** A number of actions targeting the inspection services and the scrutiny of the relevant legal framework has been announced within the newly adopted programme for supressing the informal economy. However, the analytical work and foreseen actions should start in mid-2024 and be

powers.	finalised in 2025.
PG 6: Prepare activities for the implementation of the Youth Guarantee pilot planned for 2025, analyse its performance, and in parallel identify and implement necessary structural, operational and organisational changes to ensure that the Employment Agency of Montenegro is prepared for the service delivery of the fully-fledged Youth Guarantee as well as its other functions. Continue efforts to reform the provision of active labour market policy measures with an emphasis on their labour market relevance, including work-based learning, and establish a continuous monitoring mechanism that will enable evidence-based active labour market policy design. Based on the Roadmap of reforms on social assistance and social and child protection services in Montenegro, establish a clear timeline and financial planning for the reform of the social and child protection system and start implementing the reforms.	There was **limited implementation** of PG6. 1) **Limited implementation**: The new government (re)appointed a working group to coordinate the Youth Guarantee implementation plan (YGIP) as well as a new Youth Guarantee coordinator. The YGIP (revised version from October 2023) is to be adopted in April 2024. Activities to prepare the pilot are progressing slowly. The digitalisation of the agency has started with the development of a single IT system. This takes the form of an application-based, modular built platform, organised to enable all of the agency's business processes. It aims to serve as a single gateway for employment for all sectors and sections of the Employment Service, as well as for the general public and companies, and - through data sharing - for other public administration bodies, both at national and local level. The system is planned to be up and running before the end of 2024. 2) **Limited implementation**: The implementation of the roadmaps, methodology and manuals for the design, implementation and monitoring of ALMMs has yet to take place. Capacity building activities for the Employment Agency of Montenegro staff for the implementation of the Youth Guarantee were identified. 3) **Limited implementation**: A new social and child protection strategy is under preparation, but the new Law on social and child protection, aimed at improving the quality and financing of services provided at national and local level, has not yet been drafted. The adoption of the Law on the disability determination system is planned for Q4-2024.

ANNEX 2: COMPLIANCE WITH PROGRAMME REQUIREMENTS

The government of Montenegro submitted its 2024-2026 economic reform programme to the Commission on 12 January 2024.

Inter-ministerial coordination

The Ministry of Finance coordinated the work to prepare the 2024 ERP. An inter-ministerial working group involved all relevant ministries.

Stakeholder consultation

The national ERP coordinator organised an initial consultation on the design of ERP measures in November 2023. Another public consultation on the draft ERP took place in December 2023, and included a roundtable discussion with members of the public.

Macro framework

The programme presents a clear and concise picture of past economic developments and covers relevant data available at the time of submission. The information provided is coherent, concise and well structured. The macroeconomic framework is coherent, consistent and sufficiently comprehensive and provides a good basis for policy evaluation and discussions. Statistical tables were not complete in the first submission and were subsequently revised several times.

Fiscal framework

The fiscal framework is well detailed, in line with stated policy objectives and consistent with the ERP macroeconomic framework. However, fiscal projections were revised due to inaccurate budgetary planning of local governments. After correcting the projections for local governments, the factors behind the ERP's projected revenues and expenditures are in line with the existing legislative measures, and are presented clearly. Montenegro's fiscal reporting does not follow ESA2010 standards, and therefore does not meet the Commission's fiscal notification requirements.

Structural reforms

The structural reform parts of the ERP respect the guidance note. A dedicated section provides information on the implementation of the policy guidance for 2023. Reporting on the progress of 2023 structural reform measures is generally of good quality. The 2024-2026 ERP sets out six major reforms, indicating the underpinning measures, as well as the costing of structural reforms.