SUMMARY

1. Since its WTO accession in April 2012, Montenegro's small and open import-dependent and services-orientated economy has been on a fluctuating growth path. Action has been taken through fiscal consolidation and reform measures to address several economic challenges. During the review period, Montenegro's annual GDP growth ranged from -2.7% (in 2012) to 3.5% (in 2013); its annual average growth rate for the period 2012-16 stood at 1.8%, a slowdown compared to 3.4% over the 2001-11 period. Following a fiscal loosening in 2016, reforms have been under way to spur economic recovery, including a Fiscal Consolidation Plan (December 2016), a Fiscal Consolidation Strategy (June 2017), and a 2017-2019 Economic Reform Programme. Developments in Montenegro's regional and international competitiveness were affected by productivity-related and other challenges, some of which are being addressed. Whereas consumer price inflation dropped from a peak of 4.1% in 2012 to 1.5% in 2015, including two years of deflation, and averaged 1.4% in the period 2012-2016, the unemployment rate declined progressively but remained relatively high at an average of 18.5%.

2. During the review period, some trade and trade-related structural reforms were undertaken in areas such as tax administration, competition policy, and the labour market. Reforms aimed at spurring productivity growth – to address Montenegro's persisting production diversification and international competitiveness challenges – are under way in several areas (e.g. public finance management, energy, transport and telecommunications, business environment, reduction of the informal economy, foreign trade and investment facilitation). The fiscal deficit has been on the rise to accommodate additional government spending related to a major highway construction project, social welfare expenses (mothers' and pension benefits) and public-sector wage increases.

3. Montenegro does not have an independent monetary policy. Its lack of a national currency constrains to some extent its ability to absorb external shocks. The adoption of the euro as the domestic currency in 2002 has benefited foreign direct investment (FDI) inflows, foreign trade and GDP growth as a whole. Persistent stagnant productivity, rising labour costs, and continued large current account deficits have resulted in an appreciation of the real effective exchange rate since 2007; the depreciation of the euro in conjunction with quantitative easing by the European Central Bank eased this appreciation. The current account registered sustained deficits, averaging 15.4% of GDP during 2012-15, with a sharp increase in 2016 reaching 19% of GDP due to the continuing decline of exports of goods and the steady rise of imports of construction goods for large-scale infrastructure projects. Gross external debt dropped from 155.9% of GDP in 2012 to 152.1% in 2015. Foreign exchange reserves have increased steadily, *inter alia,* due to negative interest rates in the euro area.

4. The openness of the Montenegrin economy to international trade and its aim to integrate into the world economy continues to be reflected in the ratio of its trade (exports plus imports) in goods and services to GDP, which was 103.4% in 2016, a progressive decline from a peak of 111.8% in 2012. International trade and FDI trends reflect the continued importance of Europe as Montenegro's main regional market and supplier, with the European Union remaining its major trading and FDI partner. Furthermore, trade under regional trade agreements (RTAs) continues to account for more than 80% of total foreign trade. Montenegro is open to FDI; its only FDI restrictions relate to the ownership of land and assets within one kilometre of the border line and agricultural land. It actively encourages investment through various incentive schemes which are applied in a non-discriminatory manner. Efforts to improve the business environment have been reflected in improved international rankings but seemingly not yet in the country's competitiveness.

5. Since WTO accession, Montenegro has adopted constitutional amendments to reinforce judicial independence and has undertaken institutional and legislative reforms to combat corruption. As outlined in its 2017-2019 Economic Reform Programme, Montenegro's trade and trade-related policy objectives are focused on strengthening the competitiveness of service exports, diversifying goods exports and increasing value-added in export-orientated production.

6. Despite the country's attachment to multilateralism, Montenegro's authorities consider that its geographical and economic specificities make regionalism an important driving force in its legal and institutional developments. Since joining the WTO, Montenegro has undertaken commitments in government procurement and trade facilitation; it also accepted the Protocol Amending the TRIPS Agreement. Montenegro has never been involved in a WTO dispute settlement case either

as complainant, respondent or third party. While Montenegro has submitted notifications to the WTO in most areas, some remain outstanding; the pending notifications (e.g. on import licensing, SPS, TBT, and production support) are expected to be addressed in the course of 2018.

7. Montenegro participates in five RTAs with a total of 41 economies. It is a founding member of the Central European Free Trade Agreement (CEFTA), it is a party to the EU–Montenegro Stabilization and Association Agreement, and it has RTAs with the European Free Trade Association (EFTA), Turkey, Ukraine and the Russian Federation. Only the RTAs with the European Union and Ukraine incorporate specific commitments on services. Over the review period, the RTAs with EFTA and Ukraine entered into force, and at the CEFTA level there have been developments with respect to trade facilitation, rules of origin and trade in services. EU accession negotiations were launched in 2011 and are ongoing; as at end-2017, negotiations had been opened on 28 policy chapters.

8. Over the review period, new and/or amended trade and investment-related laws and regulations have been introduced across the board. Many of the legislative reforms have been driven by requirements to align relevant legislation with the EU *acquis communautaire*. Various initiatives to cut red tape and to involve stakeholders in policy formulation have been taken. For example, Montenegro: introduced new guidelines for stakeholder consultations in the process of formulating laws; continued to implement a "regulatory guillotine project" to simplify administrative procedures; established an obligatory regulatory impact assessment process for all primary and secondary legislation; and set a framework for conducting public hearings as part of the process of drafting laws.

9. The tariff is one of the main trade policy instruments and a significant, albeit declining, source of tax revenue (2.4% of total tax revenue in 2016). Although most tariff lines are *ad valorem*, and therefore transparent, the tariff's complexity increased as a result of its EU alignment and in 2017 it involved a multiplicity of rates (55 *ad valorem* duties and 29 compound duties). As a result of an increase in both the number of tariff bands and the number of duty-free tariff lines (including on information technology items), and a decrease in the coverage of compound rates, the simple average MFN applied tariff rate dropped slightly from 6% in 2012 to 5.1% in 2017. Tariff protection varies substantially across and within sectors, averaging 12.3% for agricultural products and 3.1% for non-agricultural products in 2017 (WTO definitions). Tariff rates range from zero to 30% (*ad valorem* rates) or 50% (ceiling of compound rate, tomatoes); almost 89% (86.8% in 2012) of rates are 10% or below. All tariff lines are bound on an *ad valorem* basis and the implementation of the few remaining commitments is to be completed in 2022. Whereas all *ad valorem* ceilings of the compound rates seem to be in line with bound levels, the MFN rates applied to at least 56 eight-digit HS items (e.g. meat, fish, office machines, electrical equipment, telephone sets and instruments) appear to have exceeded their bound level in 2017; action was to be taken to correct this situation as from 1 January 2018. The small gap between the simple average MFN applied and bound rates (1.4 percentage points) ensures largely predictable and stable market access conditions. Montenegro's expansion of bilateral and regional free trade agreements meant that its simple average tariff rate on imports from preferential sources remained considerably below the MFN average tariff rate; under its RTAs with the European Union and Turkey, Montenegro applies tariff rate quotas to 149 agricultural products.

10. During the review period, trade facilitation developments included the ratification of the WTO Trade Facilitation Agreement (TFA) in 2016, steps to implement an authorized economic operator scheme, the establishment of a National Trade Facilitation Committee to address bottlenecks in this area, and participation in trade facilitating initiatives at the CEFTA level. Regarding customs valuation, the transaction value was the most used method and no reference or minimum prices or fixed valuation schedules were used.

11. Import licensing requirements, which cover approximately 356 ten-digit HS tariff items or 3.6% of all tariff lines (240 in 2011 or 2.6% of all tariff lines (HS07)), are maintained for various reasons including protection of national security, human, animal or plant life or health, and to meet international commitments. The fees for import licences for medicines and medical devices are based on the total import value and those relating to the import/export/transit of drugs and psychotropic substances amount to 1% of the total import/export/transit value, in line with the international conventions. Standard harmonization and full integration into the European and international standardization systems remain a significant element of Montenegro's industrial policy. Montenegrin standards have more than doubled over the review period and those adopted in mandatory technical regulations accounted for 40.7% of all adopted standards in 2017; 98.8%

of standards in place were identical to European standards and the rest identical to international standards. Only two purely Montenegrin standards seem to be in place. During the review period, changes and updates were made to the comprehensive regulatory and institutional framework for sanitary and phytosanitary measures to, *inter alia,* ensure compliance with the EU *acquis* in numerous areas; certain imports of different origin are subject to bans or controls for SPS purposes. A traceability system for genetically modified organisms is to be introduced in 2018. No contingency measures have been introduced so far despite the existence of a regulatory and institutional framework in this area.

12. Montenegro does not apply any export duties. It has temporarily (2017-2019) prohibited exports of some kinds of wood and wood products. Quantitative restrictions on exports may be imposed in cases of critical shortage or to protect exhaustible natural resources, but so far there have been no such cases. A free zones and warehouses scheme provides tax and non-tax incentives to established firms; currently there is only one free trade zone in Montenegro.

13. Grants, tax concessions, guarantees, concessional loans, debt write off and rescheduling continued to support investment, production and trade by, *inter alia,* encouraging micro, small and medium-sized enterprises (MSMEs), R&D, competitiveness improvements, cluster development, regional development, entrepreneurship and job creation. Their duration ranges from one year to the completion of a project. Industry-specific support is available to agriculture, fisheries, energy, and processing activities. Depending on the support scheme, corporate tax exemptions and other types of support do not apply to primary production of agricultural products, fisheries, steel shipyards, transport, the defence industry and gambling activities.

14. State involvement in the economy, including trade, seems limited and targeted at areas considered to be of current strategic importance (e.g. energy, broadcasting, transport, and tourism). The State or state funds hold shares in 60 companies and the internal debt of state-owned firms dropped recently. Privatization plans are set annually, and the privatization process seems to be in its final phases. Substantial changes have been made to the government procurement legislation to bring it in line with the EU *acquis* and the WTO Agreement on Government Procurement (GPA) of which Montenegro became a Member in July 2015. Although the value of contracts awarded to foreign suppliers rose more than fourfold over 2013-16, they are equivalent to about 14% of the total contracted value and roughly 6% of the total number of contracts. No preferences are granted to domestic suppliers and SMEs participating in government procurement operations. Public procurement remains decentralized, though monitored and facilitated by a single agency; ongoing initiatives to raise procurement efficiency and monitoring, *inter alia,* involve the introduction of e-procurement tools.

15. Montenegro's intellectual property rights legislation has been strengthened with wide-ranging and comprehensive amendments or new laws. Protection was further enhanced with the expansion of international commitments. Nevertheless, enforcement remains subject to challenges involving, *inter alia,* resource constraints. During the review period, several legislative and institutional changes were undertaken under the competition policy and consumer protection framework; pro-competitive agreements in certain areas (e.g. spare parts and servicing of motor vehicles, insurance, and road/rail/maritime traffic) are exempt from competition rules. Competition policy and consumer protection enforcement difficulties relating to limited financial and human resources and expertise are being addressed; difficulties relating to the fragmented nature of the existing consumer protection legislation and regulations are noticeable. Price controls on certain medicines, oil derivatives, and electricity tariffs are in place.

16. Agriculture (excluding agro-processing), together with forestry and fishing, accounted for 9% of GDP in 2016; it is estimated that around 8.3% of the working age population in Montenegro is engaged in agriculture. The sector is characterized by low productivity with competitiveness hindered by: fragmented parcels (the average farm size being 4.3 ha); obsolete mechanization; unfavourable credit terms; and underdeveloped rural infrastructure. Recognizing Montenegro's inability to produce on a large-scale, emphasis is, *inter alia*, being placed on helping farmers to produce high-quality products which can be marketed through tourism. Montenegro's main agricultural activity is livestock breeding, mainly of cattle and sheep. Montenegro is a net importer of agricultural products. Only a few export products (wine, meat, bakery products, and beer) account for the vast majority of agricultural and agro-food exports. With the exception of cereals, the main products produced are assisted by significant levels of MFN (and sometimes preferential) tariff protection. The State owns some agricultural land, which is partially rented and has a

majority shareholding in the country's major wine producer. Montenegro does not provide export subsidies. Domestic support is modest and comprises: market price policy measures; Rural Development Measures; support for general services and social transfers in agriculture and institutional development and fisheries development measures. Market price policy measures include direct payments which are coupled to production; the main beneficiaries being the beef and milk sectors. In the context of EU accession, a gradual decoupling of payments from production is envisaged. Since 2002, the Government and the Pension and Disability Insurance Fund have provided subsidies for the purchase of lamb meat, in order to support producers and consumption of lamb by the most vulnerable group of pensioners.

17. Nearly 70% of Montenegro's territory is covered by forests or forest land and in recent years reforestation has occurred as farmers have abandoned agricultural land. Sawmilling is the main economic activity in the wood processing industry and rural populations continue to rely on wood as a source of energy. Around half of the country's forests are state-owned and commercial exploitation takes place under concession agreements. Wood cut from state-owned forests must be processed (to a primary level of production) before it is exported. In mid-2017, Montenegro imposed temporary export restrictions on certain wood products in order to ensure adequate supply for the domestic market in the wake of a logging ban in neighbouring Albania and a consequent surge of exports to this market.

18. Montenegro's fisheries sector is underdeveloped, under exploited and of an artisanal character. Foreign fishing vessels may obtain a licence to operate in Montenegrin waters. Every year Montenegro sets a maximum allowable catch; over the review period the actual catch has been significantly below this threshold. Montenegro is a net importer of fish products. Tariff protection ranges from zero to 20%. Budgetary support to the fisheries sector is small.

19. All of the Montenegro's mineral wealth is state-owned, with exploitation largely taking place under concession contracts; since 2012, revenue from concession fees has ranged from €810,517 to €5.2 million. Tariff protection in the mining sector is low; the simple average applied tariff in 2017 (ISIC definition) was 1.2%, with tariffs ranging from zero to 8%. In 2016, exports of mining products (mainly, aluminium ores and concentrates, zinc ores and concentrates, other non-ferrous base metal waste and scrap, and unwrought aluminium and aluminium alloys) accounted for nearly 32% of total exports.

20. Montenegro's energy production comes from hydro-electricity, coal and fuelwoods. To meet domestic demand, it imports around 10%-15% of its energy needs. All petroleum is currently imported; all but one of the oil and gas companies operating in Montenegro are privately owned. Offshore exploration for hydrocarbons is in a research phase. The electricity market was unbundled and fully opened to competition in 2015; however, the State has a significant ownership stake in the electricity market in the areas of generation, transmission and distribution. Prices of electricity transmission and distribution are regulated. Electricity tariffs do not differ by the type of subsector but only by voltage levels; the only preferential electricity prices in place are for those considered to be vulnerable customers (households and small customers that do not belong to the household category). Electricity from renewable sources is supported through a feed-in tariff.

21. In 2016, the GDP share of manufacturing (including agro-processing) in the economy was 4.6% and the sector accounted for 6.3% of the total number of employed persons. Manufacturing production is dominated by: pharmaceutical products and preparations; basic metals and metal products; food products, beverages and tobacco; other non-metallic mineral products; machines and equipment, and wood and cork products. Its main exports are iron and steel bars and rods; medicines; and certain machinery and transport equipment. Manufacturing companies may benefit from incentives under general as well as manufacturing-specific schemes.

22. Services account for more than 70% of economic activity. Montenegro has undertaken GATS commitments in all of the 12 sector groups listed in the Services Sector Classification List and in over 80% of its subsectors. It has also scheduled a number of "additional commitments" in the areas of basic telecommunications, postal and courier services and port services.

23. Montenegro's banking and insurance sectors are open to foreign investment. Conditions in the banking sector have strengthened over the review period as steps have successfully been taken to tackle a serious problem of non-performing loans. Bank lending has picked up but has not

responded to a rebound in economic growth and conditions of high liquidity. The sector appears to be overbanked which presents a challenge for profitability. Over the review period, the Central Bank's responsibilities have been extended to overseeing consumer credit and supervising financial leasing, factoring and purchase of receivables activities. Analysis suggests a reduction in concentration in the insurance sector over the past decade. Only insurance companies established in Montenegro may insure property and persons in Montenegro, with certain exceptions, including reinsurance.

24. The telecommunications sector is fully privately owned, with significant levels of foreign direct investment. There is little real competition in the field of fixed network infrastructure and fixed line call termination prices are significantly above the European average; the opposite is the case for the mobile sector. In the area of broadcasting, foreign and domestic investors are treated equally under Montenegrin rules and regulations; the only content requirements currently in place are that the general television broadcaster must ensure that content considered as in-house production represents at least 10% of its monthly airtime. A Film Centre of Montenegro started operations in 2017 which, *inter alia*, provides incentives to foreign and domestic producers that intend to film in the country.

25. State ownership of companies operating in the transport sector remains significant in the maritime, rail and air sectors, although the Port of Adria, the main commercial port, was privatized in 2013. Efforts are being made to tackle transport infrastructural shortcomings through the construction of the first segment of a major highway project, which will ultimately join Montenegro's seaport at Bar with Boljare at the border with Serbia, and ongoing efforts to upgrade rail tracks and rolling stock. Maritime cabotage services may only be provided by vessels flying the Montenegrin flag. The maritime sector is facing competition from ports in neighbouring countries, which has resulted in declining passenger and freight numbers.

26. Tourism remains one of Montenegro's main economic activities and sources of government revenue as well as serving as a stimulus to other sectors; its main tourism products are currently related to coastal activities, but diversification efforts are ongoing. There are no FDI restrictions on any type of tourism accommodation in Montenegro, and no nationality requirements applied to tourist service providers. Various incentives are offered, particularly to stimulate investment in high quality facilities.

27. Montenegro's growth is likely to accelerate in the near future, driven largely by highway construction spending and tourism and energy investments, as well as related higher consumption. Notwithstanding these prospects and existing buffers, downside risks to the economic outlook remain. As a consequence of its size, import dependence and limited diversification, the economy remains vulnerable to exogenous shocks including reliance on foreign capital to fund large public financing needs and fluctuations in external demand, as well as endogenous risks, *inter alia,* related to the implementation of large public infrastructure investment projects, an early retiring and aging population, and a high unemployment rate. Future prosperity and sustainable and inclusive growth depend on the implementation of the fiscal consolidation strategy, continued vigilance in the financial sector, labour market reforms and gains in the business environment and governance. These and productivity- and production diversification-enhancing structural reforms would increase the flexibility of the Montenegrin economy and its ability to respond to growing external challenges as well as its further integration into the multilateral trading system, thus enabling it to continue meeting its broad-based economic and welfare objectives including inclusive growth and a narrower wealth divide.