



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 6.11.2007  
SEC(2007) 1434

COMMISSION STAFF WORKING DOCUMENT

**MONTENEGRO 2007 PROGRESS REPORT**

*accompanying the*

**COMMUNICATION FROM THE COMMISSION  
TO THE EUROPEAN PARLIAMENT AND THE COUNCIL**

**Enlargement Strategy and Main Challenges 2007-2008**

{COM(2007) 663 final}

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# COMMISSION STAFF WORKING DOCUMENT

## Montenegro 2007 Progress Report

### 1. INTRODUCTION

#### 1.1. Preface

Since March 2002, the Commission has reported regularly to the Council and the Parliament on progress made by the countries of the Western Balkans region.

In October 2006, the Commission issued the first progress report on Montenegro since its independence following a referendum which was held on 21 May 2006.

This is the second report wholly dedicated to Montenegro since its independence. This report:

- briefly describes relations between Montenegro and the Union;
- analyses the political situation in Montenegro in terms of democracy, the rule of law, human rights, protection of minorities and regional issues;
- analyses the economic situation in Montenegro;
- reviews Montenegro's capacity to implement European standards, that is to gradually approximate its legislation and policies with the *acquis*, in line with a Stabilisation and Association Agreement and the European Partnership priorities.

This report covers the period from 1 October 2006 to early October 2007. Progress is measured on the basis of decisions taken, legislation adopted and measures implemented. As a rule, legislation or measures which are being prepared or are awaiting parliamentary approval have not been taken into account. This approach ensures equal treatment across all reports and permits an objective assessment.

The report is based on information gathered and analysed by the Commission. Many additional sources have been used, including contributions from the government of Montenegro and from the Member States, European Parliament reports<sup>1</sup> and information from various international and non-governmental organisations.

The Commission draws detailed conclusions regarding Montenegro in its separate communication on enlargement<sup>2</sup>, based on the technical analysis contained in this report.

#### 1.2. Context

The EU recognised the independence of Montenegro in June 2006. Montenegro is a potential candidate for EU membership. The Stabilisation and Association Agreement between

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<sup>1</sup> The rapporteur for Montenegro is Mr Vernola.

<sup>2</sup> Enlargement Strategy and Main Challenges 2007-2008.

Montenegro and the EU was signed in October 2007. An Interim Agreement was also signed on the same date and will enter into force in January 2008.

### 1.3. Relations between the EU and Montenegro

Following the recognition of the independence of Montenegro in June 2006, the Council authorised the Commission, in July 2006, to continue negotiations with Montenegro on conclusion of a **Stabilisation and Association Agreement** (SAA). The negotiations on an SAA with Montenegro were re-launched on 26 September 2006 and were technically completed in December 2006. The SAA was signed in October 2007. An Interim Agreement on free trade and Community matters was also signed and will enter into force in January 2008 and remain in force until the SAA has been ratified by every EU Member State and by Montenegro. Acknowledging the need to strengthen its administrative capacity to implement the SAA, Montenegro has drafted an action plan and started preparations for implementation of the agreement. The Commission gave a positive assessment of Montenegro's administrative preparedness to implement the SAA in the area of customs and rules of origin. Preparations for implementation of the Interim Agreement have been stepped up<sup>3</sup>. Montenegro is therefore expected to be in a position to implement the Interim Agreement fully. However, this will require continued attention and commitment combined with allocation of the necessary administrative resources.

The EU is providing guidance to the Montenegrin authorities on reform priorities via the European Partnership. Following a proposal by the Commission, the Council adopted a revised **European Partnership** for Montenegro in January 2007. In May 2007, Montenegro adopted an action plan for implementation of the European Partnership following consultations with the Commission. It provides a sound basis for implementation of the priorities set by the European Partnership. Progress on these reform priorities is encouraged and monitored by the enhanced permanent dialogue. In January 2007, the first **political dialogue** meeting between the EU (troika) and Montenegro was held.

In September 2007, the EU and Montenegro signed agreements on **visa facilitation** and readmission. The new arrangements will simplify procedures for issuing visas to certain categories of citizen of Montenegro, including students, scholars, businesspeople, journalists and tourists. They will also keep the cost of visas at their current level or, in some cases, lead to visas free of charge.

From 2007 onwards, Montenegro will receive pre-accession **financial assistance** under the Instrument for Pre-Accession Assistance (IPA). The 2007-2009 Multi-Annual Indicative Planning Document (MIPD) for Montenegro was adopted in June 2007. In 2007 a total of € 31.4 million was allocated to Montenegro. The main focus areas are public administration reform and rule of law, the business environment, transport, the environment, agriculture and food safety.

During the last 3 years, € 1.6 million was earmarked for financial support to **civil society** and € 3.1 million for minorities and refugee return. For 2007, € 1 million has been allocated from the IPA to support the development of civil society. Ongoing CARDS assistance is implemented by the European Agency for Reconstruction, but preparations are being made to

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<sup>3</sup> The Interim Agreement enables parties to apply the trade and Community part of the SAA before it has been ratified by all parties. Montenegro has prepared for this, in particular in the areas of protection of competition, public procurement and customs (introduction of the Common Nomenclature).

transfer that responsibility to the new EC Delegation in Podgorica. IPA assistance will be implemented by the EC Delegation. Decentralised management of aid is a medium-term objective for Montenegro.

Montenegro's participation in Community programmes will come into effect upon the signature of the SAA and an exchange of letters, as the SAA includes a protocol on participation in Community programmes.

## **2. POLITICAL CRITERIA**

This section examines the progress made by Montenegro towards meeting the Copenhagen political criteria, which require stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities. It also monitors regional cooperation, good neighbourly relations with enlargement countries and Member States and compliance with respect for international obligations, such as cooperation with the UN International Criminal Tribunal for the former Yugoslavia.

### **2.1. Democracy and the rule of law**

#### *Constitution*

Good progress has been achieved with the adoption of the new constitution. Following independence, Montenegro launched preparations for its adoption. In October 2006, the newly constituted parliament adopted a law establishing the procedure for preparing a draft, organising public debate and deciding the final draft, along with the procedure for adopting and proclaiming the constitution.

In November 2006, parliament formed a constitutional committee made up of 17 members representing the political parties in parliament and chaired by the speaker. The committee published a draft constitution in March 2007 and submitted it to parliament. Following a period of public debate which lasted until May 2007, a new draft version of the constitution was produced. It was finally adopted by the parliament in October 2007, together with an implementing law.

The new constitution largely respects the principles Montenegro had accepted when acceding to the Council of Europe as well as the European standards. The constitution defines Montenegro as a civic state, guarantees the independence of the judiciary. It prohibits capital punishment and provides for the respect for human rights and minority rights. It foresees means to guarantee civilian control over the armed forces, security forces and intelligence services. However, in a number of areas, the constitution needs to be complemented with implementing provisions in line with European standards. This applies to the definition of the role of the prosecution in order to avoid conflicts of interest when the prosecution represents the state on property and legal matters. Overall, the adoption of the new constitution is an important step in order to further strengthen democratic institutions, but the implementation in line with European standards will require further efforts and determination. Efforts to build a broader consensus on basic features of state building need to continue.

#### *Parliament*

The current parliament, following the September 2006 elections, is considered a constitutive assembly by law. The parliament is made up of 81 members. There are eight parliamentary

groups. The governing coalition, consisting of members of the Democratic Party of Socialists and the Social Democratic Party, is formed by 41 members. The main opposition parties and coalitions are the Serb List, the coalition of the Socialist People's Party, the People's Party and the Democratic Serbian Party and the Movement for Changes. The ethnic Albanian community is also represented in parliament.

Parliament has continued its legislative activity and adopted 55 legislative acts, a slight increase in comparison with the previous year. These include a number of acts needed to enact the commitments given by Montenegro in the course of the negotiations on a Stabilisation and Association Agreement (customs tariff, amendments to the Law on protection of competition and Public Procurement Law).

Parliament has started to implement the rules of procedure adopted in 2006, which give it greater powers and streamline its work. In particular, these rules provide a clearer framework for parliament's scrutiny functions. They also define the role of the various parliamentary committees and bodies in the legislative process. A number of new support staff have been recruited. A number of *ad hoc* seminars have been organised, addressing the needs of members of parliament and their staff. There is no framework for staff training. The committee for European integration (which also covers international relations and foreign affairs) has been reinforced. However, it still does not have a clear focus and lacks effectiveness.

There has been some improvement in the climate between the government and the opposition, resulting in greater readiness to work towards consensus on major issues.

The lack of sufficient administrative and other resources continues to affect parliament's work. Parliament is not yet adequately supervising the defence and security structures. Also, parliament lacks capacity to scrutinise the compatibility of new legislation with EU legislation adequately.

### *Government*

Following the resignation of the Prime Minister in October 2006, the President gave the outgoing Minister of Justice a mandate to form a government in October 2006. Parliament passed a vote of confidence in the new government in November 2006. The programme of the new government is based on a commitment to reforms aiming at European and Euro-Atlantic integration. The government has been working on finalising negotiations on the Stabilisation and Association Agreement (SAA), completing the reforms leading to participation in the NATO partnership for peace (to which Montenegro was invited in November 2006) and continuing a policy of macroeconomic stability and economic reform. Reorganising the state institutions and establishing new powers following the country's independence in June 2006 have been the government's key activities. The government has decided to rationalise and streamline its work and has reduced the number of ministries to 13. Strengthening the Ministries of Defence and of Foreign Affairs has been a priority.

In this new configuration, the former Ministry of European Integration and International Economic Relations was abolished and its activities have been taken over in part by the Ministry of Economic Affairs (international trade) and the newly created Secretariat for European Integration (SEI). The work of the SEI and overall government coordination on European integration are the responsibility of the Deputy Prime Minister in charge of European integration, a new post. The appointment of the former Minister of European

Integration and International Economic Relations to this new post has ensured continuity and high quality in management of European affairs, including the SAA negotiations. In May 2007, the government set up a committee on European integration chaired by the Prime Minister which will discuss strategic issues and monitor overall process. A commission on European integration, made up of representatives of every ministry and relevant government agencies and chaired by the Deputy Prime Minister, was also set up. The SEI coordinates and supports this process. The SEI has built up its administrative capacity with additional staff, intensive training and seminars. EU units are being set up in every ministry. This has to be fully implemented and the EU units need to be fully integrated in the work of the relevant ministries. Furthermore, the government needs to clarify the role of the SEI in checking the compatibility of new legislation against the requirements of EU legislation. The SEI gives its opinion on draft legislation. However, there is no system for assessing full EU compatibility. Overall, the government has proceeded with adaptations to the requirements created by the independence of the country and has continued streamlining its activities. It needs to continue upgrading capacity in ministries and relevant agencies to address European integration issues effectively. Its efficiency needs to be further enhanced. The involvement and consultation of civil society need to be improved.

### *Public administration*

Work on the reform of the public administration has continued. The government has been focusing on reorganising the structure of the public administration (streamlining the government's work into 13 ministries and two secretariats), adopting new rules on administrative procedures and, in particular, on establishing and setting up new institutions to deal with Montenegro's new powers following independence.

Under the new rules of procedure, every legislative text is subject to a consultation process before being approved by the government. It is mandatory to attach the opinions of a number of institutions on the subjects of European integration, constitutionality, legal and administrative procedures and foreign affairs. The horizontal tasks of the General Secretariat of the government have been strengthened by establishing a sector on strategic planning, coordination and monitoring and also an office for cooperation with NGOs.

Responsibility for public administration reform and local self-government now lies with the Ministry of the Interior. This should further streamline action in this area. The human resources management (HRM) authority coordinates management of human resources for all state bodies. This authority gives its opinion on the internal organisation of state institutions and deals with the process of appointing employees in the public administration. It also organises horizontal and specialised training for the personnel of state bodies. The HRM authority runs training programmes for civil servants. It has also signed cooperation agreements with academic institutions in Montenegro and abroad, and with sister organisations in neighbouring countries in the European Union, for exchanges of experience, organisation of joint programmes and support.

The ombudsman's legal status has been enhanced in the constitution. The ombudsman's office is gradually establishing itself as an advocacy centre for citizens' rights and as a corrective force to action by the state. In 2006, the ombudsman received 495 complaints. A total of 600 cases were dealt with in 2006. Most of the complaints concerned the work of the courts. 19 of the ombudsman's 33 recommendations referred to courts. The ombudsman's recommendations are generally followed up.

However the policy recommendations made in the ombudsman's annual report are not consistently followed. The ombudsman's office has cooperated with civil society and international organisations, in particular on training and communication issues. The ombudsman's office needs to be further strengthened.

The government has continued its efforts to upgrade its administrative capacity and to complete public administration reform. The legal framework is being completed. However, a number of structural problems affect the performance of the public administration. These are due to significant gaps in the legal framework and weaknesses in the arrangements for implementing certain horizontal tasks relating, in particular, to financial and asset management (e.g. public procurement, financial control and concessions) and human resources and career management, including recruitment and conflict of interests. The continuing politicisation of the administration also plays a role in this regard. Much remains to be done, particularly in the areas of transparency and accountability, financial control, public procurement, budget management, management of public assets and licensing procedures. Appropriate resources need to be allocated to match the ambitions of Montenegro in this area. In order to implement the SAA adequately, Montenegro needs to continue upgrading its administrative capacity in the areas covered by the agreement. Particular attention needs to be paid to enhancing administrative capacity and law enforcement, especially as regards the fight against corruption and organised crime and protection of personal data. The Office of Statistics needs particular strengthening.

Montenegro has further upgraded its capacity to exercise new responsibilities since its independence. The focus has been on foreign affairs and defence, asylum and migration, intellectual property and standardisation.

The Ministry of Foreign Affairs has been reorganised to focus on Montenegro's foreign policy priorities, namely European and Euro-Atlantic integration and regional cooperation. A charter for the internal organisation of the ministry has been adopted. Particular attention needs to be paid to the consular and visa department, which will have to develop a visa policy based on EU standards and requirements.

Over the past year, a dynamic reform of defence has been under way in Montenegro, as this is a key area for development and reform related to the policy objective of NATO membership. Further progress has been made on implementation of the defence reform strategy and the national security strategy. Military conscription has been abolished and the principle of having professional personnel in the defence and security structures is being implemented. The basic priority is participation by Montenegro in collective security structures. Montenegro was accepted into the partnership for peace programme in December 2006. Montenegro has signed an agreement with NATO on information security. In parliament, a security and defence committee has been put in charge of parliamentary oversight of the work of security structures (including the national security agency and the police). 2% of GDP is earmarked for the defence sector.

The Institute for Standardisation and the accreditation body of Montenegro were established in April 2007. An Intellectual Property Office was established in May 2007 within the Ministry for Economic Development. Work on upgrading the statistical infrastructure has continued.

Activities aimed at further supporting decentralisation and local self-government have continued. A draft law on territorial organisation has been prepared.

Municipalities face a general problem of administrative capacity and a lack of substantive powers. There is a need to harmonise systemic local self-government legislation with sectoral laws. Under the current legislation it is possible to delegate to municipalities the task of performing duties related to public services, but this has not yet happened. Financial issues regarding both the revenue and expenditure of municipalities and municipal property remain unresolved. The constitution provides for the autonomy of local self-government.

As part of the government reorganisation, responsibility for decentralisation and local government were moved from the Ministry of Justice to the Ministry of the Interior. A decree on establishment of a joint commission between central and local government was adopted in February 2007. This commission has not yet been established. It is expected to become a platform for institutional dialogue between central and local authorities, but in order to function properly it requires a strong and competent secretariat. This is to be provided by the Ministry of the Interior, which will have to increase its capacity in this area substantially.

Overall, the process of strengthening the administrative and management capacity of the local authorities has been slow. The public administration remains weak and inefficient. Further efforts will be needed to ensure the impartiality of public administration and strengthen its capacity. Future work on decentralisation is expected to continue to strengthen local democracy, upgrade the administrative capacity of the municipalities and clarify sectoral responsibilities in a manner which permits oversight and transparency. The capacity of the municipalities for financial management, including public procurement, needs to be further improved. The process of putting together municipal budgets, including consolidation of revenue and an objective system for establishing and allocating grants, needs to be overhauled. Central government capacity for dealing with local government reform needs to be substantially strengthened.

#### *Judicial system*

The new constitution provides for important changes in the judiciary. It significantly reduces the influence of the parliament on the appointment and dismissal of judges by transferring it to a new body, the Judicial Council. The decision to lift the immunity of a judge is also transferred from the parliament to the Judicial Council.

In Montenegro, there are 228 judges in 15 basic courts, two high courts, two commercial courts, administrative and appellate courts and the Supreme Court. There are 83 state prosecutors, working under the responsibility of the supreme state prosecutor. There is one prosecutor and one deputy prosecutor for the fight against organised crime. Whereas the overall number of judges is not low, the efficiency of the judiciary suffers from serious institutional, legal and organisational shortcomings. Recent steps include adoption of the judicial reform strategy for 2007-2012, the Law on the legal profession, the Law on salaries and other income of holders of judicial office and the rules of procedure of the state prosecutor's office. The centre for the education of judges has been converted into the judicial training centre as an organisational unit of the Supreme Court. It provides initial, specialised and continuing education to both judges and prosecutors. The centre for alternative solution of disputes is being set up.

However, the provisions of the new constitution still need to be implemented. The constitution only contains basic rules, particularly in the area of prosecution. In addition, the members of the new Prosecutorial Council will be elected by the parliament. Therefore a risk of political influence remains after the implementation of the new constitution.

Pending the entry into force of implementing legislation to the new constitution, the existing system of appointing judges and prosecutors continues to apply. This system raises serious concerns of political interference. In particular, judges and prosecutors are elected by parliament, on a proposal from the Judicial Council and the Prosecutors' Council. Both the Judicial Council and the Prosecutors' Council are appointed by parliament. Under the existing system, parliament also decides on promotions, disciplinary proceedings and the dismissal of judges and prosecutors, on a proposal from the Judicial Council and the Prosecutors' Council. Prosecutors have to go through a re-election procedure every five years. A further risk of political influence arises from the fact that the government decides on the financing of the judicial system and also provides judges with apartments and loans without any clear criteria.

The significant backlog in both civil and criminal cases is a matter of serious concern, although there was a slight reduction in 2006 compared with 2005. There is no clear strategy to tackle this problem; in particular, insufficient use is made of simplified procedures for minor cases. Inefficient career development rules also affect the efficiency of the judiciary. To gain promotion, judges and prosecutors have to go through the same procedure as for initial appointment. No case management system is in place. The performance of the prosecutors in the criminal field is further hampered by their obligation to represent the state in property and legal matters.

As regards domestic trials of war crimes, the pre-trial procedure concerning the deportation and disappearance of more than 80 Bosnian civilians in 1992 is ongoing. The length of both the criminal investigations and the civil procedures is a cause for concern. The fact that the state prosecutor is dealing with the criminal investigations, but also representing the state of Montenegro in the civil claims for damages, might give rise to conflicts of interest.

Recognition and enforcement of court decisions between Serbia and Montenegro are not yet regulated by a bilateral agreement. The Ministry of Justice has to improve its administrative capacity for international judicial cooperation.

Overall, despite some progress on strengthening the judiciary, there is a lack of confidence in the system and concern about the level of political influence. Judicial reform is only just beginning.

#### *Anti-corruption policy*

The government has taken some further steps to fight corruption. A national commission was established in February 2007 to monitor implementation of the action plan for the strategy for the fight against corruption and organised crime. This commission is headed by the Deputy Prime Minister for European integration and includes government officials and one representative of civil society. The constituent session was held in March and the first report was adopted in July 2007.

The Directorate for the Anti-Corruption Initiative (DACI) is the central government body in charge of prevention and coordination of anti-corruption activities. In the period from November 2006 to May 2007, DACI produced 15 reports, 11 of which concerned alleged corruption cases.

Montenegro is continuing to participate in the Council of Europe's GRECO initiative. In October 2006, Montenegro deposited the notification of accession to the United Nations Convention against Corruption. In line with GRECO recommendations and the action plan,

DACI started preparations to conduct a comprehensive investigation into corruption with expert support from UNODC. Montenegro, together with other members of the Stability Pact anti-corruption initiative, signed a memorandum of understanding concerning cooperation in fighting corruption through the South-Eastern European Anti-Corruption Initiative in 2007. A Law on criminal liability of legal persons has been adopted.

However, corruption is widespread and is a very serious problem. Decision-makers at the highest level have highlighted the need to tackle corruption. However, enforcement remains a problem. Very few cases have been brought to justice.

The Council of Europe's Civil Law Convention on Corruption and the additional protocol to the Criminal Law Convention on Corruption have not been ratified by parliament. The current Law on conflict of interest needs to be substantially amended. Little has been done to implement the action plan on the strategy to fight corruption and organised crime. There are concerns about the independence of the national commission. NGO representatives have encountered difficulties, in particular as regards access to information.

There have been no improvements in activities to curb political corruption. The funding of political parties and election campaigns lacks transparency. The laws on political parties and their financing are not being implemented sufficiently; there is no reliable disclosure of sources of income. Management of public assets raises serious concerns. There is considerable room for corruption, especially in the cases of construction and land-use planning, privatisation, concessions and public procurement. Procedures for reporting conflicts of interest in privatisation have yet to be established.

Police resources within the economic crime division are limited, as are experience and results in dealing with corruption. The capacity of the authorities effectively to monitor, prosecute and try corruption cases remains limited. The number of persons convicted therefore remains low. The lack of appropriate control over state institutions and the influence of organised crime further limit the capacity to fight corruption.

Overall, there have been a few results in this area. The situation calls for urgent action in order to achieve relevant results on the ground, especially in the area of high-level corruption

## **2.2. Human rights and the protection of minorities**

### *Observance of international human rights law*

Montenegro is a signatory or a party to the Council of Europe conventions open to non-member states. In October 2006, Montenegro signed the optional protocol to the United Nations Convention against torture and other cruel, inhumane or degrading treatment or punishment. The constitution contains provisions on the primacy of international law on **human rights** and on the direct applicability of **international human rights treaties**. There are commitments on the retroactive application of human rights legislation in the implementation law, but their exact legal status needs to be clarified.

### *Civil and political rights*

Activities in the area of civil and political rights have been focusing on discussion of the new constitution. Progress on the ground remains limited.

Little progress has been made on **prevention of torture and ill-treatment**. Material conditions in police detention facilities remain unsatisfactory.

As regards **access to justice**, there is still no system of free legal aid covering all sectors. The existing provisions granting some aid for specific areas, in particular in criminal procedures, are not sufficient.

The situation of the **prison system** has seen some progress in the form of building new facilities and better training for prison staff. The prison system is regulated by the Law on the execution of criminal sanctions, the criminal procedure code and a number of secondary acts.

However, the required total overhaul of the probation/parole system has not yet been conducted. Conditional sentences combined with probation have not yet been introduced as an alternative to imprisonment.

There were no major concerns regarding **freedom of expression**. However, one criminal conviction of a journalist for defamation was reported in 2007.

The editor of the daily newspaper “Vijesti” was assaulted in September 2007. This serious attack on democratic principles and human rights requires thorough investigation.

The Law on free access to public information is still being implemented with mixed results as, overall, the state administration seems unprepared to handle requests for access to information. In most claims which reached court on the grounds of failure of state institutions to provide access to information, the requesting party has won the case.

Concerning **freedom of assembly and association**, the overall framework remains largely satisfactory.

The framework for **civil society organisations** is largely satisfactory. There are over 3,800 registered NGOs in Montenegro, of which only 10% are active. In fiscal terms, NGOs are treated satisfactorily. An office for cooperation with NGOs has been established within the government. A working group representing a coalition of NGOs, the UNDP, various ministries and the SEI is supporting its activities.

NGOs receive funding from donors and can apply for funding from the government and from local authorities. NGOs have recommended that the allocation procedure for government funds be made more transparent, with clear criteria for distribution of funds, and that monitoring and evaluation mechanisms be developed.

Overall, cooperation between the government and NGOs is improving, in particular in relation to drafting or revising legislation in social or environmental fields. However, tensions in cooperation with NGOs which perform a watchdog function have increased.

#### *Economic and social rights*

Legislation and practice in the field of social rights remain largely in line with the revised European Social Charter.

The Law on **gender equality** adopted in July 2007 explicitly provides for gender equality and positive discrimination. However, it does not clearly address the principle of equal pay. The government office for gender equality continued its information and communication activities

on various gender equality issues. In practice little progress has been made on improving protection from gender-based discrimination, in particular on the labour market, and many women remain unaware of their rights. Preparation of anti-discrimination legislation reflecting the two EU directives in this field needs to be stepped up. Domestic violence is a cause for concern and, apart from an NGO campaign combating violence against women, there is no indication of further action nor of improvements to the legal framework. There are no restrictions, but no positive action is envisaged on gender equality in parliament either. There are currently nine women members of parliament (out of a total of 81).

As regards **children's rights**, progress has been achieved in terms of bringing the legislative framework up to international standards. Issues remain with implementation of the laws, which is still partial due to lack of commitment and of institutional and financial capacity. Rights have not yet been established for juveniles in conflict with the law, equal access to social protection services needs improvement and alternative forms of child care have yet to be developed (de-institutionalisation, community-based forms of care for deprived children and children with disabilities). Positive action can be observed – a children's rights council has been established and a network of daycare centres for children is being prepared – but the special education needs of Roma and the persons with disabilities are not fully considered. Ten social work centres cover the 21 municipalities in the country; in seven of them, multidisciplinary teams to protect children from abuse and neglect are working on a UNICEF and UNHCR project.

The action plan to implement the Law on protection of the child and social protection, adopted in 2005 and covering the period until 2010, is being implemented. Montenegro adhered to the UN Convention on the Rights of the Child in October 2006. A new Family Law, prepared with support from the Council of Europe and Unicef, entered into force in September 2007.

Concerning **socially vulnerable and/or persons with disabilities**, major pieces of legislation are still missing, in particular to implement the 2007 UN Convention and Directive 2000/78 establishing a general framework for equal treatment in employment and occupation. Various activities are being carried out to develop strategies for integration of persons with disabilities (in education, for example) and social protection of elderly people, but there is no information on the steps and timetables envisaged. Action is needed to make existing measures, such as hiring incentives for employers, more effective, to improve access to social services and to accelerate preparation of the Law on VET and employment for persons with disabilities. Further progress is needed on de-institutionalisation, community-based services and aid to dependent persons, including in the field of mental health. The ministry and the office for the development of NGOs are implementing a project to support involvement of civil society organisations in social protection of the elderly, where NGOs are recognised as service providers.

Regarding **property rights**, restitution of property is still covered by the Law on restitution of confiscated property rights and compensation which was adopted in 2004. After an initial period, when requests for restitution were received by 21 municipal commissions, in July it was decided that, instead, three regional commissions will take decisions on restitution. Implementation of the Law on restitution has continued. Under this law, monetary compensation is provided where physical restitution is impossible. To this end, a restitution fund has been established. A financial limit of up to 0.5% of GDP has been set for the annual amount of compensation. Complaints are still being submitted by former owners.

### *Minority rights, cultural rights and protection of minorities*

Following independence, Montenegro signed the Framework Convention for the protection of national minorities and the European Charter on regional and minority languages in June 2006. Montenegro must submit its first report on implementation of the related provisions to the Council of Europe within one year. Working groups have been formed to prepare this report.

The Law on minority rights and freedoms which was adopted in April 2006 is still in force, except its provisions on parliamentary representation of minorities which had been annulled by the constitutional court. The constitution provides a solid legal basis for the protection of minority rights. It guarantees a number of rights and liberties to persons belonging to minorities, notably the right to express their particular identities, to use and cultivate their language, to receive education in their language, as well as rights of representation in public bodies, including through affirmative action. The implementing law of the constitution foresees that the law on minority rights should be harmonised with the constitution within three months after adoption of the constitution. Consolidation of protection of minority rights in Montenegro will depend on the way these provisions will be implemented. This will be the case of notably with respect to political representation (participation in decision making) and education in minority languages (educational and minority-specific cultural content). Current government activities in this area include adoption of a decision on the establishment of a centre for preservation and development of minority culture. The Ministry of Human Rights and Minority Protection is being reorganised.

Some problems persist in relation to the situation of **refugees and internally displaced persons (IDPs)**. Montenegro has made continued efforts to support displaced persons, in particular in relation to healthcare. However, neither the legal status and integration nor the physical conditions of subsistence of these individuals and groups have improved sufficiently.

Montenegro has made some progress over the past year in a number of key areas affecting asylum-seekers, refugees and displaced persons. It has enacted its first Asylum Law and begun to establish the administrative structures and regulations necessary to implement it. It has also confirmed its intent to be bound (through succession) to key human rights treaties, including the 1951 Convention relating to the status of refugees, its 1961 protocol and the 1954 Convention relating to the status of stateless persons. Montenegro has signed the Council of Europe's 2006 Convention on the avoidance of statelessness in relation to state succession. It has committed itself to ratify this convention without delay and also to sign and ratify the 1997 European Convention on nationality within the next two years. The Refugee Care Institute was established as a legal successor to the former government's Commissariat for Displaced Persons. This institute is directly involved in resolving all issues related to displaced persons. Apart from the activities carried out by the former Commissariat, the Institute will deal with issues relating to asylum-seekers, persons granted refugee status or persons granted additional or provisional protection. This duty implies assistance with exercising their right to accommodation, right to education, right to legal counselling, right to social and health care, freedom of religion, access to humanitarian and non-governmental organisations, humanitarian aid, family unity, social inclusion and other rights stipulated by the Law on asylum. Assistance will also be provided to returnees, in accordance with the readmission agreements.

Despite this progress, a number of serious issues remain to be resolved in these areas. Most critically, Montenegro has yet to regularise the status of its large populations of displaced

persons from Croatia, Bosnia and Herzegovina and Kosovo, who still lack full access to employment, health insurance, social welfare and property rights. Little progress has been made towards the European Partnership priorities to “repeal all discriminatory provisions” in key fields affecting refugees and displaced persons and to “provide conditions for integration” of those who choose to remain in Montenegro. Physical living conditions for displaced Roma are particularly poor. Concerns persist regarding discrimination against displaced persons for employment purposes and in relation to unemployment benefits. Montenegro needs to allow displaced persons who opt to integrate locally to do so without major obstacles.

Montenegro has fallen behind its timetable for implementing its Asylum Law and is still seeking funding for completion of its planned reception centre for asylum-seekers.

**Roma** continue to face difficult living conditions and discrimination, especially in education, healthcare, social protection and employment. Under a third of all Roma children attend primary school, and only about 20% complete primary education. Unemployment among Roma is high at 82%. The specific needs of Roma refugees from Kosovo have yet to be addressed. In the context of “2005-2015 – the decade of Roma inclusion”, progress has been made in terms of dialogue between stakeholders and finalising the strategy for the Roma population, on which consultations are currently being held. However, no budget has been allocated to implement it. A national action plan for Roma women has also been drafted. Both documents need to be finalised and adopted rapidly so that action to address the poor socio-economic conditions of the Roma can start. Provision of sufficient resources for implementing them remains an issue.

Overall there has been progress on establishing the necessary framework on minority protection. However, implementation is lagging behind in some fields. The conditions of refugees and displaced persons, including Roma, are giving cause for serious concern.

### **2.3. Regional issues and international obligations**

There are no problems regarding Montenegro’s compliance with the **Dayton/Paris Peace Agreement**.

Cooperation with the **International Criminal Tribunal for the former Yugoslavia (ICTY)** is satisfactory. As regards the freezing of assets of those indicted by ICTY, a legal framework is in place. It remains to be implemented in practice.

In October 2006, Montenegro confirmed its ratification of the Rome statute of the **International Criminal Court (ICC)**. However, on 19 April 2007 it signed a bilateral immunity agreement with the United States, covering US and Montenegrin citizens and granting exemptions from ICC jurisdiction. This agreement does not comply with the EU common positions on the integrity of the Rome statute or with the related EU guiding principles on bilateral immunity agreements. Montenegro needs to align with the EU position.

**Regional cooperation** and good neighbourly relations form an essential part of the process of Montenegro moving towards the European Union.

In January 2007, Montenegro became a member of the international financial institutions, i.e. the International Monetary Fund, the World Bank and the European Bank for Reconstruction and Development. In May 2007, Montenegro joined the Council of Europe. The country is also committed to regional cooperation in south-east Europe and to playing an

active part in regional initiatives. In May 2007, Montenegro became a member of the south-east Europe cooperation process (SEECP). It is participating fully in the transition from the Stability Pact to a more regionally owned cooperation framework and the shaping of the future regional cooperation council. Montenegro is a party to the Energy Community Treaty and a signatory of the Agreement on the European Common Aviation Area (ECAA). It has ratified the enlarged and amended Central European Free Trade Agreement (CEFTA).

Following its independence, Montenegro has gradually established good **bilateral relations with other enlargement countries and neighbouring Member States**. It has signed agreements on police cooperation with Slovenia and Romania.

It has established practical cooperation on the ground with neighbouring countries, including on border control, environmental protection and energy supply. Political relations with neighbouring countries are satisfactory. Montenegro is pursuing a constructive policy on key pending issues which are crucial for regional stability.

Relations with *Serbia* have been advancing satisfactorily since independence. The two countries have rapidly settled pending issues, including on financial assets and participation in international financial institutions and on social security. Following the establishment of diplomatic relations, a Montenegrin ambassador to Serbia was accredited in December 2006. On the basis of a bilateral agreement, Serbia continues to represent certain Montenegrin interests abroad, including issuing visas. Certain citizenship issues remain unsettled, however.

Relations with *Croatia* have been developing well. High-level visits have taken place and diplomatic representations have been opened. Both sides have indicated a willingness to move towards resolution of outstanding issues. These primarily concern property, refugees and missing persons. Border demarcation at Prevlaka is still outstanding, although the temporary border regime is running smoothly.

In relations with *the former Yugoslav Republic of Macedonia* reciprocal high-level visits took place. A memorandum on cooperation on defence was signed.

Relations with *Bosnia and Herzegovina* have intensified. Montenegro has opened an embassy in Sarajevo, and Bosnia and Herzegovina is in the process of opening one in Podgorica.

Relations with *Albania* have further developed. Albania has opened an embassy in Podgorica. The two countries established the first joint border crossing point in the Western Balkans at Muriqan/Sokobine

### 3. ECONOMIC CRITERIA

In examining the economic developments in Montenegro, the Commission's approach was guided by the conclusions of the European Council in Copenhagen in June 1993, which stated that membership of the Union requires the existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the Union.

### **3.1. The existence of a functioning market economy**

#### *Economic policy essentials*

The government submitted its first Economic and Fiscal Programme (EFP) 2007-2008 in December 2006. This programme sets out a conservative macroeconomic scenario in which the aim of the fiscal framework is to consolidate the fiscal stance and reduce public debt. In January 2007, Montenegro became a member of the International Monetary Fund (IMF) and the World Bank (WB). Eventually, the Montenegrin authorities decided not to conclude a stand-by arrangement with the IMF. The World Bank adopted a new Country Partnership Strategy focused on reforming the labour market, improving living standards and strengthening administrative capacity.

The consensus on economic policy was challenged by the so-called "January electric shock", when expensive imports of electricity led to households' electricity bills rising to 35% of the average monthly salary. These developments, and the discussion within the government on a comprehensive energy strategy, delayed the decisions of the government on the overall privatisation process.

#### *Macroeconomic stability*

GDP grew by 6.5% year on year in 2006. The main drivers were the strong expansion in tourism and construction, helped by massive FDI inflows and rising levels of bank lending. This trend continued in the first half of 2007, when the year-on-year growth in GDP was 6.9%. Once again the main driver was the robust expansion of the services sector, in particular tourism, financial intermediation and real estate. Industrial production rose by only 1% in 2006, and in the first eight months of 2007 it recorded a further year-on-year fall of 4.4%. Output shrank, mainly as a consequence of the halt of the thermal power plant for maintenance repairs and the stoppage of the associated coalmine. Moreover, severe drought hampered the production of the two main hydropower plants. Overall, economic growth remained strong, but became increasingly exposed to a possible correction of mounting imbalances.

In 2006 the current account deficit widened to 26% of GDP, driven by the large increase in imports of goods triggered by strong domestic consumption and investment. The solid performance of the tourism sector only partially succeeded in offsetting the widening of the trade deficit and the fall in net current transfers. The balance of net factor income reported a solid increase, but still remained modest. However, foreign exchange reserves had increased by 80% at the year's end to reach 16% of GDP. The current account deficit was financed by very strong inflows of net foreign direct investment (FDI) of 23.7% of GDP. The current account deficit widened further during the first half of 2007 to 31% of GDP in annualised terms, driven by the growing trade deficit. Exports of goods barely covered one third of imports, which grew faster. The balances on services, income and current transfers were all positive, but insufficient to offset the negative impact of the huge trade deficit. In the same period, net FDI increased rapidly to reach 28.4% of GDP in annualised terms, and was accompanied by a surge in portfolio investments. Moreover, net foreign assets of commercial banks almost doubled in the first half of the year. Overall, the large external imbalances are being covered by foreign investments and increasing foreign exchange reserves.

The officially registered unemployment rate was down to 14.7% at the end of 2006, and fell further to 11.8% by end-August 2007. Employment grew by 3.8% in 2006, and continued

expanding in July 2007 at a year-on-year rate of 4.2%. The biggest increases in employment are being recorded in services, particularly in the retail and wholesale trade. The fall in the number of local employees in the most dynamic sectors, namely tourism and construction, was offset by the rising numbers of non-resident employees, mainly coming from neighbouring countries. Overall, the growth in economic activity is having a positive effect on the labour market.

The country unilaterally uses the euro as legal tender, an issue which is completely separate from membership of the euro area<sup>4</sup>. Consequently, it does not conduct any monetary policy, does not participate in the joint management of the single currency, including notably monetary policy, and does not enjoy the rights of a euro area Member State. The central bank is not an issuing bank, and most of its executive functions are related to banking supervision. It also engages in liquidity management operations for the banking sector and issues treasury bills on behalf of the government.

Annual broad money growth<sup>5</sup> accelerated in 2006 by 85% year on year. At the end of July 2007, the money supply had increased by 47.8% since the beginning of the year. At the end of 2006, total assets of commercial banks were up by 104.8% year on year representing 72.6% of GDP. The main factor in this strong expansion was the rapid growth of almost 125% year-on-year in the credit portfolio, with household lending surging by 198% and corporate loans by around 102.3%. Bank deposits also expanded strongly (119.6% year on year).

However, during 2007, the average monthly growth rate of deposits (6.8%) has been lower than that of loans (9.5%), and foreign borrowing is rapidly supplanting deposit growth. Total assets of commercial banks reached 106.7% of GDP in July, of which, deposits amounted to 78.9% of GDP. In the first seven months of the year, loans increased by 88.6% and accounted for 74.2% of GDP, compared to 25.2% of GDP a year earlier. In July, loans to enterprises accounted for 59.2% of total lending, while households and the government sector accounted for 36.2% and 2.9% respectively. Despite a fall in interest rates on lending, they remain relatively high. The average weighted nominal lending interest rate stood at 8.24% at end July. In general, the surge in consumer loans is becoming a matter of concern which needs to be closely monitored by the Central Bank.

Average annual consumer price inflation rose from 2.3% in 2005 to 3% in 2006, dropping back to 2.8% on average between January and August 2007. The major factor behind this deceleration is the steady fall in the price of food since the beginning of the year. Prices of all other goods and services have remained relatively stable during the same period, although the prices went up during summer, mainly due to international price increases, but also due to higher domestic food and electricity prices. Overall, the low inflation environment is helping the positive performance of the economy.

The consolidated budget for 2006 revealed a surplus of 1.1% of GDP (cash-based accounting standard). The better-than-expected fiscal performance was the result of solid growth of revenues, outpacing the growth of public expenditure. Strong economic performance led to

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<sup>4</sup> In October 2007 the Council adopted a declaration on the *de facto* use of the euro in Montenegro which is due to exceptional circumstances. The conditions for adoption of the euro and join the euro area are defined by EU law.

<sup>5</sup> Broad money (M21) aggregate comprises banks' deposits with the CBM, the estimated amount of cash in circulation, demand deposits and term deposits by the non-banking sector including, central government's.

continued surpluses in the first half of 2007, despite the introduction of a reduced flat rate of 15% for personal income tax at the beginning of the year. Revenue growth accelerated strongly to reach 36.7% year on year. The strong performance of the economy and robust import growth explained the higher than planned VAT receipts. Additionally, the proceeds from corporate income tax significantly exceeded their target, reflecting the improved performance of the real sector. By contrast, total government spending grew more slowly, at a rate of 11.2% year-on-year, despite the increase in spending on gross wages and transfers to state funds and local self-government. However capital spending was still substantially below target (38%). Overall, fiscal consolidation continued on the back of solid revenue growth.

In 2006, public debt fell to 35.6% of GDP at year-end. However, the share of domestic debt has been rising, driven by the settlement of restitution claims and compounded by the rapid growth in real estate prices. In the first half of 2007, public debt remained at the same level after increasing to 36.9% of GDP at the end of the first quarter. Domestic debt, which represents one third of the total, grew by 17.6% in the same period. In July 2007, the Parliament adopted amendments to the Law on restitution, limiting the annual payments for this concept to 0.5% of the previous year's GDP. However, the law may still be revoked by the Constitutional Court.

Substantial progress has been achieved in enhancing the transparency and accountability of public sector governance. A new Law on public procurement was adopted in 2006 aimed at harmonising legislation with the EU acquis and strengthening procurement procedures and practices. Internal and external audit functions are being implemented; however, owing to administrative capacity constraints, neither of them is fully operational and effective. The gradual separation of current and capital expenditures was further pursued in the 2007 budget exercise, which extended the coverage of investment projects by the capital budget. Moreover, in July, the government adopted the bill on amendments to the budget law, which will further consolidate public expenditure by integrating former extra-budgetary funds within the treasury system.

However, budget planning is still hampered by weaknesses in forecasting government revenues and expenditures. Also, the implementation of programme budgeting in line ministries and the development of a medium-term fiscal framework have not yet been finalised. Local governments have significant extra-budgetary activities and arrears which are currently not accounted for clearly in the consolidated budgetary framework. The quasi-fiscal activities of state-owned enterprises are fairly substantial and include debts and arrears to the government, company debts covered by state guarantees, intra-company transfers and some tax subsidies. As these contingent liabilities are not yet included in general government reporting, there is a risk that they easily become a fiscal burden on the budget. This has made it all the more urgent for there to be careful supervision of the financial operations and the issuing of debt by local government, and of state-owned enterprises.

The policy mix is determined by euroisation and the absence of a proper monetary and exchange rate policy. The authorities are committed to continuing the consolidation of fiscal policy. The good performance of revenues provides the necessary fiscal space to push ahead with tax and labour market reforms.

#### *Interplay of market forces*

About 86% of the original social and state owned capital has been privatised. However, the privatisation process has slowed down since the September 2006 elections. The appointment of

the Privatisation Council, the government decision on the privatisation of the thermal power plant and the adoption of the Energy Development Strategy were delayed. A new privatisation programme was finally adopted in July 2007. It contains a list of 58 companies to be privatised. Some of the major state-owned companies listed are Montenegro Airlines, the port of Bar, the railways company, the shipyard Bijela, the tobacco producer Duvanski Kombinat, and the tourism resorts HTP Ulcinjska Rivijera and HTP Budvanska Rivijera. However, a few companies that were initially included in the draft plan will not be privatised, at least not in 2007 (the power utility EPCG –excepting its distribution sector–, Montenegrin airports, wine producer Plantaže, and the national post company). The privatisation process has been put on track again with the publication in October 2007 of the tender for shipyard Jadran. The Parliament has appointed a commission to monitor the transparency of privatisation procedures. Meanwhile, the share of employment in the public sector has increased, partly due to new responsibilities arising from sovereignty and the EU integration process. Overall, state intervention and ownership remain limited.

#### *Market entry and exit*

The establishment of new firms is facilitated by the limited number of requirements on founding capital, registration time and costs. The number of established companies rose by 17% in 2006, and by 10% in the first half of 2007. The cost, in both time and money terms, of obtaining a licence to run a business is still the major constraint on firms. In October 2007 the government adopted a programme for the elimination of barriers for the development of enterprises. Moreover, there are still some outstanding difficulties concerning bankruptcy cases. To improve the situation, a new law amending the Law on Company Insolvency was adopted in 2007. This new law, which is much easier to implement, simplifies the conditions required to file for bankruptcy and sets a limit (EUR 25,000) on compensation by the bankruptcy administrator. Overall, further progress is needed to facilitate the procurement of business licences.

#### *Legal system*

In June 2007 the new law on land surveying and cadastre entered into force. This law guarantees equal rights to national and foreign citizens. It further facilitates registration of property and transparency, including a new cadastre online service reporting on property status. However, further progress is still needed to make it easier to enforce commercial contracts. It still takes up to 18 months for a company to collect its debt, and the cost is 15% of the debt. These circumstances may discourage economic actors from taking cases to court and undermine the effective enforcement of creditors' rights and property rights.

#### *Financial sector development*

Driven by the completion of the privatisation process in 2006, the banking sector has continued to expand rapidly. The ownership structure at the end of 2006 was 80% foreign capital, 15.4% domestic capital and 4.6% state capital. The degree of concentration in the banking sector is moderate, with the assets of the five biggest banks accounting for 80% of the total assets of the sector. In the first half of 2007, total domestic credit growth rose by 77.3% to reach 69.7% of GDP. Increasing competition between commercial banks is resulting in lower lending interest rates. In June, the average weighted effective interest rate fell slightly to 9.1%, and deposit interest rates to 5%. The surge in domestic credit, and particularly in consumer lending, exacerbated the credit risk in the banking system (a deterioration of asset quality and an increase in non-performing loans). Further strengthening

of banking supervision is hampered by the delay in the adoption of the new banking law. Overall, financial intermediation continued to expand strongly.

Capital markets saw very strong growth. In 2006, the total turnover of the two stock exchanges amounted to 19% of GDP, while market capitalisation represented 100.7% of GDP. These very dynamic developments continued in 2007, driven by strong interest from both foreign and domestic investors. Furthermore, the abolition of capital gains tax and the adoption of the legislative framework on voluntary pension funds in 2007 gave additional impetus to the stock markets. In June, a commercial bank placed a bond issue for the first time. In August, a second voluntary pension fund was established. However, since May 2007 stock markets have witnessed a moderate correction for three consecutive months. Overall, despite its dynamic development, the role of the capital markets remains limited.

In 2006, insurance market premiums rose by 18% and accounted for 2.1% of GDP. Although there are six insurance companies in the country, one of them maintains a dominant market share (70%). The sector is dominated by car insurance, while the life segment, which is less developed, accounts for less than 5% of billed premiums. An insurance law, establishing an independent supervisory agency, was adopted at the end of 2006. The government passed the law on receivership and liquidation of insurance companies in June 2007, thus completing the legal framework of the sector. The proposed legislation defines the terms of and procedures for receivership, voluntary and judicial liquidation of insurance companies and the rights and liabilities of parties to these proceedings. In addition, three insurance companies have re-established a mutual guarantee fund (absent since the dissolution of the state union with Serbia). In 2007, the sector expanded further with the entry of two new firms, including the first life insurance company.

Since the adoption of the law on financial leasing in 2005 this market has been growing. By the end of June 2007, four companies and three banks were providing leasing services accounting for 3.7% of GDP. Most of the leasing contracts are related to business activities, in particular for the purchase of vehicles. Overall, non-banking supervision remains incomplete in that leasing companies are not yet covered.

### **3.2. The capacity to cope with competitive pressure and market forces within the Union**

#### *Existence of a functioning market economy*

Generally, macroeconomic stability has been maintained. However, there remain some risks to macroeconomic stability in the medium term, such as the large external deficit and the surge in consumer loans. The functioning of the market mechanism has lately been strengthened in particular by the continuing relatively low level of inflation and the reduction of the fiscal burden, whereas the pace of structural reforms has been slowing.

#### *Human and physical capital*

The government continues ahead with the reform programme to improve vocational and technical education, update teacher training and link pay to performance. At 5% of GDP, expenditure on education is fairly significant with some 80% of it going on current expenditures. The aim of the reform programme is to allocate a biggest share to infrastructure and the provision of computers and textbooks. Enrolment rates are very high – up to 96% in primary schools and between 85 and 90% in secondary schools. However, 75% of secondary

students are enrolled in vocational or technical programmes which, for the most part, do not match the needs of future employers.

Despite falling unemployment and rising employment levels, the labour market continues to face significant challenges. The main reasons are the structural character of unemployment, the strong seasonal pattern of employment (construction, agriculture and tourism) and the significant impact of the informal sector. The current legal framework provides for high dismissal costs, low wage flexibility and a fairly high tax rates on labour. Consequently, the rate of participation is low (51%), unemployment among young people is high (20.1%), and a significant proportion (58.2%) of job seekers are long-term unemployed. With a view to raising participation and employment rates, the authorities are investing around 1% of GDP in active employment measures, which were responsible for the creation of some 20,000 new jobs in 2006 (or 7.6% of the labour force). However, there are no significant measures to increase labour market flexibility. Moreover, the regulations governing temporary contracts are even stricter than for permanent contracts. Overall, improvement of labour market flexibility remains the most important task to be addressed.

The surge in domestic credit to private enterprises is an indication of an increase in investment. Net inflows of foreign direct investment (FDI) continued their strong growth. Net FDI on an annual basis reached 24.2% of GDP in 2006, and 28.4% by the end of June 2007. The real estate sector accounts for half of FDI inflows, reflecting the strong performance of the construction sector (178% in 2006). A Council for Scientific Research has been established which is expected to facilitate future investments in research and development. Overall, the economy is benefiting from strong and increasing levels of investment.

#### *Sector and enterprise structure*

The reform of the energy sector remains the key issue in the reform of state-owned enterprises, and not only because of the sheer size of the sector. Electricity demand is growing fast, while production is hampered by outdated structures and the urgent need for capital investment. From July 2007, the regulator has introduced a new tariff system, reflecting the relative shares of transmission, distribution and supply fees. The 2007 increases in the price of electricity by an average of 9% are not sufficient to cover production costs. The new tariffs are contested by the generator and consumers. The government intervened by adopting a programme of subsidies to be paid through the Ministry of Health, Labour and Social Welfare, in the form of direct subsidies to low-income households to cover 30% of their electricity bill, and thereby avoid price distortions.

The completed unbundling of electricity distribution, in accordance with the Energy Community Treaty signed by Montenegro, makes it easier for new players to enter the local market. In September 2007, Balkan Energy - a Greek-owned company - acquired the Berane lignite mine and committed investments to build a 110Megawatt power plant. The discussion on a comprehensive energy strategy delayed the decisions of the government on the privatisation process. Overall, the Energy Development Strategy needs to be implemented without further delay.

The liberalisation of the telecommunication market is complete. The sector accounted for 13% of GDP in 2006. Despite full liberalisation, there is practically no competition in the fixed-line market. However, the mobile phone market, although saturated (teledensity exceeding 100%), remains extremely competitive. A third mobile operator began operating in July 2007, and new wireless and 3G services have also been introduced. The share of internet

users (23.9%) is increasing but more slowly. However, although the country has five internet service providers, some parts of the population still do not have access to modern telecommunication services.

Preparations are being made for restructuring the railways and the port of Bar. In both cases, the government is maintaining ownership of the infrastructure, while offering concessions to the railway and port operators.

The sectoral evolution in the economy continues to be characterised by further consolidation of the services sector as the main pillar of the economy. The shares of employment in agriculture and industry continued their downward trend in 2006, representing 4.5% and 26% of the total labour force while, in the same period, services - in which 70% of the total labour force is employed - increased their share by 7%. Overall, the consolidation of a service economy continues.

In 2006, the number of small and medium-sized enterprises (SMEs) rose by 3.8% and accounted for half of the GDP, but their share of the total number of registered companies fell slightly. Employment in SMEs grew by 2.1% year on year, accounting for 35.6% of the labour force in 2006. Credit to firms is expanding very rapidly, doubling in 2006 and practically doubling again in the first half of 2007, despite high interest rates and the fact that commercial banks do not yet have access to the credit register of the Central Bank. Companies have the option of paying their taxes electronically. However, this facility is not yet available for payment of VAT on imports, as the Customs Office still requires presentation of proof of payment. A first business incubator was established in 2007. In October 2007 the government adopted a mid-term strategy for development of the SME sector. Overall, the performance of SMEs has moderately improved, but some administrative procedures still hamper the business environment.

#### *State influence on competitiveness*

Subsidies doubled in 2006 compared with the previous year and accounted for 0.7% of GDP. Moreover, other subsidies in kind have been granted for limited periods to privatised enterprises, to help them with their reform process. Subsidisation of electricity prices to the aluminium and steel mill companies is one example of this. In the case of indebted companies awaiting privatisation, it is not uncommon for the government to make debt-to-equity swaps to increase the proportion of state ownership, thus making the share to be privatised more attractive to potential investors. However, during privatisation negotiations, bidders can obtain additional advantages such as a corporate profit tax break, or a concession for custom duties and VAT on imported machinery and equipment.

Following the exceptional drought of 2007, the government adopted temporary measures to help the agricultural sector. The consequences of the negative impact, which the government estimated at some EUR 10 million, will be mitigated by the reduction in the VAT rate – for a period of one year - on some basic agri-products, an increase in the price paid by the state to purchase milk and tobacco, the reduction of tariffs on meat imports, tax relief on agricultural land and the supply of cereals and sugar by the state to avoid rises in the price of the end-products. Overall, state intervention in the productive sector remained limited to post-privatisation arrangements and agriculture.

## *Economic integration with the EU*

Montenegro is an open economy. In 2006, exports and imports of goods and services as a percentage of GDP rose to 49.1% and 84.7% respectively. Tourism remains the main source of export revenue; despite current infrastructure shortages, the sector accounted for 17% of GDP in 2006. The main manufactured product (aluminium) accounts for 11% of GDP and 40% of exports in value terms. The EU remains Montenegro's main trading partner. Trade with Serbia also remains significant, accounting for 32.7% of total exports and 28.2% of imports. However, the proportion of import and export trade with Serbia is decreasing with time. Total foreign direct investments in 2006 represented 33.4% of GDP. The EU accounted for the overwhelming part of total inflows. Others include Russia with 3.7%. Overall, the level of economic integration with the EU is fairly high, although dependent on the performance of a few markets.

However, the structure of the external sector has been adversely affected by the strength of the euro, in particular as regards trade with Serbia and exports of aluminium. Trends in wages and labour costs also show how the price competitiveness of the economy has been eroded. In 2006, unit labour costs increased by 18.3% as the average net wage rose by 12% in real terms (well above the 2.6% growth in labour productivity growth). Overall, increasing labour costs and the recent rise of the euro have affected the country's competitiveness.

## **4. EUROPEAN STANDARDS**

This section examines Montenegro's capacity gradually to approximate its legislation and policies to the *acquis* related to the internal market, sectoral policies and justice, freedom and security, in line with the Stabilisation and Association Agreement and the European Partnership priorities. It also analyses Montenegro's administrative capacity.

### **4.1. Internal market**

#### *4.1.1. Free movement of goods*

Overall, progress has been made with introducing quality infrastructure in Montenegro. *De facto* Montenegro continues to apply the framework laws on quality infrastructure adopted by the former State Union (laws on accreditation, standardisation and metrology, together with technical requirements and conformity assessment of products). New drafts for Laws on standardization and on technical requirements for products and conformity assessment have been approved by the Government in July 2007.

The Centre for Metrology was established as a state authority in September 2006 and is already functioning, with a director appointed and an organisational structure approved. In April 2007 the government adopted decisions establishing the Institute for Standardisation and the accreditation body of Montenegro as non-profit organisations with independent legal personality and appointed acting directors of both bodies. Funds for the Centre for Metrology and the Institute for Standardisation have been included in the 2007 budget, the funds for establishment and operation of the accreditation body are provided from the current budget reserve.

In June 2007 the government adopted a strategy for building quality infrastructure in Montenegro, defining ways to develop standardisation, accreditation, conformity assessment

and metrology. Ministry for Economic Development is responsible for coordinating the policy as regards quality infrastructure and will also keep a register of technical regulations.

A recently approved action plan for **standardisation** provides for adoption of around 12,000 European product standards (ENs) developed through the European Committee for Standardisation (CEN) and the European Committee for Electrotechnical Standardisation (CENELEC). In order to provide transparency, the government adopted a decree outlining the procedure for preparation, adoption and registration of technical regulations. A further decree on notification of technical regulations, standards and conformity assessment procedures is being prepared. This is expected to designate the Department for Quality Infrastructure in the Ministry of Economic Development as the enquiry point for technical regulations and the Institute for Standardisation as the enquiry point for standards.

A strategy for the development of **metrology** in Montenegro was adopted in September 2007. A significant effort will be required to improve traceability, scientific control, monitoring and the functioning of laboratories, six of which have been identified for further **accreditation**.

**Market surveillance** comes under the Market Inspectorate, which performs all market surveillance duties and also exercises some control over intellectual property rights, investigative tasks on competition issues and tasks connected with receiving consumers' complaints and acting as an intermediary for resolving disputes. The Market Inspectorate is not yet equipped with the appropriate ICT tools needed to improve its overall performance and prepare the way for it to become the future national contact point for the RAPEX system.

Progress has been observed in the area of **consumer protection**. The Law on consumer protection was adopted by parliament in May 2007. It takes into account recent Community legislation in this field. However, Montenegro still lacks a comprehensive framework in this field and needs to strengthen the institutions' and NGOs' capacity to implement the legislation and the national strategy for consumer protection along with future regulations on handling consumer complaints, arbitration, inspections and consumer awareness-raising.

Overall, some progress has been attained in the area of free movement of goods. Montenegro's institutional framework has improved but needs to be further enhanced and completed. Human and physical resources are not yet up to the standards and awareness-raising on consumers' rights is at an early stage.

#### *4.1.2. Movement of persons, services and right of establishment*

In the field of **free movement of persons**, the first steps have been taken on coordination of social security systems with the signing of the agreement with Serbia, the entry into force of the protocol for the payment of pensions and disability insurance and the adoption of the law confirming the social insurance part that will apply until the agreement is ratified by Serbia. No development has been reported on the announced law on aliens that was expected to clarify the rights of employment of foreigners or on other measures concerning access to employment. As the number of non-resident employees, mainly coming from neighbouring countries, is sharply increasing, Montenegro needs to step up its efforts in the area of movement of persons.

The ongoing negotiations for accession to the WTO also cover the free **movement of services**. In this field Montenegro is pursuing a liberal policy.

Regulation and supervision of the **financial sector** has been developed since the Central Bank started to perform its supervisory function in 2001. Nonetheless the current legal framework still displays deficiencies with reference to corporate governance and risk-management requirements. The new banking law currently being prepared could strengthen the Central Bank's enforcement and supervision powers, in accordance with international standards allowing banks to implement Basel II requirements.

With reference to regional and international cooperation, the Central Bank of Montenegro signed the agreements on understanding in the field of bank control with the Bank of Slovenia, the National Bank of Serbia and the *National Bank of Macedonia* and on 18 January 2007 Montenegro became a member of the International Monetary Fund and the World Bank.

Supervision of the non-banking financial sector was improved at the end of 2006 with the adoption of the law establishing an independent supervisory agency followed by a government bill on receivership and liquidation of insurance. The whole framework still needs to be completed with supervision of leasing companies.

On the **right of establishment** limited progress can be reported. The duration of the registration procedure is limited to three days, by the "silent approval" application. In spite of this, the whole process for establishing a business still consists of 15 steps. Montenegro will therefore have to look closer at streamlining the start-up process in the broader sense and particularly the issue of licensing. Simplification and harmonisation of procedures at central and local level is needed, as well as extension of the silence-is-consent principle in dealings with public administration. Overall a major effort is required on systematic reduction of administrative barriers to business.

#### *4.1.3. Free movement of capital*

Current payments, direct investment and repatriation of profits have already been liberalised and an inter-banking payment system is in place. Remaining restrictions, such as those on purchase of real estate by non-residents, are based on reciprocity. Further improvements were the approval of the rules of procedure of the Real Estate Directorate in February 2007 and the adoption, three months later, of the Law on the state survey and real estate cadastre, which also covers the pipe and wire cadastre, basic state maps, topographic maps and border surveys.

In order to ensure proper controls on suspicious transactions, Montenegro needs to step up its efforts to replace cash transactions by electronic transactions.

Overall, preparations for implementing the SAA and the IA in the area of free movement of capital are on track, but preparations on the fight against money-laundering are at a very early stage.

#### *4.1.4. Customs and taxation*

Some progress was made in the area of **customs rules** during the reporting period. The Republic of Montenegro acceded to the World Customs Organisation in October 2006.

The Law amending the Customs Law and an amendment to the Law on customs tariffs introducing the EU combined nomenclature were adopted by parliament in January and March 2007 respectively and have entered into force.

Montenegro has introduced legislation providing for the closure of duty-free shops at land borders by the end of 2007, which represent a positive development whose implementation will have to be carefully monitored. Fees applied for customs declarations have been reviewed.

Customs legislation is mostly aligned with the EU acquis but further alignment is required in the areas as origin, transit procedures and customs valuation.

In terms of administrative capacity, some progress can be reported. In the first six months of 2007, the collection of Customs duties showed a considerable increase compared to the same period in 2006. Moreover, 76% of customs documents were filed via the internet.

A significant number of customs officers were trained on application of the rules regarding origin of goods and received instructions in money laundering handling firearms and assessment of work performance.

An agreement on customs cooperation and mutual assistance with Slovenia was signed in April 2007. Intensification of customs cooperation and mutual assistance with neighbouring countries could significantly contribute to the customs upgrade.

Relevant improvements can be also reported in the field of application of preferential origin rules. A technical mission in February 2007 on the issuing of EUR 1 certificates concluded that the customs authorities had sufficient capacity to monitor preferential rules. On this basis the notice to importers issued by the European Commission is being removed.

The first phase of the Business Strategy implementation was completed.

In the field of **taxation**, limited progress has been made with the entry into force of amendments to the Law on personal income tax. However, no progress can be reported with indirect taxation.

The tax administration signed agreements for cooperation with the Police Directorate and the state prosecutor aiming at developing administrative capacity. The organisational structure of the tax administration was recently reformed. Four new sectors, in charge of collection, service to taxpayers, processing of tax returns and IT respectively, will be put in place, alongside functional and territorial units. Alignment in the area of direct taxation is at a very early stage, in particular as regards company tax directives and the Code of Conduct for business taxation. Montenegro's indirect taxation legislation is mirroring the acquis. However, there are differences in exemptions, special schemes and reduced VAT rates.

Further modernisation of the tax administration is at an early stage, in particular with regard to tax collection and controls, including by means of effective use of risk analysis.

Overall, preparations in the area of customs and taxation are under way. However, Montenegro needs to step up its efforts in order to be able to implement its commitments under the Stabilisation and Association Agreement.

#### *4.1.5. Competition*

In the area of **anti-trust**, Montenegro has made some progress. In line with the European Partnership priorities, the January 2006 Law on competition protection was amended in May 2007. The new law provides for the establishment of an operationally independent

competition authority, the Directorate for Competition Protection, to replace the department for protection of competition within the Ministry of Economic Development, which employs five experts. A set of by-laws has been adopted, laying down the conditions for issuing group exemptions and the procedure for obtaining individual exemptions. The competition protection department has already assessed a number of concentrations and opened investigations with regard to anti-competitive agreements by undertakings. A system has yet to be established for imposing effective deterrent fines.

A **state aid** law has been approved and entered into force in May 2007. Adoption of by-laws giving details of the criteria, purposes and conditions for granting state aid and the methods and procedures for control and reporting is still pending. The state aid control commission, to be established under the new law, would be appointed by the government and would consist of representatives from various ministries, with powers to authorise the granting of aid and order recovery of unlawful aid and *ex-post* supervision. A new state aid unit will replace the permanent team based at the Ministry of Financial Affairs to monitor and report on the aid allocated. Up-to-date state aid inventories and reports for 2003 and 2004 have been adopted and the 2005 inventory is waiting for approval by parliament.

However, the current state aid structure remains weak, since an effective system for *ex-ante* control of all new aid measures and alignment of existing aid measures does not yet exist.

Overall, preparations in the area of competition are moderately advanced. However, in view of forthcoming obligations under the Stabilisation and Association Agreement, Montenegro needs to make further improvements to its legislative framework and to set up operationally independent competition and state aid authorities.

#### 4.1.6. *Public procurement*

Some legislative progress can be reported. A first set of implementing regulations with no provisions on domestic preferences was adopted within 90 days of the entry into force of the Public Procurement Law (PPL) in July 2006. The PPL is based on the relevant EC directives in the areas of public authorities, utilities and remedies.

At the present stage, the PPL fails to comply with the *acquis* in several areas and the agreed institutional framework has not yet been completely established. One crucial step remaining is separation of the administrative tasks of the public procurement agency (PPA) on the one side and review of complaints by the public procurement commission (PPC) on the other, subsequently eliminating any risk of conflict of interests.

The relevance of introduction of a modern public procurement system is accentuated by the high share of this sector in the Montenegrin economy (over 12% of GDP in 2005). With more than 700 contracting authorities and 170 public procurement officers in Montenegro, training of human resources carrying out public procurement activities needs to be improved, as does the availability of information to all stakeholders, including taxpayers and the media.

The public procurement system of Montenegro has developed in the right direction over the past year. However, any capacity improvement will depend on the availability of central institutional resources for supporting and monitoring public procurement efficiently, ensuring that the organisational structure effectively reflects the functions and responsibilities provided for by the PPL. A positive development in this regard is the creation of a Public Procurement Directorate within the State Commission with a staff of 15 in a Sector for Public Procurement

and a Sector for general and financial affairs, operational as of September 2007. A number of procedural improvements would both promote good and sound procurement practices and reduce the currently over-formal, legalistic approach. Overall, preparations for alignment are under way.

#### 4.1.7. *Intellectual property law*

In the field of **intellectual property rights** some progress can be reported.

Since 2006, responsibilities have been shared between the Ministry of Culture, Sport and Media, competent for copyright and other rights, and the Ministry for Economic Development in the case of **industrial** and commercial **property rights**. In this framework, under the control of the second of these ministries, an intellectual property office was established in May 2007. Its director was subsequently appointed, its internal organisation has been approved and initial funds totalling around € 100,000 have been provided from the current budgetary reserve.

Cooperation within the public administration, with the involvement of social partners, has been significantly intensified in order to supervise implementation of the existing measures and to strengthen the system to protect IPR. *Ex officio* intervention against piracy was introduced in the Penal Code, but cooperation with neighbouring countries has not yet been developed in this field.

Training activities, seminars and study visits in the field of intellectual property protection and counterfeiting were organised for market inspectors, customs officers and employees of the Ministry for Economic Development.

In 2006, a set of key intellectual property rights previously adopted by the State Union, including authors' and related rights, patents and topographies of integrated circuits, was introduced in Montenegrin law. In 2007, a first decree was adopted to define the status of applications and recognized intellectual property rights prior to the beginning of the work of the Office, and, regarding international applications, prior to membership of WIPO. The Government also adopted a second Decree to assert the rights of those registered in the Office for Intellectual Property Rights of Serbia and to provide the conditions for the signing of a bilateral agreement at the level of line ministries in this field, which will ensure the mutual exchange of databases (registers).

On 4 December 2006, the Republic of Montenegro became a member of the World Intellectual Property Organisation (WIPO). It is also continuing to apply all the conventions and protocols on intellectual property signed by the former State Union of Serbia and Montenegro. A decree was drafted on recognition of intellectual property rights acknowledged by the Intellectual Property Office of Serbia and Montenegro and international application before acceding to WIPO.

Overall, progress still needs to be made on IPR protection, especially with reference to the weak institutional capacity, poor level of enforcement, high piracy and counterfeiting and low level of awareness among public bodies and stakeholders. These issues need to be addressed, *inter alia* by training customs officers, with a view to implementing the Stabilisation and Association and Interim Agreements which require Montenegro to attain a similar level of protection of IPRs as in the EC.

#### 4.1.8. *Employment and social policies*

A strategy on poverty reduction and social exclusion was adopted by the government setting out the activities to be carried out over the period 2007-2011 in the areas of health services, education, social protection and employment. Implementation now needs to be given priority.

As regards **social insurance**, progress can be seen in the form of a draft law to unify the three types of contributions (pension and invalidity fund, health insurance and unemployment insurance), which also includes proposals for reductions. This will certainly improve the existing situation for businesses. **Social protection** of certain categories, such as children, the persons with disabilities, women and the elderly, is prescribed and strategies have been adopted. However, implementation has been either partly or, in some instances, neglected. **Social security** allowances remain low.

As regards **health protection**, some progress has been made with adoption and preparation of framework legislation. The degree of implementation is nevertheless uncertain. The general organisation of the system remains unclear. Healthcare capacity is still failing to meet the needs of the population, while the budget framework is far from meeting all the needs. Therefore, a large number of beneficiaries are turning to private practice, which is relatively costly and an additional expense on top of the compulsory contribution set by law. This applies to all branches of medicine and also to pharmacy, with an increasing number of patients turning to purchasing their medication, even during hospital treatment. Concerning the placement and treatment of the mentally ill and of narcotics addicts, institutions have poor material and accommodation capacity, which points to the conclusion that treatment must be improved.

Some progress has been made in relation to tripartite **social dialogue**. The decision establishing the Economic and Social Council (ESC) was revised by the government in December 2006. A constitutive session of the new ESC as a tripartite, professional advisory body with the task of monitoring, encouraging and analysing socio-economic activities was held in April 2007. This tripartite board consists of two representatives each from the government, chamber of commerce and the Confederation of Independent Trade Unions of Montenegro (CITUM). The Law on the ESC is expected to be adopted by parliament in November 2007; the council should then consist of 11 representatives of the government; 11 of the authorised trade union organisations and 11 of the authorised employers' association (MUE).

Of the 19 branch trade unions, the civil servants and judiciary union has the most members (approximately 10,000). However, it is the only union denied the right to sign collective agreements as stipulated in the Labour Law (Article 131-2).

The problem of weak bipartite social dialogue remains unaddressed, however. Efforts should be made to secure the active involvement of employers' organisations in social dialogue mechanisms, taking into account that up to December 2004 the chamber of commerce used to play the role of employers' organisation. Despite the fact that the ESC has examined numerous laws over a four-year period, both the MUE and CITUM agree that it is still not functioning properly due to lack of financial resources (as the ESC was established by a government decision, without its own budget), the problems of employers' representation and over-representation of state bodies. In the future, the questions of representation of social partners and participation by the rest of civil society need to be considered.

Recent economic growth has helped to reduce **unemployment** further. However, structural unemployment persists and long-term measures will be needed to address it. Furthermore, a concern exists over the lack of coherence and consensus between institutions in getting to publicly recognized measures of unemployment, due to the existing divergences upon the respective roles of the Employment Agency and the National Statistical Office (MONSTAT) on labour force surveys.

Another related concern is the governance arrangement which leaves policy responsibility and accountability of the Ministry of Health, Labour and Social Welfare on employment unclear. The capacity of the Ministry of Health, Labour and Social Welfare for developing employment policy remains poor. The **employment agency** of Montenegro plays the key role in employment services, but often assumes a political role, which creates some confusion over the nature of its activity.

In spite of generally satisfactory delivery of services, the **employment agency** needs further to enhance its capacity. Legislation allowing tax relief for hiring unemployed persons was adopted in 2007. There is no indication of the situation of public expenditure on active employment measures or of the steps taken to optimise existing budget resources. Only 3.4% of the registered unemployed benefit from training. Efforts need to be continued to improve management of active labour market measures and ensure that they are targeted correctly.

The employment agency of Montenegro has drafted, in consultation with key stakeholders, a human resources development strategy covering the period 2007-2011. The strategy follows the EU employment guidelines and provides a sound basis for further development of active labour market measures. Integration of the long-term unemployed, redundant workers, disadvantaged groups, youths, women and minorities into the labour market forms part of the strategy. The strategy also provides for immediate development of an employment action plan and an annual operational programme for 2008. The sequencing of these activities provides a good working framework in this area, which needs to be followed consistently.

#### *4.1.9. Education and research*

In terms of access to **education**, the data underscore almost universal enrolment (approximately 97%) of primary school children (7-14 years) with secondary education numbers equally impressive (85-90%). In 2007/2008, a total of 4,210 new students were enrolled in the first year of higher education. The total number of students at the University of Montenegro is 19,446. Private higher education institutes (HEI) have 1,800 students. In September 2006 the first private university – the Mediterranean University – was established. The latest results, for the 2006/07 academic year, show that the pass rate between the cycles is still low, on about 29%. Spending on education stands at approximately 5.4% of GDP. Some 3.4% of the registered unemployed benefit from training, underlining underdeveloped provision.

Montenegro has promulgated a range of education legislation (on general, pre-school, primary, secondary, vocational, higher and adult education). First attempts have also been made to devolve the country's highly centralised education system. The Ministry of Education has taken a number of strategic steps to accommodate the quality principles enshrined in the EU's Bologna and Copenhagen declarations. In particular, the education authorities, in cooperation with the labour administration and social partners, have engaged in initial discussions on the policy and institutional implications of the wider drive within the EU to establish a European qualifications framework. The University of Montenegro is taking steps

to upgrade its quality assurance system. The qualification assurance (QA) procedures are still relatively new in Montenegro, and there is currently a lack of trained professionals in this field. Standards and guidelines for accreditation of study programmes and HEI in line with QA standards and guidelines in the European Higher Education Area (ENQA standards) were adopted by the National Council for Higher Education on 15 February 2007. A new Law is introducing a transparent system of recognition and evaluation of foreign diplomas.

In general, the difficulties with achieving optimum financing arrangements for different parts of the learning system reflect the general disconnection between the range of different stakeholders in understanding and applying themselves to a fully-fledged, life-long learning policy and delivery framework. This will need to be addressed as Montenegro converges with the EU's life long-learning objectives and employment policies. There is increasing understanding of the importance of shared policy discussion, of structured partnership and of adopting cross-ministry and more inclusive governance arrangements, with social partners and civic society bringing added value to policy discourse and reform. Greater efforts by the education and training authorities will be required for meeting the quantity and quality requirements of training provision. Demand for training exceeds supply by 51%.

As regards **research**, the government is fully aware of the importance of science and technology (S&T) and, accordingly, in 2006 established a strategy for scientific research which sets priorities and indicates the annual budget for research aiming at a gradual increase.

Montenegro has increased the number of bilateral S&T cooperation agreements and/or research projects, mainly with regional partners. Montenegro is participating modestly in the sixth framework programme for research (FP6), and in December 2006 it expressed its interest in becoming associated to the seventh framework programme (FP7). To this end, Montenegro has initiated the procedure enabling association to FP7 by of 1 January 2008. This will increase the research opportunities within Montenegro. Since February 2007, Montenegro has also been a full partner in the NATO science for peace and security (SPS) programme, with a representative from the Ministry of Education and Science on the SPS Committee. Cooperation priorities have also been decided.

#### *4.1.10. WTO issues*

Montenegro has made good progress in the negotiations on WTO accession. Internal preparations to become a WTO member are advancing.

## **4.2. Sectoral Policies**

### *4.2.1. Industry and SMEs*

Limited and uneven progress has been made in the area of industry and SMEs. Montenegro is fully involved in the European Charter for Small Enterprises and has shown a good performance on tax reform (boosting the lowest corporate tax rate and total tax payable), on facilitating start-ups for SMEs and on advocacy and representation of SMEs. The recent preparation of the strategy on "competition and export encouragement" by the SME Directorate is a further encouraging sign for promotion of export potential and SMEs' competitiveness. The planned adoption of a new SME development strategy for 2007-2010 was not achieved.

In the area of entrepreneurship learning, pilot projects have been carried out that will lead to inclusion of this subject as an option in primary-school curricula, but more could be done in the higher echelons of education. Development of dedicated business support structures is sluggish. A business incubator has been set up in Bar and another is planned in Podgorica. Development of clusters and other services such as business and technology parks is still at a very preliminary stage.

In terms of the regulatory and institutional framework, Montenegro has a proper institutional set-up (an SME Directorate and an operational SME strategy) and is also advancing on online access for tax calculation. Nevertheless, on the regulatory issues more could be done in the form of impact assessment, extension of the silence-is-consent principle in public administration, systematic lowering of administrative barriers to business, rationalisation of the company registry and further development of a single information portal for SMEs.

In the last few years the banking credit system has developed its capacity and credit to enterprises has increased. Government policies have accompanied this improvement with subsidised credit lines managed by the SME Directorate and the development fund. Nonetheless establishment of a national guarantee fund remains a priority to compensate for the shortage of collateral for start-ups and enterprises in rural areas.

Business representation and advocacy, in December 2006 the government reached agreement with the Montenegrin Union of Employers (MUE/UPCG) and the trade unions. On this basis the Economic and Social Council was reorganised and, in April 2007, held its constitutive session as a tripartite, professional advisory body with the task of monitoring, encouraging and analysing socio-economic activities. Other business associations and think-tanks, such as the Montenegrin Business Alliance (MBA) and the Centre for Entrepreneurship and Economic Development (CEED) are also performing representative and advocacy activities. However, the reform of the chamber of commerce structure is still stalling.

On industrial policy, the need for an overall economic/industrial strategy should be explored. An all-embracing, forward-looking view is needed on where competitive advantages and the needs for restructuring lie. The steel sector requires restructuring to achieve viability.

On the whole, Montenegro has made little progress on implementing the European Partnership priorities in this area and preparations remain at an early stage.

#### *4.2.2. Agriculture and fisheries*

Progress can be reported on meeting the European Partnership priorities and improving the administrative capacity to manage **agricultural policy**. The “Strategy on food production and rural development – Montenegro’s agriculture and the European Union” (adopted in 2006) provides the basis for further major reforms and legislative work required for modernising agriculture. Amendments to the Law on agriculture and rural development and to the accompanying by-laws derived from the new strategy are being drafted. In the field of legislation reform, a law on wine was adopted.

In the field of agricultural policy, assistance measures and programmes for the agricultural sector are being adjusted to the new reforms of the CAP, in particular rural development policy. Efforts have been made to improve the administrative capacity of the Ministry of Agriculture, Forestry and Water Management, in the form of institution-building, training and equipping inspectorates and laboratories.

A substantial progressive opening-up of the Montenegrin market to agricultural products from the EU within five years has been agreed in the framework of the Stabilisation and Association Agreement (SAA). Within the new CEFTA, Montenegro has totally liberalised trade in agricultural products with Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia and Serbia (including Kosovo) and has agreed additional concessions with Albania and Croatia, which is a step further towards mutual liberalisation of trade. Montenegro has joined several international organisations, including the International Organisation of Vine and Wine (OIV), and has observer status in the Food and Agriculture Organisation (FAO). With the exception of the wine sector, comprehensive legislation on geographical indication and protection of indication of origin does not yet exist.

Some progress can be reported in the area of **food safety and veterinary and phytosanitary policy**. The veterinary framework law has been revised. A system for identification of bovines and registration of their movements is at the final stage of preparation. Identification of sheep and goats and registration of their movements is at an early stage. Inspection services and laboratories have been equipped, with EC assistance. Montenegro joined the World Organisation for Animal Health (OIE) in July 2007. Montenegro has adopted several laws in the phytosanitary sector, including laws on protection of plant variety rights, plant nutrition and forest reproductive materials. Montenegro needs to review the organisational set-up of its administration in the sectors concerned and assign clear responsibilities and powers to the individual departments. Control capacity needs to be reinforced.

The "Strategy for development of Montenegrin fishery and for capacity building regarding implementation of the Common EU fishery policies", adopted at the end of 2006, is being implemented. It aims at developing the legal basis for fisheries and food safety, including incorporation of the relevant acquis, strengthening institutional capacity to implement fish hygiene regulations and monitor food safety.

Overall, progress in the agriculture and food safety, veterinary and phytosanitary areas should be maintained and extended.

With regard to **fisheries**, the inspection and control services should be strengthened. Overall, preparations in the area of fisheries are at an early stage.

#### *4.2.3. Environment*

There has been progress in Montenegro's efforts to approximate to European standards in the field of environmental protection. Montenegro has pursued alignment with the EU environmental legislation and taken big steps forward with horizontal legislation, air quality, water quality and chemicals. Efforts have been made to take account of environmental considerations in other policies. The national strategy on sustainable development has been adopted plus an action plan for integration of sustainable development into the education system (2007-2009). A strategic environmental assessment has been conducted on the capacity development strategy for Montenegro (2007-2010) and the strategy on renewable energy resources (wind, solar and biomass energy). A strategy for integrated management of coastal areas and the national Programme for Eliminating the Use of Ozone Depleting substances have been adopted by the Government.

Progress has been made as regards **horizontal legislation**. A decree on projects subject to an environmental impact assessment has been adopted. The Kyoto Protocol to the UN Framework Convention on Climate Change (UNFCCC) and the UN Convention to Combat

Desertification were ratified in 2007. Montenegro's first national communication on climate change is being prepared. The national programme for eliminating use of ozone-depleting substances has been adopted. Montenegro is not a party to the Espoo and Aarhus Conventions. However, preparations for signature and ratification of them are under way. Overall, transposition in this sector is advanced. However, implementation and enforcement pose a significant challenge and further efforts are needed in this regard.

A major step forward on **air quality** was taken with the adoption of a Law on ambient air quality in September 2007, which aims to align with the EU framework and daughter directives on air quality. Montenegro will need to ensure that the law is implemented once it enters into force. Overall, harmonisation with the EU standards in this area is at an early stage and significant efforts are needed to ensure implementation and enforcement.

Limited progress has been made in the area of **waste management**. Montenegro acceded to the Basel Convention in November 2006. The national waste management plan has not yet been adopted. Overall, alignment with the EU standards on waste is low, except with the Waste Framework Directive and with the Hazardous Waste Directive. The permit system for establishments and undertakings carrying out disposal or recovery operations, as provided for by the Waste Management Law adopted in 2005, has not yet been established. Overall, the track record on implementation and enforcement is weak.

Some progress can be reported on **water quality**. A new Law on water was adopted in May 2007, transposing some of the obligations imposed by the Water Framework Directive. The Ministry of Agriculture, Forestry and Water Management (MAFWM) has been designated as the competent authority for the Water Framework Directive. Coordination between the MAFWM and the Ministry of the Environment and Tourism needs to be improved. Overall, the level of alignment with the European standards in this area is low. Implementation and enforcement are weak and pose significant challenges.

No progress can be reported in the case of **nature protection**.

Limited progress can be reported on **industrial pollution and risk management**. The date of entry into force of the Law on integrated pollution prevention and control (IPPC) has been brought forward from 1 August 2008 to 1 January 2008. The inventory of IPPC installations has not yet been completed. Existing installations are required to comply with the IPPC requirements by 2015. Overall, the level of alignment is low and implementation and enforcement require particular attention.

Legislative developments can be reported on approximation with the EU standards for **chemicals**. A Draft Law on chemicals has been adopted by government and submitted to parliament for approval. Overall, the level of alignment is low. Implementation and enforcement are weak. No progress can be reported in the area of **genetically modified organisms (GMOs)**.

As regards **administrative capacity**, the Ministry of Tourism and the Environment (MTE) was established in November 2006. There are now four departments in the MTE responsible for: air and radiation; control of industrial pollution, waste and wastewater management; nature protection, environmental impact assessment (EIA), strategic environmental assessment (SEA) and IPPC; and strategic integration and strategic processes in the field of the environment. The environmental protection agency has not yet been established. Overall, administrative capacity is weak and suffers from lack of staff and of satisfactory coordination

between the bodies involved in environmental protection issues, in particular inspection activities. The lack of implementation capacity at local level and poor coordination between central and local government further limit enforcement capability.

Overall, some progress has been achieved in terms of alignment with the EU environmental standards and harmonisation seems to be on track. However, further efforts are needed, in particular on implementation and enforcement which pose a significant challenge. Particular attention needs to be paid to strengthening administrative capacity.

#### 4.2.4. *Transport policy*

Montenegro has made good progress with the development of the **trans-European transport networks**. It is continuing to participate in development of the core regional transport network and in the south-east Europe transport observatory (SEETO) and has approved the second rolling five-year multi-annual plan, covering 2007-2011 (MAP). Implementation of the priority projects, coordination of investments and the annual revisions of the MAP require continued cooperation in the framework of SEETO.

Preparations are well on track in this area.

There has been progress on **road transport**. Under the Interim Agreement (IA) with the European Community on trade and trade-related matters, initialled in April 2007, Montenegro has undertaken to ensure unrestricted Community transit traffic through its territory with effect from the entry into force of the IA. However, Montenegro has not yet simplified the flow of goods, bilateral or in transit, by road and rail. Priority needs to be given to legislative harmonisation in the field of road safety and technical and social conditions. Preparations in this sector are lagging behind.

Progress has been limited in the **rail transport** sector. The restructuring process and division of the railway company into separate entities for managing infrastructure and transport services is continuing at a good pace. Montenegro is actively participating in the railways group of the south-east Europe transport observatory. However, laws on rail safety and security have not yet been adopted by the government. Preparations in this sector are not very advanced.

There is no progress to report on **inland waterways** and **combined transport**.

Some progress can be reported on **air transport**. Montenegro has started to implement the first transitional phase of the Agreement establishing the European Common Aviation Area (ECAA), including the market access rules. It has started to develop its administrative capacity, in particular by setting up the Directorate for Civil Aviation, but this capacity must still be further reinforced. Legal approximation has not yet started on air traffic management and a national supervisory authority has yet to be set up. Preparations in this sector are at an early stage.

In the **maritime transport** sector, some progress can be reported. In October 2006, Montenegro became a member of the International Maritime Organisation and in February 2007 it accepted the relevant conventions and protocols. However, the law on maritime navigation has not yet been adopted and special attention is to be paid to safety and security issues, including flag state conditions and port state control facilities. Preparations in this sector are starting.

Overall, Montenegro has made progress in the area of transport. But the new national transport development strategy remains to be adopted by the government in order to move forward with better approximation of the legislation to the *acquis*. Administrative capacity also requires further strengthening.

#### 4.2.5. *Energy*

There is no progress to report as regards **oil stocks** and **security of supply**.

Regarding the **internal energy market**, progress has been made. Montenegro has ratified the Energy Community Treaty. Therefore it is bound to apply the relevant EU energy *acquis* with effect from 1 July 2007, except for the provisions on market opening to which a specific timetable applies. The energy regulatory agency has adopted the rules on electricity tariffs and pricing of coal for electricity generation. Montenegro has made good progress on electricity generation and technical rules and adopted its electricity action plan in November 2006. However, implementation started only recently in the gas sector, and the Energy Development Strategy up to 2025 has not yet been adopted. The draft Energy Development Strategy presented to public consultation in September 2007 needs to be adopted and to reflect the commitments taken in the framework of the Energy Community Treaty, in line with the recommendations of the European Partnership. In addition, privatisation of the Pljevlja power plant was suspended in June 2007. Overall, an uneven start has been made in the area of the internal energy market.

In the area of **energy efficiency** and **renewable energy**, some progress can be reported. A working group has been established to implement the action plan on the energy efficiency strategy. However, the renewable energy sources action plan has not yet been adopted. Preparations in this field are at an early stage.

There is no progress to report in the field of **nuclear safety** and **radiation protection**. The basic rules in this field need to be adopted and implemented and an appropriate regulatory body established. Montenegro has to accede to the relevant international conventions, in particular to the Convention on Nuclear Safety and to the Joint Convention on the Safety of Spent Fuel Management and on the Safety of Radioactive Waste Management.

Overall, some progress can be reported in the energy sectors, but it remains uneven. Continued efforts are still needed to meet the Energy Community Treaty requirements.

#### 4.2.6. *Information society and media*

There has been little progress on **electronic communications** and information technology. Based on the strategy adopted for the electronic communications sector in June 2006, preparations are under way to draft a new primary law on electronic communications aligned with the 2002 EU regulatory framework. There have been hardly any changes in the level of competition on the telecommunications market. Competition still exists only on the mobile telephony market, which a third operator entered in the course of the reporting period.

The interconnection tariffs were due to be reviewed by the regulatory authority (Agentel) towards the end of 2006, but remained unchanged over the reporting period. This has led to more delays in introduction of competition on the fixed market. Other issues, such as further rebalancing of tariffs and lowering of other market barriers, still need to be addressed. The high fee for international licences has been significantly reduced.

Responsibility for telecommunications policy has been moved to the Ministry of Maritime Affairs, Transportation and Telecommunications. The relevant directorate in the ministry still lacks sufficient administrative capacity.

Regarding development of competition on the market, practical improvements still have to be made, notably with implementation of the currently applicable legislation, which appears to have been stalled by the preparations for the new legislative framework. The lack of specific expertise and administrative capacity on the part of the authorities needs to be addressed in order to increase the level of expertise and its independence from the strong market players.

In the area of **information society** services, there has been little progress. Montenegro has not yet passed the legislation necessary in order to align with the *acquis* on conditional access. Legislation on electronic commerce and electronic signatures is in place.

In the area of **audiovisual policy**, amendments to the Law on cinematography were adopted in 2006. The broadcasting agency has adopted the rules on cable and wireless systems for distribution of radio and TV signals to end-users. The broadcasting agency issued multi-annual licences to radio and TV stations in March 2007 after verifying that the holders had fulfilled all the programme and technical conditions required by the law and by the agency's by-laws. In May 2007, the broadcasting agency carried out an intensive programme of technical controls with a view to examining compliance with technical standards (electromagnetic compatibility, protection zones and corridors, permitted radiation in cities, technical conditions for broadcasting radio/TV programmes, etc.) both by commercial broadcasters without multi-annual licences and by public broadcasting services. A new mechanism for collecting the broadcasting fee is being prepared. Internal reorganisation of the public service broadcaster is continuing.

Two major outstanding issues are ratification of the UNESCO Convention on Cultural Diversity and signature and ratification of the European Convention on Transfrontier Television.

Overall, there has been some progress in the area of the information society and media. New primary legislation is needed in order effectively to liberalise the electronic communications market. Legislative measures are also needed in order to align with the *acquis* on information society services. The broadcasting agency is well established, is independent from the government and is working efficiently, but Montenegro has not yet ratified the UNESCO Convention on Cultural Diversity and has not signed and ratified the European Convention on Transfrontier Television. Preparations in this area are at an early stage.

#### 4.2.7. *Financial control*

A few elements of public internal financial control (PIFC) are in place. An administrative cooperation agreement between DG Budget and the Minister of Financial Affairs was agreed in June 2007 to facilitate exchanges of information and expertise in the areas of PIFC and external audit. The Ministry of Financial Affairs is drafting a PIFC strategy paper. The state audit institution is developing its capacity to take account of INTOSAI standards and EU best practice and is due to develop a strategic plan for its future activities.

In conclusion, PIFC and external audit are at an early stage of development and the independence of the state audit institution has yet to be strengthened adequately.

#### 4.2.8. *Statistics*

As regards **statistical infrastructure**, an annual work programme has been drawn up but the amended statistical law and statistical council have not had a sufficiently positive impact on development of the national statistical system.

Significant progress has been made on development of the statistical business **register**. It has a functional user interface and the contents are used for sampling. Routines for updating information and guidelines on use are being prepared.

As regards **classifications**, the only progress which can be reported is with introduction of the HS2007 harmonised customs tariff system, while compliance with EU standards remains limited. As regards the different **sectoral statistics**, the following progress can be reported:

For demographic and social statistics MONSTAT carries out the household budget survey without external assistance. Further improvements are needed in its scope. The labour force survey established in 2005 is almost compliant and further improvements will be made. Available resources ought to be concentrated on this effort, avoiding duplication that could be detrimental to response rates and confuse users.

For macro-economic statistics MONSTAT has published GDP data partly harmonised with SNA 93 and ESA 95 and alignment is continuing. For purchasing power parities two new surveys have been conducted on capital goods and equipment, but progress on price statistics has been slow. For business statistics there has been progress on both short-term and structural business statistics, with pilot surveys being conducted. At the Central Bank, the level of knowledge of the EU requirements and understanding of the gaps has improved significantly.

For external trade statistics progress has been limited. The output in terms of statistics produced is insufficient. No progress can be reported on regional statistics. There have been no major developments on agricultural and fishery statistics, but MONSTAT has substantially increased knowledge of the EU requirements regarding agricultural statistics.

Overall, slight progress has been reported. The management capacity remains weak and major shortcomings have been identified in the statistical infrastructure. Corrective measures are needed, including clarification of stakeholders' roles and raising awareness about the necessity of reliable official statistics in public and private decision-making. Moreover, to achieve progress, resources need to be increased and used more efficiently, by setting clear short- and long-term priorities.

### 4.3. **Justice, freedom and security**

#### 4.3.1. *Visa, border, control, asylum and migration*

With regard to **visa** management, the visa facilitation agreement between Montenegro and the European Community was signed in September 2007.

However, as Montenegro does not have a sufficient number of diplomatic missions, visas for entering Montenegro are issued by Serbian diplomatic missions. Consultations are ongoing with other countries to cover the issuing of visas in countries where there are no Serbian diplomatic missions. Visas are also available at the border crossing points. As Montenegro

has become a fast growing tourist destination, a comprehensive long-term solution remains highly important.

The list of countries for which Montenegro requires a visa for entry to its national territory and the detailed procedures applied have not been harmonised with European standards. Activities for setting up a central citizens' registry are ongoing. New travel documents including biometric features have not yet been issued. The issuing has been postponed to April 2008. In the area of visa management, Montenegro has only begun to address the main priorities.

In the area of **border control**, progress has been limited. The action plan for implementation of the strategy on integrated border management (IBM) was adopted in December 2006. The border police comprises the following organisational units: the State Border and Cross-border Administration and the border police departments, which consist of a department for cross-border activities and foreigners and a department for the state border. Around 8,000,000 border crossings were registered in the first eight months of 2007, an increase of 108% over the previous year. Some 1,400 persons were denied entry, 206 illegal crossings were prevented and 517 illegal stays were detected.

There is still a need to adopt secondary legislation on the management of border crossings and to establish a coordinating mechanism for integrated border management at national level. Agreements or memoranda of understanding on inter-agency cooperation in the area of border management have yet to be signed. An inter-ministerial commission has been set up for this purpose. The allocation for administration of legal stays of foreigners within the border police raises concerns, especially as the relevant office for foreigners in Podgorica is facing difficulties as regards modern equipment and clear definition of responsibilities.

The basic equipment of the border police, such as cars and boats, is sufficient, although there is a lack of modern IT and control devices. Specific border police training has been launched, but has to be made accessible to a larger number of border police officers. Overall, preparations in the area of border control are still at an early stage.

Little progress can be reported in the area of **asylum**. The Law on asylum entered into force in January 2007. The Office for Asylum, which is responsible for decisions on asylum applications, was established in February 2007 under the auspices of the Ministry of the Interior. Since the independence of Montenegro, a total of ten asylum applications have been registered.

Problems with implementing the Law on asylum remain. There is still no secondary legislation. The office for asylum and the State asylum appeals commission, which is responsible for second-instance reviews of asylum applications, have yet to become fully operational. Legal aid and certified translation are not yet fully available. A reception centre for asylum-seekers and refugees is still being built. In the area of asylum, Montenegro's preparations are not very advanced.

No particular progress can be reported in the area of **migration**, apart from the signature of the readmission agreement between Montenegro and the European Community in September 2007. Montenegro still has no law on foreigners. There are no facilities for detaining foreigners found to be staying illegally.

In June 2007, 417 foreign nationals were living in Montenegro with a permanent residence permit and 3,000 with a temporary residence permit. Under the Law on employment and work of foreign nationals, the government adopts annual quotas for granting work permits to foreigners. The practical effect of this system is limited. In addition to legally admitted workers, an unknown number of foreigners, mainly from other Western Balkan countries, Bulgaria and Ukraine, are working illegally in Montenegro.

Around 7,000 refugees from Croatia and from Bosnia and Herzegovina are residing in Montenegro. Also around 16,000 displaced persons, mainly Roma and Serbs, from Kosovo are residing in Montenegro, facing an unclear situation. The official status of the latter as IDPs is largely undefined in written law. It does not carry with it the right to permanent residence or domicile and interferes with access to an array of economic and social rights. Roma IDPs from Kosovo, in particular, form the most marginalised group and often live in unacceptable circumstances. The status of IDPs urgently needs to be regulated by law. Provisions should be included in any such law to prevent the statelessness of IDPs. Overall, preparations in the area of migration are lagging behind.

#### 4.3.2. *Money laundering*

Little progress has been made in fighting **money-laundering**. Cooperation between the relevant agencies has continued. Currently, the Administration for the prevention of money-laundering is operating as a financial intelligence unit (FIU). There is provision for 19 staff, of which 13 have been recruited. In 2006, 170,000 transactions were reported to the FIU, of which 29 were forwarded to the police and the prosecutor's office on suspicion of money-laundering, along with eight cases relating to other criminal offences. From January to April 2007, 109,000 transactions were reported, with 18 cases being forwarded to the relevant bodies on suspicion of money-laundering, along with four cases concerning other criminal offences. The Administration for the prevention of money-laundering updated its list of indicators for suspicious transactions in March 2007.

However, money-laundering remains an area of serious concern. A new law on the prevention of money-laundering and financing of terrorism is being prepared, but has not yet been adopted by parliament. Within the police, there is no specialised unit to fight money laundering. There is not yet any proper monitoring of financial transactions beyond the banking system, especially in relation to real estate and inward investment. Urgent action is needed. Montenegro needs to step up its efforts to replace cash transactions by electronic transactions in order to ensure proper controls on suspicious transactions.

Overall, preparations in the fight against money laundering are not very advanced.

#### 4.3.3. *Drugs*

Some progress can be reported in the fight against **drug** smuggling and in addressing the problem of drug abuse in the country.

Between January and June 2007, the Office for drug addiction prevention organised numerous activities on this subject in Montenegro. Based on the decree on organisation and working procedures in public administration, a high-level interministerial working group was created to design the national strategy for the suppression of drug abuse and prevention of drug addiction, with the aim of defining efficient mechanisms to achieve these aims. Another task

of the group is to propose an action plan for the implementation of this strategy. A similar strategy is also needed for prison inmates. Legislation on precursors is in force.

A Group for combating drugs and smuggling has been set up to deal with organised crime involving drugs. It is also responsible for international cooperation in the fight against drug smuggling and other significant issues related to the abuse of narcotics at international level. It is supported by seven police units at local security centres. The new act on organisation of the Police Directorate increased the number of officers assigned to this field.

However, Montenegro faces very significant problems related to drug abuse in the country as well as problems with drug transit and trafficking. There has been a further increase in drug addiction and the number of drug-related crimes. Drug-related crime remains a major threat to society as a whole. The capacities of the law enforcement bodies therefore need to be further strengthened, and activities to combat drug abuse have to be intensified. Overall, Montenegro has started to address its priorities in the fight against drugs, but drug trafficking remains a serious concern.

#### 4.3.4. *Police*

There has been some progress in the reorganisation of the police. Several legal acts have been adopted, notably the Law on the prevention of violence and improper behaviour at sports events, the decrees on the ranks and on insignia, armament and equipment of police officers, the rules on conditions for detention premises on the manner of providing assistance to public administration bodies and the rules on the conditions for and recruitment of police officers and on disciplinary procedures. The Police Academy became fully operational in October 2006, and the first 45 students were enrolled and have embarked on 18 months of training.

The Interpol Office is currently being established within the criminal police sector. It will be responsible for international police cooperation. At present, the office has 15 staff. It became a full member of Interpol in September 2006. Data on stolen vehicles, organised crime and narcotics smuggling are regularly exchanged. International warrants are now on the database and 12 felons have been arrested since September 2006. Ten international arrest warrants have been issued for crimes in Montenegro and five notifications for missing persons have been circulated, all in conjunction with the criminal justice department.

However, the professional capacity of the police still has to be further strengthened, in particular as regards specialised training and development of intelligence and risk-analysis tools. Equipment and facilities are not yet up to European standards. The department for the fight against organised crime is not yet adequately equipped for its tasks. Additional training and better equipment have not yet been fully provided for the Interpol Office. The department for internal control of the police has been reorganised, but neither training nor sufficient facilities and equipment have been provided. The number of policemen remains high.

Overall, owing to the progress made, police reform in Montenegro is moderately advanced.

#### 4.3.5. *Fighting organised crime and terrorism*

No particular progress can be reported in the fight against **organised crime**. Organised crime remains a source of serious concern in Montenegro.

Cooperation with neighbouring countries is positive, but there is a further need to share intelligence with neighbouring countries for operational reasons. Within the police, there is a

department to fight organised crime and specific units have been established to deal with particular areas of organised crime. These units lack manpower, equipment and training. There is still room for improvement of the witness protection unit. Overall, Montenegro's preparations in the fight against organised crime are lagging behind.

There has been some progress in combating the **trafficking of human beings**. Legislative reforms are under way. A national anti-trafficking strategy has been approved. The office of the national coordinator for the fight against trafficking in human beings has carried out various activities, including some aimed at better cooperation with countries in the region. Montenegro is not a country of origin, but mostly a country of transit and destination.

Overall, Montenegro is moderately advanced in combating the trafficking of human beings.

In Montenegro, no acts of **terrorism** were reported. The legal framework for the fight against terrorism is included in the criminal code and the criminal procedure code and also in the Law on the prevention of money-laundering and terrorism financing. An anti-terrorism unit exists within the police. Training for the special anti-terrorist unit continued, but its equipment has still to be improved.

#### *4.3.6. Protection of personal data*

No progress has been achieved in the area of data protection. Montenegro has not yet signed the Additional Protocol to the Council of Europe Convention for the protection of individuals with regard to automatic processing of personal data, regarding supervisory authorities and trans-border data flows. A new law on personal data protection has not yet been adopted. The current legislation is not in line with the Data Protection Directive. There is still no independent supervisory authority in place for data protection.

The situation in the area of data protection is a matter of serious concern. Montenegro needs to harmonise its legislation with Community law, especially with the Data Protection Directive, as a matter of urgency, in particular as it has committed itself to complying with it with effect from the entry into force of the Stabilisation and Association Agreement.

### **Statistical annex**

## STATISTICAL ANNEX

### STATISTICAL DATA (as of 5 October 2007) Montenegro

Basic data	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Population (thousand)	1)	606	608	610	612	615	617	619	621	623	624
Total area of the country (km <sup>2</sup> )	2)	13 837	13 834	13 830	13 831	13 833	13 833	13 833	13 833	13 812p	.

National accounts	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Gross domestic product (GDP) (million national currency)	3)	.	.	.	1 999e	2 435e	.	.	.	.	.
GDP (million euro)		.	.	.	1 022e	1 245e	.	.	.	.	.
GDP (euro per capita)		.	.	.	1 565e	1 898e	.	.	.	.	.
GDP (in Purchasing Power Standards (PPS) per capita)		.	.	.	.	.	.	.	.	.	.
SI: GDP (in PPS per capita, EU-25=100)		.	.	.	.	.	.	.	.	.	.
SI: Growth rate of GDP (national currency, at constant prices, % change on previous year)		.	.	.	3.1	-0.2	1.7	2.4	4.2	4.0	.
SI: Employment growth (national accounts, % change on previous year)		.	.	.	.	.	.	.	.	.	.
Labour productivity growth: GDP growth per person employed (% change on previous year)		.	.	.	.	.	.	.	.	.	.
SI: Unit labour cost growth (national accounts, % change on previous year)		.	.	.	.	.	.	.	.	.	.
SI: Labour productivity (GDP in PPS per person employed, EU-25=100)		.	.	.	.	.	.	.	.	.	.
Gross value added by main sectors (%)		.	.	.	.	.	.	.	.	.	.
Agriculture	4)	.	.	.	13.0	12.6	12.9	12.5	.	.	.
Industry	4)	.	.	.	20.0	22.0	21.1	20.8	.	.	.
Construction	4)	.	.	.	4.5	4.1	4.3	3.6	.	.	.
Services	4)	.	.	.	62.6	61.4	61.7	63.2	.	.	.
Final consumption expenditure, as a share of GDP (%)		.	.	.	93.5	101.6	108.0	102.7	102.7	100.7	.
Households and NPISH, as a share of GDP (%)		.	.	.	70.6	75.4	82.0	73.7	73.6	72.7	.
General government, as a share of GDP (%)		.	.	.	22.9	26.2	26.0	29.0	29.0	28.1	.
Gross fixed capital formation, as a share of GDP (%)		.	.	.	17.6	18.2	15.3	14.4	.	.	.
Changes in inventories, as a share of GDP (%)		.	.	.	3.8	4.7	2.3	0.7	.	.	.
Exports of goods and services, relative to GDP (%)		.	.	.	38.4	40.0	37.0	33.2	.	.	.
Imports of goods and services, relative to GDP (%)		.	.	.	53.3	64.5	62.6	51.0	45.3	55.5	.

Industry	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Industrial production volume index (2000=100)		105.0	105.0	96.0	100.0	99.0	100.0	102.0	116.0	114.0	.

Inflation rate	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SI: Consumer price index (CPI), (total, % change on previous year)		.	.	.	.	.	.	.	.	.	.

Balance of payments	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Balance of payments: current account total (million euro)		.	.	.	.	.	.	.	.	.	.
Balance of payments current account: trade balance (million euro)		.	.	.	.	.	.	.	.	.	.
Balance of payments current account: exports of goods (million euro)		.	.	.	.	.	.	.	.	.	.
Balance of payments current account: imports of goods (million euro)		.	.	.	.	.	.	.	.	.	.
Balance of payments current account: net services (million euro)		.	.	.	.	.	.	.	.	.	.

Balance of payments current account: net income (million euro)		:	:	:	:	:	:	:	:	:	:	:
Balance of payments current account: net current transfers (million euro)		:	:	:	:	:	:	:	:	:	:	:
of which government transfers (million euro)		:	:	:	:	:	:	:	:	:	:	:
Foreign Direct Investment (FDI) in the reporting economy (million euro)		:	:	:	:	:	:	:	:	:	:	:

<b>Public finance</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
General government deficit/surplus, relative to GDP (%)		:	:	:	:	:	:	:	:	:	:
SI: General government debt, relative to GDP (%)		:	:	:	:	:	:	:	:	:	:

<b>Financial indicators</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Gross foreign debt of the whole economy, relative to GDP (%)		:	:	:	:	:	:	:	:	:	:
Gross foreign debt of the whole economy, relative to total exports (%)		:	:	:	:	:	:	:	:	:	:
Money supply: M1 (banknotes, coins, overnight deposits, million euro)		:	:	:	:	:	:	:	:	:	:
Money supply: M2 (M1 plus deposits with maturity up to two years, million euro)		:	:	:	:	:	:	:	:	:	:
Money supply: M3 (M2 plus marketable instruments, million euro)		:	:	:	:	:	:	:	:	:	:
Total credit by monetary financial institutions to residents (consolidated) (million euro)		:	:	:	:	:	:	:	:	:	:
Interest rates: day-to-day money rate, per annum (%)		:	:	:	:	:	:	:	:	:	:
Lending interest rate (one year), per annum (%)		:	:	:	:	:	:	:	:	:	:
Deposit interest rate (one year), per annum (%)		:	:	:	:	:	:	:	:	:	:
Euro exchange rates: average of period - 1 euro = ... national currency		:	:	:	:	:	1.000	1.000	1.000	1.000	1.000
Effective exchange rate index (2000=100)		:	:	:	:	:	:	:	:	:	:
Value of reserve assets (including gold) (million euro)		:	:	:	:	:	:	:	:	:	:

<b>External trade</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Trade balance: all goods, all partners (million euro)		:	:	:	:	:	:	:	:	:	:
Value of exports: all goods, all partners (million euro)		:	:	:	:	:	:	:	:	:	:
Value of imports: all goods, all partners (million euro)		:	:	:	:	:	:	:	:	:	:
Terms of trade (export price index / import price index, % change on previous year)		:	:	:	:	:	:	:	:	:	:
Share of exports to EU-27 countries in value of total exports (%)		:	:	:	:	:	:	:	:	:	:
Share of imports from EU-27 countries in value of total imports (%)		:	:	:	:	:	:	:	:	:	:

<b>Demography</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Natural growth rate: natural change (births minus deaths) (per 1000 inhabitants)	1)	5.9	6.4	5.6	6.1	5.5	4.8	4.3	3.4	2.4	1.9
Net migration rate: immigrants minus emigrants (per 1000 inhabitants)		:	:	:	:	:	:	:	:	:	:
Infant mortality rate: deaths of children under one year of age per 1000 live births	1)	14.8	13.9	13.4	11.1	14.6	10.8	11.0	7.8	9.5	11.0
Life expectancy at birth: male (years)	1)	70.8	70.6	70.7	71.1	71.4	70.9	70.4	71.0	70.4	70.6
Life expectancy at birth: female (years)	1)	76.2	76.5	76.1	76.3	76.5	75.7	74.9	75.3	74.9	74.8

<b>Labour market</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Economic activity rate (15-64): share of population aged 15-64 that is economically active (%)	5)	56.0	58.9	58.5	60.4	57.1	59.1	58.9	51.7	49.9	:
SI: Employment rate (15-64): share of population aged 15-64 that is in employment (%)	5)	38.2	38.8	39.2	38.5	37.1	37.7	36.2	37.4	34.8	:
Share of male population aged 15-64 that is in employment (%)	5)	47.4	48.8	47.3	46.2	45.6	46.6	44.5	46.5	42.4	:
Share of female population aged 15-64 that is in employment (%)	5)	29.3	29.1	31.4	30.6	29.0	29.0	28.1	28.8	27.6	:
SI: Employment rate of older workers (55-64): share of population aged 55-64 that is in employment (%)		:	:	:	:	:	:	:	:	:	:

Employment by main sectors (%)												
Agriculture	6)	2.2	2.5	2.6	3.4	3.1	3.0	1.8	10.9	8.6	:	
Industry	6)	24.4	24.4	22.5	22.4	25.8	26.0	25.7	16.5	16.3	:	
Construction	6)	4.1	3.2	3.0	3.5	2.1	2.1	2.0	3.4	2.9	:	
Services	6)	69.4	69.8	71.8	70.8	69.1	68.8	70.6	69.2	72.1	:	
SI: Unemployment rate: share of labour force that is unemployed (%)		21.8	18.5	19.3	19.3	21.2	20.7	22.7	27.7	30.3	:	
Share of male labour force that is unemployed (%)		:	:	:	:	:	:	:	:	:	:	
Share of female labour force that is unemployed (%)		:	:	:	:	:	:	:	:	:	:	
Unemployment rate of persons <25 years: share of labour force aged <25 that is unemployed (%)		:	:	:	:	:	:	:	:	:	:	
SI: Long-term unemployment rate: share of labour force that is long-term unemployed (%)		:	:	:	:	:	:	:	:	:	:	

<b>Social cohesion</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Average nominal monthly wages and salaries (national currency)	7)	136.0	104.6	164.4	96.6	107.8	149.1	173.9	195.3	213.1	246.0
Index of real wages and salaries: index of nominal wages and salaries divided by CPI (2000=100)		103.5	109.7	103.1	100.0	106.0	108.5	109.9	120.6	128.7	144.1
SI: Early school-leavers: share of population aged 18-24 having not completed upper secondary education and not currently in education or training (%)		:	:	:	:	:	:	:	:	:	:

<b>Standard of living</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Number of passenger cars per 1000 population		:	:	173.5	173.8	150.9	161.4	171.9	176.1	190.9	:
Number of subscriptions to cellular mobile telephone services per 1000 population		:	:	:	:	599.4	750.0	674.7	779.0	871.9	:

<b>Infrastructure</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Density of railway network (lines in operation, per 1000 km <sup>2</sup> )		18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	18.1	:
Length of motorways (thousand km)		-	-	-	-	-	-	-	-	-	-

<b>Innovation and research</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SI: Spending on human resources (public expenditure on education) relative to GDP (%)		:	:	:	:	:	:	:	:	:	:
SI: Gross domestic expenditure on research & development, relative to GDP (%)		:	:	:	:	:	:	:	:	:	:
SI: Percentage of households who have Internet access at home (%)		:	:	:	:	:	:	:	:	:	:

<b>Environment</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
SI: Total greenhouse gases emissions, CO2 equivalent (tons, 1990=100)		:	:	:	:	:	:	:	:	:	:
SI: Energy intensity of the economy (kg of oil equivalent per 1000 euro GDP)		:	:	:	:	:	:	:	:	:	:
SI: Share of renewable energy in electricity consumption (%)		:	:	:	:	:	:	:	:	:	:
SI: Road freight transport as a share of total inland freight transport (modal split) (%)		:	:	:	:	:	:	:	:	:	:

<b>Energy</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Primary production of all energy products (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Primary production of crude oil (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Primary production of hard coal and lignite (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Primary production of natural gas (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Net imports of all energy products (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Gross inland energy consumption (thousand TOE)		:	:	:	:	:	:	:	:	:	:
Electricity generation (thousand GWh)		:	:	:	:	:	:	:	:	:	:

<b>Agriculture</b>	Note	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Agricultural production volume index of goods and services (producer prices, previous year=100)		109.0	99.0	106.0	95.0	107.0	106.0	101.0	104.0	:	:
Total utilised agricultural area (thousand hectare)	8)	520p	519p	518p	518p	518p	518p	518p	518p	517p	:
Livestock: cattle (thousand heads, end of period)	9)	176e	178e	180e	179e	178e	183e	175e	169e	:	:
Livestock: pigs (thousand heads, end of period)	9)	24e	23e	22e	19e	21e	22e	24e	27e	:	:
Livestock: sheep and goats (thousand heads, end of period)	9)	392e	333e	306e	293e	244e	240e	252e	254e	:	:
Production and utilisation of milk on the farm (total whole milk, thousand tonnes)	10)	163e	177e	195e	197e	194e	198e	203e	209e	:	:
Crop production: cereals (including rice) (thousand tonnes, harvested production)	11)	7p	5p	5p	3p	4p	5p	4p	3p	3p	:
Crop production: sugar beet (thousand tonnes, harvested production)		:	:	:	:	:	:	:	:	:	:
Crop production: vegetables (thousand tonnes, harvested production)		:	:	:	:	:	:	:	:	:	:

SI: Structural Indicator

e: estimate

f: forecast

p: provisional

1. Source: Eurostat.
2. Total land includes: agricultural area, forests and non-agricultural land.
3. Data are given in DEM.
4. Without Financial Intermediation Services Indirectly Measured (FISIM).
5. Age group refers to '15+'.
6. From 2004 a new methodology is used, which is harmonised with the EU requirements.
7. In the period 1997-1999, the national currency was Yugoslav Dinar. According to the Central Bank of Montenegro, the official exchange rate in 1997 was 1 DEM = 3.30 DIN; in the period 1998-1999 it was 1 DEM = 6.00 DIN; in 2000, the national currency was German Mark. According to the Central Bank of Montenegro, the official exchange rate in 2000 was 1 EUR = 1.95583 DEM.
8. Agricultural area includes arable land, as well as area under pastures, fishponds and ponds.
9. Number of livestock in 1000 cattle including enterprises, cooperatives and households.
10. Calculated net quantity in 1000 tonnes; includes enterprises, cooperatives and households.
11. Includes households, enterprises and cooperatives.