

Screening Report

Montenegro

Chapter 17 – Economic and Monetary Policy

Date of screening meetings:

Explanatory meeting: 10-11 January 2013

Bilateral meeting: 25-26 February 2013

I. CHAPTER CONTENT

The *acquis* in the area of economic and monetary policy is governed by Title VIII (Art. 119 to 144) of the Treaty on Functioning of the European Union (TFEU), and by relevant implementing legislation. Treaty provisions related to the adoption of the euro do not apply to Member States with a temporary derogation as defined in Article 139 of the TFEU.

The *acquis* in the area of economic and monetary policy contains specific rules requiring the independence of central banks in Member States, prohibiting direct financing of the public sector by the central banks and prohibiting privileged access of the public sector to financial institutions. Member States shall regard their economic policies as a matter of common concern and are subject to fiscal and broader economic and financial surveillance. New Member States also need to comply with the criteria laid down in the Treaty in order to be able to adopt the euro in due course after accession. Until then, they will be a Member State with a derogation from the use of the euro and shall treat their exchange-rate policies as a matter of common interest.

The *acquis* consists mainly of Treaty provisions and protocols as well as regulations and decisions that do not require transposition into national legislation. Nonetheless, as indicated in Article 131 of the TFEU, each Member State shall ensure that its national legislation, including the statutes of its central bank, is compatible with the TFEU and the Statute of the European System of Central Banks (ESCB). Regulations under this chapter require Member States to identify potential risks, prevent or correct any excessive fiscal deficits and harmful macroeconomic imbalances and correct the imbalances that are already in place. Directive 2011/85 lays down the requirements for the budgetary frameworks.

II. COUNTRY ALIGNMENT AND IMPLEMENTATION CAPACITY

This part summarises the information provided by Montenegro on its legislation and administrative capacity as well as the discussion at the screening meetings held on 10 and 11 January and 25 and 26 February 2013, as well as additional information provided thereafter.

Montenegro indicates that it can accept the *acquis* regarding Chapter 17, Economic and monetary policy. It indicates that it does not expect any difficulties to implement the *acquis* by the time of accession.

Montenegro confirmed that its present use of the euro is distinctly different from membership in the Economic and Monetary Union (EMU). Montenegro wants to keep the euro as sole legal tender but does not request to join the euro area on the day of the accession. Montenegro agreed that its use of the euro will be addressed during the accession negotiations. In this context, Montenegro indicated that it will strive to achieve the convergence criteria for joining the euro area.

II.a. Monetary policy

(i) Functional independence

Pursuant to Article 4 of the Central Bank of Montenegro Act (CBM Act), the main objective of the Central Bank of Montenegro (CBM) is to foster and maintain the stability of the financial system. The CBM shall contribute to achieving and maintaining price stability. The Montenegrin authorities explained that, given the country's use of the euro as a sole legal tender, the CBM lacks certain instruments to influence price stability. They acknowledged that their legislation is not in line with the *acquis*.

(ii) Institutional independence

The CBM Act establishes the independence of CBM in pursuing its objectives and exercising its functions as defined by law. It also explicitly prohibits the giving of instructions to, or receiving of instructions by, the CBM or members of its decision-making board.

The main tasks and duties of the CBM are defined by Article 14 of the CBM Act as follows: oversight and maintenance of the stability of the financial system; definition and use of monetary policy instruments; managing the international reserves; prudential supervision of the banking sector and managing the operation of payment systems. According to Montenegro, the CBM Law is in line with Article 130 TFEU and Article 127 paragraphs (2) and (4) on institutional independence. However, Montenegro stated that the legislation is not in line with Article 219 of the TFEU on foreign exchange as, according to Article 11 of the Law on foreign current and capital operations, the CBM may introduce protective measures only with the consent of the Montenegrin government.

Montenegro stated that the relevant amendments to the legal framework, ensuring alignment with the *acquis*, will be completed by the end of 2016.

(iii) Personal independence

According to Montenegro, Article 49 of the CBM Act complies with the general requirement under Article 14.2 of the ESCB/ECB Statute as regards the minimum five year period for the term of office of a Governor and the members of the Central Bank Council. However, the Montenegrin authorities acknowledged that there is only partial alignment of the legislation concerning grounds of dismissal of the Governor, the Deputy Governor, and members of the Council, as well as judicial protection in case of their being relieved of duty.

The CBM Act foresees safeguards against conflicts of interest including provisions on the eligibility for Central Bank Council's members, on incompatibility of functions and on prevention of conflicts of interest.

Montenegro stated that the relevant amendments to the legal framework, ensuring alignment with the *acquis* on personal independence, will be completed by the end of 2016.

(iv) Financial independence

The CBM generates its own income and can independently plan and allocate resources in accordance with its financial plan which it decides independently pursuant to Article 71 of the CBM Act. It determines profits and losses for each financial year in compliance with international financial reporting standards and may allocate the distributable profit as described in Article 69 of the CBM Act.

Pursuant to Article 6 of the CBM Act, the CBM is able to autonomously acquire, manage, use and dispose of the state property required for the exercising of its functions. However, the Parliament of Montenegro has the right to decide on the disposal of CBM property of a value exceeding EUR 150 million. Montenegro acknowledged that this provision is not in line with the *acquis* and stated that it plans to remove it in the course of the accession negotiations.

The initial capital of the CBM is established by the CBM law at EUR 50 million. Capital increases need to be authorised by the Parliament.

According to Montenegro, the audit of financial statements of the CBM is performed by an internationally recognised independent external auditor in accordance with the international standards on auditing. There is also an independent internal audit committee. Pursuant to the Law on the State Audit Institution, the CBM is also audited by a state audit institution. Montenegro stated that it envisages an amendment of the legislation in order to limit the scope of the state audit before the end of 2016.

(v) Prohibition of the monetary financing of the public sector

Article 43 of the CBM Act prohibits the monetary financing of the public sector. According to Article 41 of the CBM Act, the CBM is a depository and banker of state bodies and organisations. Article 17 of the CBM Act and the CBM Decision on granting last-resort financial assistance allow the CBM to extend liquidity loans to banks in exceptional circumstances.

Montenegro stated that its legislation in this area is fully compliant with Article 123 of the TFEU.

(vi) Prohibition of privileged access of the public sector to financial institutions

As regards the prohibition of privileged access of the public sector to financial institutions, Montenegro explained that the minimum reserve requirements allow banks to invest up to 35% of their minimum reserves in treasury bills issued by the government of Montenegro. Montenegro acknowledged that this provision is not compatible with the prohibition of privileged access of public authorities to financial institutions and stated that it envisages a phasing out of this instrument by the end of 2016.

Montenegro informed that the investment rules established for insurance companies and voluntary pension funds contain provisions that cause different treatment for Montenegrin securities compared to securities of the Member States of the European Union by imposing different rating requirements. Similar provisions are contained in the investment rules for

credit guarantee funds and for the deposit protection fund. Montenegro indicated that it intends to bring these provisions in line with EU legislation by the date of accession.

(vii) Integration of the central bank into the ESCB

As regards the integration of the central bank into the ESCB, Montenegro informed that it intends to put in place the necessary provisions in the CBM Act allowing the integration of the CBM into the ESCB by the end of 2016.

(viii) Standards for use of currency

Montenegro informed the Commission that it has introduced a legal framework for authenticity and fitness checking of banknotes and coins and for handling suspect notes and coins based on the EU *acquis* in the field, in particular through article 25 of the CBM Law and two decisions of the CBM. Montenegro stated that it cooperates with the OLAF, ECB, and some national Central Banks of EU Member States in the field of cash management and protection of the euro against counterfeiting.

II.b Economic policy

Montenegro stated that the objective of its economic policy is to achieve real convergence with the EU. Montenegro started participating in the pre-accession fiscal surveillance in 2005, as a potential candidate country. Since then it has submitted six Economic and Fiscal Programmes and three Pre-accession Economic Programmes. Montenegro indicated that it has not submitted any fiscal notifications so far, but committed to making further efforts to submit fiscal notification as soon as possible.

The fiscal policy of Montenegro is based on three fiscal programming documents prepared each year: the guidelines for macroeconomic and fiscal policy, the annual budget, and the Pre-accession Economic Programme. The first two have their legal basis in the Budget Law. The third is an obligation arising from the accession process to the EU. There is a mid-term macroeconomic and fiscal framework, which is not binding but provides the background for annual budgetary process.

The guidelines adopted by the government contain macroeconomic and fiscal revenue projections for the current year and the following three years as well as the key economic policy orientations for the forthcoming period. The annual budget, based on the organic budget law, consists of two laws: the annual budget law (covering the central government and state funds) as well as the law on financing local governments. The annual budget law consists of two parts: the normative part prescribing allocated funds for the expenditure units and the explanatory part describing the use of funds and providing the macroeconomic and fiscal mid-term framework as the basis for expenditures planning. According to Montenegro, the Pre-accession Economic Programme has not been formally integrated in the Budget Law (or any other legal act) and is submitted by the Ministry of Finance after obtaining government approval.

The financing of the budget deficit is defined in the annual budget law. The government debt management is based on a three-year debt management strategy covering the central

government level, which is prepared in consultation with the Central Bank. The local government can subscribe debt or issue guarantees only with the prior approval of the Ministry of Finance.

Current Montenegrin legislation does not include numerical fiscal rules and binding multi-annual budgetary framework. However, the government submitted to the parliament a draft Law on Budget and Fiscal Responsibility in January 2014 foreseeing the introduction of a numerical fiscal rule and a binding mid-term budgetary framework, to be implemented in 2015 together with the new annual budget law. The aim is to strengthen the governance of public finances as well as setting upper limits for public debt and budget deficits at 60% and 3% of GDP, respectively.

Montenegro stated that its macroeconomic statistics are not in line with European System of Accounts (ESA) 95. Montenegro intends to align its statistics with the ESA 95 or its successor (ESA 2010) by 2021. (*see also chapter 18 Statistics*).

II.c The use of the euro as a legal tender

In the 1990s, Montenegro experienced hyperinflation, leading to fiscal problems and the destabilisation of the financial sector. As a response to those problems, the country introduced the German Mark as sole legal tender in November 2000. According to Montenegro, this monetary regime, followed by the replacement of the German Mark with the Euro, helped contain inflation and stabilise the banking sector. It eliminated the exchange rate risk, reduced transaction costs and led to an increase in foreign trade. Consequently, FDI and GDP growth increased. Montenegro stated its preference for the continued use of the euro as a legal tender and outlined a number of risks of leaving the euro, such as increasing inflationary expectations, risks to financial stability, the deterioration of fiscal imbalances, an increase in the grey economy, decrease in FDI, and ultimately, economic recession.

Montenegro stated its wish to keep the euro as sole legal tender but does not expect to join the euro area on the day of the accession.

III. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTATION CAPACITY

The legislation of Montenegro is partially aligned with the *acquis* on economic and monetary policy. Montenegro possesses the basic legal and institutional framework in the field of economic and monetary policy. Its legislation on monetary policy and the functioning of the central bank needs to be further aligned with the *acquis* in order to ensure the institutional independence of the Central Bank as well as the prohibition of monetary financing and the prohibition of privileged access of the public sector to financial institutions. In the field of economic policy, the budgetary framework is not yet in line with the *acquis*. Montenegro will need to develop further its administrative capacity in order to participate in the fiscal and the broader economic and financial surveillance in the EU.

A Treaty-based procedure for full participation in the EMU in case where a country already uses the euro as a legal tender does not exist. The implications of this specific situation for assessing Montenegro's convergence of the economy with the EU will be considered in due course during

the accession negotiations. Montenegro should pursue real convergence with the EU and strive to fulfil in a sustainable manner the nominal criteria for the adoption of the euro as defined in the TFEU.

III.a Monetary policy

(i) *Functional independence* requires the primary objective of the National Central Bank (NCB) to be stated in a clear and legally certain way and to be fully in line with the primary objective of price stability set out in Articles 127(1) and 282(2) of the TFEU. The NCB needs to be equipped with the necessary means to independently pursue this objective. The law regulating the NCB should provide for a precise definition of its mandate in line with the primary objective of price stability.

Article 4 of the CBM Act stipulates that the main objective of the CBM shall be to foster and maintain the stability of the financial system, including a sound banking system and safe and efficient payment systems. Additionally, the Act states that the CBM shall contribute to achieving and maintaining the stability of prices. This is not in line with Article 127 of the TFEU which stipulates that price stability shall be the prevailing objective. The CBM does not hold the full set of monetary policy instruments required for the steering of money supply and may therefore not have all appropriate instruments to influence price stability. The CBM Act will therefore need to be amended in order to establish price stability as the primary objective in a clear and legally certain way as it is foreseen in Articles 127 (1) and 282 (2) of the Treaty and Article 2 of the Statute of the ECB. Equally, Article 143 of the Constitution of Montenegro has to be brought in line with these provisions and has to establish that price stability is the prevailing objective of CBM.

In addition, in order to ensure the functional independence of the CBM, the CBM Act should also clearly and in a legally sound way state the objectives, other than the main objective, and define precisely the tasks and functions of the CBM, in line with article 2 of the ESCB/ECB Statute.

The secondary objective of the CBM, which needs to apply from the date of accession, is the support of the European Union economic policies.

(ii) *Institutional independence*, as defined by Article 130 of the TFEU, involves a prohibition on NCBs seeking, or taking instructions from public authorities and a prohibition on the latter from seeking to influence the members of the NCB's decision-making bodies, whose decisions may affect the fulfilment of the NCB's ESCB related tasks.

Article 7 of the CBM Act provides that the CBM shall be independent in pursuing its objectives and exercising functions under the CBM Act. This article also contains a general prohibition of third parties giving instructions to the decision making bodies of the CBM. It also prohibits the CBM, the members of its bodies, and its employees to receive or seek any instruction from the government, other bodies, and organisations or any other entities.

Although these general rules of the CBM Act are in accordance with the Treaty, there are other provisions in the Montenegrin legislation incompatible with the prohibition of giving instructions, which need to be brought in line with the *acquis*:

- Pursuant to Article 11 of the Law on foreign current and capital operations, the CBM may introduce protective measures only with the consent of the Montenegrin government. This provision needs to be amended to allow the CBM to introduce protective measures without the involvement of the government.

- Article 6 of the CBM Act allows the CBM the autonomous acquisition, management, use and disposal of the state property required for the exercising of its functions under the CBM Act, but gives the Parliament of Montenegro the right to decide on the disposal of property of a value exceeding EUR 150 million. This article will need to be amended to allow the CBM to dispose of its property independently.

- Pursuant to Article 62 of the CBM Act, other persons than members of the Central Bank Council may attend the Central Bank Council meetings by invitation, without the right to vote. This article will need to be amended so as not to allow members of the government or any organisation mentioned in Article 7 of the CBM Act to attend Central Bank Council meetings, even without voting rights.

- The CBM Act does not include a prohibition for bodies, other than independent courts, to censor on legal grounds decisions related to the performance of the ESCB-related tasks of the CBM. Such prohibition should be included in the legislation.

- As regards central bank reserves, the CBM may, pursuant to Article 13 of the CBM Act, establish special reserves to be used for the coverage of specific operating expenses only after consultation with the government. In order to protect the independence of the CBM, any statutory obligation for an NCB to consult third parties *ex ante* will need to be eliminated by the date of accession.

- The CBM Act and the CBM Decision on granting last-resort financial assistance establish rules on a specific monetary policy instrument which allows the CBM to provide emergency liquidity assistance to banks, but do not precisely distinguish between this instrument and the possibility of the Montenegrin government to give financial assistance and act as a lender of last resort. The absence of a clear separation of competences may bring the CBM into a situation in which it might be under pressure to take over responsibilities of the government. This does not correspond to the prohibition of giving/taking instructions and is also not consistent with the prohibition of monetary financing (see III.a (iii)). Montenegro needs to introduce in its legislation a clear distinction between emergency liquidity assistance to banks, granted by the CBM and the function of the government to give financial assistance and act as a lender of last resort.

(iii) The requirement for *personal independence* aims at ensuring security of tenure for members of the NCB's decision-making bodies (e.g. minimum term of office, rules on grounds for dismissal, rights of judicial review). Members of the ESCB decision-making bodies may not hold an office or have an interest that may influence their activities, whether through holding office in the executive or legislative branches of the state or in regional or local administrations, or through involvement in a business organisation. They have to avoid any situation that could give rise to a conflict of interest.

Article 49 of the CBM Act complies with the general requirement under Article 14.2 of the ESCB/ECB Statute as regards the requirement of security of tenure for the term of office of a Governor and the members of the Central Bank Council, by providing a 6-year term of office.

Pursuant to Article 57 of the CBM Act, the term of office of a Central Bank Council member appointed to replace a Central Bank Council member who has been relieved of duty before the expiry of his term of office shall last until the expiry of the remaining term of the replaced member. This provision is not in line with Article 14.2 of the ESCB/ECB Statute. In order to protect the personal independence of the new member of the Central Bank Council, he/she should also be given the full period of six years for his/her term, unless the terms of the Central Bank Council members are phased in a way that they are deliberately appointed at different points in time in order to ensure continuity in the decision-making body.

Article 14.2 of the ESCB/ECB Statute stipulates that NCB Governors who have been dismissed from office may refer such a decision to the Court of Justice of the European Union. National legislation should either refer to the Statute or remain silent on the right to refer such a decision to the Court of Justice of the European Union (as Article 14.2 of the ESCB Statute is directly applicable). Accordingly, the CBM Act in Article 56 remains silent on this as it only refers to 'the competent court'. However, the deadline for the implementation of such proceedings has to be brought in line with Article 14.2 of the ECB/ESCB Statute by the date of accession.

The CBM Act provides for grounds for dismissal of other members of the central bank decision-making bodies. In cases where the national law has opted for the listing of specific grounds for dismissal, the Commission recommends, for reasons of legal certainty, either to make reference to Article 14.2 of the ECB/ESCB Statute or to at least mention 'serious misconduct' as the overarching ground for dismissal, as other listed grounds may only be a specification thereof.

(iv) *Financial independence* should be assessed from the perspective of whether any third party is able to exercise either direct or indirect influence not only over the NCB's tasks, but also over its ability to fulfil its mandate. Member States should notably not impair an NCB's ability to employ and retain the qualified staff necessary for the NCB to perform independently the tasks conferred on it by the Treaty and the Statute. Member States are under an obligation to step in when absolutely needed to financially support the NCB.

Pursuant to Article 6 of the CBM Act, the CBM autonomously acquires, manages, uses and disposes of the state property required for the exercising of its functions. However the Parliament of Montenegro has the right to decide on the disposal of such property exceeding a value of EUR 150 million, which is not in line with the *acquis*. This prerogative of the Parliament needs to be abolished by the date of accession.

Furthermore, the Law on state property regulates the requirements for and the manner of the use of certain state property legally owned by the state but at the CBM's disposal. In this context, the state authorities could instruct the CBM about the assets it holds. The CBM's financial independence would be undermined since it would no longer be entirely free to decide on the allocation of its resources and could be unable to secure sufficient means for the

performance of its tasks. Therefore, the Law should explicitly state that the CBM should be the legal owner of the necessary property.

As regards the reserves of the central banks, the CBM may, pursuant to Article 13 of the CBM Act, establish special reserves to be used for the coverage of specific operating expenses only after consultation with the government. In order to protect the financial and institutional independence of the CBM, any statutory obligation for an NCB to consult third parties *ex ante* needs to be avoided.

Pursuant to the Law on state audit, the CBM is audited by a state auditor. The audit should be performed on a non-political, independent and purely professional basis. The activities of the NCB's independent external auditors, as laid down in Article 27.1 of the Statute and Article 76 of the CBM Act, should not be prejudiced. The state audit should not cover the NCB's ESCB-related tasks. The audit should comply with the prohibition of giving instructions to NCBs and their decision-making bodies. For reasons of clarity, the Law on the State Audit Institution should be amended accordingly or relevant provisions could be added to the CBM Act.

(v) Article 123(1) of the Treaty provides for *the prohibition of monetary financing* as a tool in the area of economic policy. It prohibits overdraft facilities or any other type of credit facility with the ECB or the NCBs of Member States in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States, and the purchase directly from these public sector entities by the ECB or NCBs of debt instruments. The Treaty contains one exemption from the general prohibition under Article 123(2). It does not apply to publicly owned credit institutions which, in the context of the supply of reserves by central banks, must be given the same treatment as private credit institutions. Moreover, based on Article 21.2 of the ESCB/ECB Statute, the ECB and the NCBs may act as fiscal agents for the public sector bodies referred to above.

Article 43 of the CBM Act contains a provision prohibiting the monetary financing of the public sector, corresponding to Article 123 of the TFEU. Nevertheless, the range of public sector entities referred to in this paragraph needs to be extended to be completely consistent with Article 123 of the Treaty. Local and other public authorities, other bodies governed by public law and public undertakings in Montenegro as well as central, regional, local and other public authorities, other bodies governed by public law and public undertakings of the other Member States and Union institutions and bodies need to be covered as well.

Article 17 of the CBM Act allows the CBM to extend emergency liquidity loans to banks or financial institutions in exceptional circumstances. Further details are described in the CBM Decision on granting last-resort financial assistance. Article 123 of the Treaty does not prohibit NCBs granting 'emergency liquidity assistance' (ELA) to their counterparties. In order to comply with the prohibition of monetary financing of the public sector, ELA may only be allowed under the following conditions: the credit institution should be solvent; the loan should be short-term; it should cover urgent and unforeseen liquidity needs and be sufficiently secured by adequate collateral. A penalty rate should preferably be required. The instrument created by the above mentioned Montenegrin legal acts largely complies with these

requirements, but some divergences have to be removed. The possible recipients of ELA should be restricted to CBM's counterparties as set out in the CBM Decision on detailed conditions for granting liquidity loans to banks and thus include only banks/credit institutions and not financial institutions. The latter may nevertheless benefit from government's activities as a lender of last resort.

Both the CBM Act and the CBM Decision on granting last-resort financial assistance need to make a clear distinction between the CBM's monetary policy instrument ELA, as described above, and the possibility of the Montenegrin government to give financial assistance to banks and financial institutions in difficulties and thereby act as a lender of last resort. The CBM may not act as a lender of last resort and take over fiscal policy functions or responsibilities of the government as this would be in conflict with the prohibition of monetary financing and could also threaten the CBM's independence. Article 4 of the Decision on granting last-resort financial assistance should be amended to prohibit the CBM to assume debt or pay due liabilities of a bank or a financial institution, or settle a debt of a bank or a financial institution arising from a guarantee issued by the bank or the financial institution.

Pursuant to Article 15 of the CBM Decision on granting last-resort financial assistance, the CBM may act as a fiscal agent for the government when governmental financial assistance is being granted. This is in line with EU law and the monetary financing prohibition as is the CBM Act when describing the general fiscal agent function of the CBM in Articles 41 and 42. The CBM Act, however, should provide that the remuneration margin on deposits/current account balances of state bodies and organisations should be at or below market rates. A payment of interest above market rates as permitted under Article 41 of the CBM Act contravenes the prohibition of monetary financing.

(vi) Article 124 of the Treaty establishes the *prohibition of privileged access of public authorities to financial institutions*. Any specific incentives for or requirements imposed on the financial sector to acquire and hold liabilities of the public sector are prohibited. Council Regulation (EC) No 3604/93 of 13 December 1993 provides for the precise scope of application of the prohibition of privileged access and specifies definitions for its application.

Regarding compliance with Article 124 of the Treaty, the CBM Act does not contain provisions establishing privileged access by the public sector to financial institutions, which is in line with the *acquis*.

However, pursuant to Articles 8 and 17a of the CBM Decision on bank reserve requirement to be held with the CBM, a bank may allocate and hold up to 25 or 35% of its minimum reserves in treasury bills issued by Montenegro. Such a provision alienates the concept of minimum reserves and creates specific incentives for banks to acquire and hold liabilities of the public sector and therefore establishes privileged access for public authorities to the financial sector. This provision will, therefore, need to be removed.

(vii) With a view to the *integration of the central bank into the ESCB*, Montenegro needs to complement the CBM Act with the necessary provisions ensuring the integration of the CBM into the ESCB from the date of accession to the EMU. This includes provisions ensuring its

subordination to the guidelines and instructions of the ESCB and ECB as from the date of the formal adoption of the euro.

(viii) Concerning the *standards for use of currency*, Montenegro needs to put into place all necessary legislation and administrative capacities to carry out authenticity and fitness checking and re-circulation of euro banknotes in order to comply with ECB decision 2010/14. This is necessary to protect the integrity of euro banknotes and enable a proper detection of counterfeits. Euro banknotes in circulation must be maintained in good condition to ensure that they can be easily and reliably checked for genuineness, and therefore euro banknotes must be checked for fitness. Furthermore, suspect counterfeit euro banknotes must be quickly detected and handed over to the competent national authorities. (see also Chapter 32, Financial Control)

III.b Economic policy

In the field of economic policy, Montenegro will need to participate in the coordination of economic policies at the EU level. According to Article 121 of the TFEU, Member States shall regard their economic policies as a matter of common concern and shall coordinate them within the Council. Montenegro participates in the pre-accession fiscal surveillance since 2005 for which it contributes a mid-term oriented economic programme (i.e. PEP) every year. This contributes to developing the administrative capacity of the country for future participation in economic policy coordination, and fiscal as well as broader economic and financial surveillance. Montenegro's PEPs have served as a sound basis for discussion in the fiscal surveillance mechanisms. However, they still exhibit deficiencies due to weak analytical capacities in the Ministry of Finance. The development of the institutional capacity to co-ordinate between the various ministries, government agencies and the central bank is a particularly important aspect ensuring the success of the Pre-Accession Fiscal Surveillance Procedure. In terms of content, the most recent programme provides an analysis of external sustainability and competitiveness issues as well as of the main structural bottlenecks, as requested by the Commission.

In addition, candidate countries are invited to submit pre-accession fiscal notifications to the Commission. They serve as a preparation for the surveillance procedures in the Economic and Monetary Union. Montenegro has not presented fiscal notifications so far. In order to ensure that government data is of a sufficient standard during the pre-accession period to allow fiscal policy analysis, Montenegro needs to start submitting fiscal notifications as soon as possible.

As of the date of its accession to the EU, Montenegro will need to participate in the European Semester, which combines the obligations of the Stability and Growth Pact with the National Reform Programmes. As part of the preventive arm of the Pact, it will need to define a medium-term budgetary objective (MTO), set in structural terms which will reflect the need to ensure that deficit provides stabilisation over the cycle while staying within the 3% limit, and ensures the sustainability of the public finances over time. With its MTO defined, Montenegro will need to keep its structural balance at or above its MTO, or be on an appropriate adjustment path towards it. This adjustment path will have to be assessed by looking at both the evolution of the structural balance and the dynamics of expenditure net of discretionary revenue measures.

From the accession of Montenegro to the EU, the Commission and the ECB will present Convergence Reports on the country every second spring. According to Article 126, Member States shall avoid excessive government deficits. The respective reference values determined in Protocol 12 to the TFEU are 3% for the ratio of the government deficit to gross domestic product at market prices and 60% for the ratio of government debt to GDP, unless the debt is sufficiently diminishing and approaching the reference value at a satisfactory pace. If the country is in breach of either of these conditions, it may be placed under the Excessive Deficit Procedure (EDP) and given a deadline to correct its breach and intermediate targets to meet. The EDP also contains provisions for monetary sanctions – for non-euro area countries these are currently related to the suspension of contributions from the EU Cohesion Fund.

Montenegro will also need to participate in procedures under the Stability and Growth Pact, which concerns all Member States, and aims to identify potential risks, prevent or correct excessive fiscal deficits and harmful macroeconomic imbalances and correct the imbalances that are already in place. In this context, Montenegro will have to collect the necessary statistics in order to contribute to the scoreboard consisting of a set of 11 indicators covering the major sources of macroeconomic imbalances from the date of accession.

The economy of Montenegro presents significant imbalances which need to be addressed. The fiscal balance of general government was in balance or surplus before 2008, but has shown deficits of around 5% of GDP annually over the past five years. Over the same period, public debt as a ratio of GDP has increased gradually, reaching 57% at the end of 2013. External imbalances are considerable, with current account deficit at around 15% of GDP in 2013, and trade deficit of 42% of GDP 2013, although they have narrowed since 2008. The unemployment rate remains high at 19% in 2013 with a substantial structural component.

Montenegro will need to make significant administrative efforts to align its legislation with the *acquis* in the field of economic policy. The country will need to align its budget legislation and practices with the requirements set in Directive 2011/85/EU. In particular, the content of the multi-annual budgetary framework will have to be improved, and numerical fiscal rules introduced and monitored independently. Montenegro will also need to develop its capacities for macroeconomic and budgetary forecasting and for dissemination of main fiscal data, assumptions and documents. Significant efforts will be needed to improve the capacity for economic policy formulation as well as the coordination across sub-sectors as required by the Directive.

The statistics on economic and monetary policy are not compiled on the basis of the European System of Accounts ESA 95. Montenegro developed an action plan in order to introduce ESA 95, respectively ESA 2010, in the period until 2021. No official data exist on international investment position or on external private debt. Concerning government statistics, the reconciliation between the national budget balance and the balance used under the EU fiscal surveillance has proved to be challenging for Montenegro. Montenegro should achieve compliance with ESA 95, respectively ESA 2010 on the fiscal statistics significantly earlier than announced in order to be able to submit pre-accession fiscal notifications in due course.

III.c The use of the Euro as legal tender

As Montenegro uses the euro as sole legal tender, the exchange rate criterion established by the TFEU for assessing the nominal convergence of the economy with the euro area cannot be directly applied. However, Montenegro will need to achieve economic convergence with the EU and a high level of macroeconomic stability. The concrete modalities to be used for assessing the convergence of Montenegro's economy will be determined during the accession negotiations.