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MONTENEGRIN EMPLOYERS FEDERATION

*Report*

# **REGULATORY FRAMEWORK IN MONTENEGRO**

- The Enabling Environment for  
Sustainable Enterprises in Montenegro-



**Title:**

Report: Regulatory Framework in Montenegro – The Enabling Environment for Sustainable Enterprises in Montenegro

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## Purpose of the document

The basic purpose of this document, based upon MEF strategic documents: a report *The Enabling environment for sustainable enterprises* and *5 business killers (2013)*, as well as on thematic research through focus groups discussion carried out by MEF in 2014, is to establish, as soon as possible, a regulatory framework that would ensure stimulating business environment and the increase of economic activities in Montenegro and thereby creation of new jobs, steady and sustainable development of the country in the long run.

## Executive summary

This report is created as part of the project *The Enabling environment for sustainable enterprises in Montenegro* that is implemented by Montenegrin Employers Federation and International Labour Organisation.

Over the last ten years and especially since gaining independence in 2006 and adoption of new Constitution of Montenegro in 2007, the Government of Montenegro has made significant steps towards improving legal and business environment in the country. Unfortunately, global economic crisis, as in many other countries, worsened the economic situation and to a significant extent annulled positive effects of initiated reforms. Another important factor that determines the development of legal and business environment are reform and EU integration processes.

In December 2010, Montenegro became a candidate country for EU membership. With Montenegro, EU started to apply a new approach in negotiations which meant that negotiation chapters 23 – Judiciary and fundamental rights and 24 – Justice, freedom and security would remain open until the end of the negotiation process. So far, Montenegro opened and temporarily closed two chapters: 18 – Science and research and 26 – Education and Culture.<sup>1</sup>

Business community led by Montenegrin Employers Federation (MEF) expects from the state to establish a stable legal system and regulatory framework, to ensure a good analysis of expected impacts of new and changes of current laws prior to their adoption, to avoid legal diversion in practice, to considerably improve the regulatory impact assessment – RIA<sup>2</sup>, as well as to timely consult MEF when creating and amending laws and regulations that have direct or indirect

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<sup>1</sup> <http://www.skupstina.me/index.php/me/pristupanje-eu/crna-gora-i-eu>

<sup>2</sup> Regulatory impact assessment

impact on enterprises. The necessary changes related to improvement of regulatory framework and increase of legal security for doing business are the key condition for economic growth and new jobs creation whereby the priority should be given to actions aimed at:

- Stabilisation and predictability of regulatory framework, its codification, especially in some sectors so that the implementation of regulations is simplified;
- Consistent implementation of the Law on General Administrative Procedure, particularly in terms of communication among competent authorities, respect of deadlines, elimination of excessive procedures and documents;
- Creation of public policies that would make adjustments to (reduce) the amount and volume of public revenues (taxes, contributions, fees, excise duties, customs, procedural and administrative costs etc.) that represent a burden for business development;
- Making labour legislation more flexible and reducing labour costs;
- Creation of penalty policy and affirmation of the reciprocity principle – prescribe penalties that correspond to the type of violation and company's financial capacity;
- Improvement of judiciary authorities work and introduction of universal court practice;
- Ensuring active participation of real sector representatives in both creation of public policies that affect business environment and working teams for creation of legislative framework.

In the coming period, the state is expected to act strategically and proactively, especially in relation to a very demanding and massive work on harmonisation of legal framework to EU legal heritage in terms of both primary and secondary EU legislation in almost every segment of social life, including business and creation of favourable conditions for doing business. It primarily means that the state, in addition to creation and supervision of regulatory framework implementation, has to be completely committed to creation of conditions that would ease doing business (of both domestic and foreign employers) and ensure greater attractiveness of business environment. Only then can we discuss competitiveness, i.e. expected growth and Montenegrin economic development that is investment and export oriented.

According to the Ministry of Foreign Affairs and European Integration official reports, Montenegro will have to adopt about 1200 regulations and approximately 300 strategies in different segments of social life in the accession period 2014-2018.

## 1. INTRODUCTION

The fundamentals of legal environment and functioning of the entire state and thereby of all segments of one society, including business, is made of constitutional-legal framework, legislative framework established by the Parliament of Montenegro, along with by-laws adopted by the Government and relevant ministries that are necessary for execution of laws. Not less important is the regulatory framework consisted of autonomous acts adopted by local governments and other public authorities (agencies, funds, special organisations, public services etc.).

A new Constitution of Montenegro from 2007<sup>3</sup> touches on economic rights and economic regulation only to a certain extent. Namely, the second part of the Constitution of Montenegro - Human rights and freedoms, under point 4 - Economic, social and cultural rights and liberties, regulates only property, entrepreneurship, principles of economic regulation and property rights of foreign nationals, while the fourth part of the Constitution – Economic system, defines only economic area, equality and tax obligations.

Property rights are guaranteed by the Constitution, and no one shall be deprived or restricted in property rights, unless so required by the public interest, with rightful compensation. The Constitution also guarantees that natural wealth and goods in general use are owned by the state.

As for entrepreneurship, the Constitution guarantees that the freedom of entrepreneurship may be limited only if so necessary in order to protect the health of people, environment, natural resources, cultural heritage or security and defence of Montenegro. A foreign national may be the holder of property rights in accordance with the law.

In regards with economic system, the Constitution guarantees that economic system is based on free and open market, freedom of entrepreneurship and competition, independence of the economic entities and their responsibility for the obligations accepted in the legal undertakings, protection and equality of all forms of property.

In the areas of taxes, the Constitution guarantees that the state is financed from taxes, duties and other revenues and that everyone is obliged to pay taxes and other duties. Taxes and other duties shall be introduced exclusively by the law.<sup>4</sup> The above described constitutional legal framework is the basis of economic system and execution of economic rights.

Legislative framework of Montenegrin economic system is massive and complex, spreading through all spheres of economic and social life. In our legislative system (at present) there are around 289 laws directly or indirectly affecting or relating to creation of business environment (in the area of both economic and social activities).

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<sup>3</sup> *Official Gazette of Montenegro*, no. 01/2007 and 38/2013

<sup>4</sup> Art. 142 of the *Constitution of Montenegro*

Particularly important segment that determines the overall business performance is the instability of legal system. It is reflected in frequent changes of legislation that makes it highly difficult for economic entities to respond to legislative changes affecting different spheres of their business in timely and quality manner. Legislative changes, almost with no exception, have as a consequence the changes of by-laws in those areas, not only at the state but at the municipal level as well, since the latter are obliged to harmonise their own regulations with legislative changes.

Legislative activity of the Parliament of Montenegro is particularly visible in the period 2009-2013<sup>5</sup> when 586 laws were adopted, of which some are newly adopted laws and others the amendments (sometimes numerous) to the existing laws, or 117 laws on the average per year.

Legislative activity of the Parliament of Montenegro		
No.	Year	Number of adopted laws
1	2009	88
2	2010	152
3	2011	154
4	2012	79
5	2013	113
<b>TOTAL</b>	<b>2009/2013</b>	<b>586</b>

In addition, the analysis of legislation in 13 key areas that affect different business sectors suggests that legislative changes were very frequent over a relatively short period of time.

No.	Legislative area	No. of laws	Time frame	No. of legislative changes
1)	Offences	2	2011-2014	26
2)	Inspections	1	2003-2014	3
3)	Finances, accounting	12	2001-2013	72
		1	1992-2003	10
4)	Securities	1	2000-2013	8
5)	Work and labour relations	4	2003-2012	21
6)	Enterprises	1	2002-2011	7
		1	1992-2011	8

<sup>5</sup> The Parliament of Montenegro Work Report for 2009 (p.4, 102-107)

[http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/GIS-2009%20MNE%2020\\_09\\_2010%20gotovo.pdf](http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/GIS-2009%20MNE%2020_09_2010%20gotovo.pdf);  
The Parliament of Montenegro Work Report for 2010, [http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/IZVJE%C5%A0TAJ%20O%20RADU%20SKUP%C5%A0TINE%20CRNE%20GORE%20ZA%202010\\_%20GODINU.pdf](http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/IZVJE%C5%A0TAJ%20O%20RADU%20SKUP%C5%A0TINE%20CRNE%20GORE%20ZA%202010_%20GODINU.pdf);  
The Parliament of Montenegro Work Report for 2011, [http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/izvjestaj\\_o\\_radu\\_skupstine\\_Crne\\_Gore\\_za\\_2011godinu.pdf](http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/izvjestaj_o_radu_skupstine_Crne_Gore_za_2011godinu.pdf) (p. 6 and 20);  
The Parliament of Montenegro Work Report for 2012, [http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/izvjestaj\\_o\\_radu\\_u\\_2012.pdf](http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/izvjestaj_o_radu_u_2012.pdf); The Parliament of Montenegro Work Report for 2013, [http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/izvjestaj\\_o\\_radu\\_Skupstine\\_za\\_2013\\_godinu.pdf](http://www.skupstina.me/images/dokumenti/izvjestaji-o-radu/izvjestaj_o_radu_Skupstine_za_2013_godinu.pdf)

7)	Transport and communications	3 1	2004-2013 1978-2013	18 12
8)	Spatial planning and construction	1	2008-2013	9
9)	Agriculture and forestry	3 2	2006-2011 1992-2011	12 11
10)	Trade and consumers protection	3	2004-2014	14
11)	Health care and social security	2 2 1	2004-2011 1993-2013 2007-2013	12 19 7
12)	Pension and disability insurance	1	2003-2014	21
13)	Environmental protection	3	1996-2013	16
	<b>TOTAL</b>	<b>46</b>	<b>1992-2014</b>	<b>306</b>

The above overview of the regulatory framework reveals that the Montenegrin legal environment is very dynamic and subject to frequent changes; the analysis of only 46 laws in the above 13 areas implies that laws have been changed or amended 306 times over the relatively short period of 10 years i.e. from the first serious economic, legal and other social reforms initiated in 2000 until today. It means that within this time frame, with minor exceptions, each law analysed herein underwent 7 changes on the average.

Despite positive shifts, regulatory framework still creates difficulties for business operations which suggest an unfavourable business environment.<sup>6</sup> Furthermore, according to employers the core problem in Montenegro lays not only or exclusively in frequent creation of laws but also in their enforcement and selective application.

The reasons for such dynamic changes of laws, according to their proposers, are mostly found in the need for harmonisation with EU *acquis* and the fact that such changes contribute to conducive business environment. However, the initial years of their implementation already reveal their weaknesses, vagueness and inconsistencies of provisions, as well as situations where one legal situation is differently interpreted by different competent authorities resulting in differing subsequent actions. It is clearly visible in the analysis of laws that we carried out, according to which laws in the areas of offences are changed 3 times a year<sup>7</sup>, while the law regulating the violation fines has been changed as much as 23 times over the last 4 years.<sup>8</sup> Another blatant example of this sort is the taxation legislation whereby the Law on Excise Duty<sup>9</sup>, the Law on Corporate Income Tax<sup>10</sup>, the Law on VAT<sup>11</sup>, the Law on Personal Income

<sup>6</sup> The prevalence of such attitude by the companies is confirmed by the data from an earlier survey when 97 per cent of companies thought that regulatory framework did not encourage business growth. The same views were shared by focus group participants at the meeting held on 31<sup>st</sup> of July 2014.

<sup>7</sup> The Law on Criminal Liability of Legal Entities, *Official Gazette of Montenegro* no. 1/11, 6/11, 39/11,

<sup>8</sup> The Law on Amendments to the Law on Penalties for Criminal Offences (40/11; 14/12; 30/12; 44/12; 45/12; 27/13; 27/13; 29/13; 35/13; 36/13; 38/13; 39/13; 40/13; 43/13; 56/13; 62/13; 1/14; 5/14; 18/14; 18/14;

<sup>9</sup> The Law on Excise Duty (65/01; 12/02; 76/05; and *Official Gazette of Montenegro*, no. 76/08; 50/09; 78/10; 40/11; 61/11; 28/12; 38/13)



Tax<sup>12</sup> underwent 10, 8, 11 and 12 changes respectively from 2001 to 2013, the Law on Administrative fees<sup>13</sup> was changed 11 times from 2003 to 2013, the Law on Contributions for Mandatory Social Security Insurance<sup>14</sup> underwent 7 changes from 2007 to 2013 while the Law on Pension and Disability Insurance<sup>15</sup> underwent as many as 21 change from 2003 to 2014 etc.

Such data on frequent legislative changes prove that the process of legislation adoption or amending has not been approached in systemic, analytic and comprehensive manner, and often without paying due attention to interrelations between numerous regulations and their impact on the overall social, economic and societal milieu of Montenegro. The impression is that ministries, as legislation proposers, often lack a complete 'picture' of our legal system when creating laws. As a consequence we have numerous collisions of norms and competences of state authorities and institutions, resulting in many laws being partially or utterly non-applicable. Such actions are not easily justified especially having in mind that all ministries submit opinions on legislation drafts other ministries are competent for, in terms of their compatibility i.e. compliance of that legislation act with other regulations, prior to their consideration and adoption by the Government.

Very often, legislation changes lead to increase instead of reduction of costs arising from the application of certain law, in terms of additional burden either to economic entities or citizens. Rarely do regulations eliminate some levies or administrative procedures with an aim to ease doing business and when it does happen, a new levy or administrative procedure is introduced by some other law (from the same or different sector) which essentially only replaces the past one.

All listed above, logically, leads to a great legal insecurity, due to impossibility to predict regulatory framework and thereby the business environment, as agreed by focus group participants at the meeting held on July 31<sup>st</sup> 2014.

The responsibility for such legal system functioning is not certainly born only by the Government of Montenegro as the proposer of laws, but also substantially by the Parliament of Montenegro, as legislative body. The situation is further sustained by the inertness of employers, citizens and other segments of society in the phase of public debate over certain

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<sup>10</sup> The Law on Corporate Income Tax (65/01; 12/02; 80/04; and *Official Gazette of Montenegro*, no. 40/08; 86/09; 40/11; 14/12; 61/13)

<sup>11</sup> The Law on Value Added Tax (65/01; 12/02; 38/02; 72/02; 21/03; 76/05; 4/06; and *Official Gazette of Montenegro*, no. 16/07; 73/10; 40/11; 29/13)

<sup>12</sup> The Law on Personal Income Tax (65/01; 12/02; 37/04; 29/05; 78/06; 4/07; and *Official Gazette of Montenegro*, no. 86/09; 73/10; 40/11; 14/12; 6/13; 62/13)

<sup>13</sup> The Law on Administrative Fees (55/03; 46/04; 81/05; 2/06; and *Official Gazette of Montenegro*, no. 22/08; 77/08; 3/09; 40/10; 20/11; 26/11; 56/13)

<sup>14</sup> The Law on Contributions for Mandatory Social Security Insurance (13/07; 79/08; 86/09; 78/10; 40/11; 14/12; 62/13)

<sup>15</sup> The Law on Pension and Disability Insurance (54/03; 39/04; 61/04; 79/04; 81/04; 29/05; 14/07; 47/07; *Official Gazette of Montenegro*, no. 12/07; 13/07; 79/08; 14/10; 73/10; 78/10; 34/11; 40/11; 66/12; 36/13; 38/13; 61/13; 6/14)

legislative acts. Unfortunately, the awareness about the need for more active involvement in the process of legislation adoption arises only upon facing a concrete problem in the course of doing business or exercising personal rights. Until that happens, the prevailing attitude is that “the decisions are already made” leaving no room for individuals to influence the change of the legal system.

To illustrate the above, we will describe a recent case of novelties brought in by the Proposal of the Law on Amendments to the Law on State and Other Holidays and the Proposal of the Law on Amendments to the Law on VAT.

Namely, formerly the group of Parliament members submitted the Proposal of the Law on Amendments to the Law on State and Other Holidays in terms of introducing a novelty of holiday work permission to be issued by the Ministry of Economy, all in accordance with previously set criteria and rules prescribed by that particular Ministry. The initiator of these changes actually wanted to prevent a frequent situation of having the majority of workers work on state and public holidays and thus provide a better protection of their rights. By pointing to the fact that misuses in regards to employees’ work engagement on state holidays can be sanctioned on the basis of labour regulations by labour inspection actions as well as by making the penalty policy additionally strict, MEF made timely implications that such hasty decisions would create problems manifested not only as business barriers that would jeopardise the freedom of entrepreneurship (thus resulting in negative effects and enormous damages to various business sectors i.e. jobs that require round-the-clock work) but also as infringement of existing competences of local authorities regulated by other laws (*lex specialis*), thus leading to collision with other similar regulations. Overall, MEF estimations, supported by the above arguments, were that those regulation changes would be non-applicable. Unfortunately, there was no willingness for accepting these suggestions. The Amendments to the Law was put into effect more than a year ago, but the by-law that would enable the Ministry of Economy to issue holiday work permission has not still been adopted nor could it have been having in mind the collisions mentioned above. The provisions thus remained a dead letter and the legislator failed to accomplish their objective.

Another example of regulatory diversion in practice is the following: the Parliament’s decision to adopt the amendments submitted by the Parliamentary members as integral part of the Proposal of the Law on Amendments to the Law on VAT (defined by the Government) led to deletion of the Article 3 of the Law on Amendments to the Law on VAT (*Official Gazette of Montenegro*, 29/13) related to VAT exemption for the services of games of chance and entertainment games organization. Beside the fact that the VAT on the games of chance and entertainment games is not in line with EU *acquis*, such tax has not been introduced in any other country thus depriving us of the possibility of using comparative experience in regards with its implementation. At the same time, the organisers of the games of chance are not technically able (due to a nature of business) to transfer the VAT to the costumer, which makes the process of determining the tax basis additionally obscure. Consequently, the existing by-laws for the implementation of the Law on VAT are impossible to adjust to the part of VAT system that relates to games of chance services.

One of the major problems identified are complex administrative procedures that require simplification. Montenegro has been intensely working on the solution to this problem since 2011. The Strategy for Public Administration Reform 2011-2016 (AURUM) set a series of measures in this direction, some of which are related to adoption of a new Law on Administrative Procedure, with an aim to simplify administrative procedures, to shorten decision making deadlines, to ensure more efficient and effective administration work and to eliminate burdensome parallel procedures imposed by sector-specific laws. The expert report for the purposes of OECD-SIGMA that the author of this Report is bringing to an end at the moment, suggests that over 360 sector-specific laws, that to a major, middle or lesser extent are inconsistent with the Law on General Administrative Procedure will have to be harmonised with the new Law on General Administrative Procedure once it is adopted.

## **2. BRIEF HISTORICAL OVERVIEW OF THE PROBLEM**

As it is already mentioned, the problem begins with initiated socio-political, economic, legal and other reforms across all segments of Montenegrin society that came as part of the EU accession process, but also as a response to effects of the global economic crisis.

Montenegrin Employers Federation (MEF) carried out an extensive survey during 2013, using a methodology of International Labour Organisation (ILO) on “enabling environment for sustainable enterprises in Montenegro” assessing the 17 pillars (conditions) necessary for improving the sustainability of enterprises. The findings of the survey are published in two publications: “5 Business Killers” and “*The Enabling Environment for Sustainable Enterprises in Montenegro*”. The key outcome of primary and secondary research as well as numerous focus groups meetings that gathered representatives of the most important enterprises from all economic sectors is a unified and unanimous opinion on 5 greatest business barriers Montenegrin enterprises face in their daily business operations. Along with identification and detailed overview of constraints, the reports offered recommendations for overcoming those obstacles.

Among the most significant obstacles for growth and sustainable development of enterprises (in both documents listed above) is inadequate regulatory framework identified as the first of five “business killers”, with 15 concrete recommendations for its improvement.

Apart from weaknesses of the regulatory framework in terms of the number of legislative acts and the frequency of changes they undergo, as well as the common practice of regulating one issue by many different laws (codification is necessary) that were presented so far, another significant problem is the content of legislative acts that very often fail to meet the needs of social and business environment, but instead are focused on addressing the issue of budget deficit and Montenegro’s debt with international financial institutions by shifting the burden to businesses and tax payers.

The most typical (among many others) example that justifies such statement may be the adoption of the Law on Prevention of Illegal Business. The purpose of this law should have been the extension of tax coverage to all legal entities and individuals that are engaged in some sort of unregistered economic activity making undeclared profit, as well as to prevent mediation, i.e. advertising of unregistered business.

However, only a few articles of the Law deal with the issue of business that is not registered according to regulations. Instead, the Law mostly contains provisions directed towards solving the problem of “legal voids” in other legislative acts, which makes it an “omnibus” law that almost entirely addresses registered tax payers (legal entities and entrepreneurs). It is the reason why the issues that should have been primarily solved with this law, such as authorising and giving jurisdiction to inspections to enter into unregistered object and to exert control in cases of indication that there is a trade of goods and services or any other activities taking place in the object, remained undefined, and the problems arising from informal economic activities continued to the same or greater extent. Rather than preventing unregistered economic activities, creating better business climate and extending the tax coverage by ensuring equal treatment of all entities that make profit out of the activities they undertake, the effects of this Law are more frequent controls and more rigorous penalties for registered business entities exclusively. In addition, the type of offense is in no correlation with the amount of penalty (which is the issue with each law that contains penalty provisions), which leaves room for selective, biased, and corruptive behaviour of individuals and bodies within inspection and penalty authorities.

Such actions by legislative and executive authorities that lack systemic approach in elimination of informal economy and its real causes (high and numerous fiscal burdens and administrative procedures, inefficiency and inconsistency of administration), does not encourage tax discipline and voluntary performance of legal obligations but rather discourage regular payers of taxes and other duties.

In general, regulatory framework provides the opportunity for local administrations to determine the amount of some taxes, surtaxes, fees and duties, autonomously, while in order to determine the amount of some levies, local administrations have a legally binding obligation to obtain a prior consent from the Government. However, the practice has shown that local governments do not take into account the existing economic situation in their municipalities when making decisions. There is no evidence of having the decisions that would make an impact to business environment considered by local social councils given that it is their main role. Sometimes, it even happened that the decisions were made without prior consent obtained by the Government, despite the above mentioned legal obligation.

For example, we now have a situation where the amount of so called membership contribution (a sort of levy that is collected depending on the amount of profits made by business entities with a purpose to finance local tourist boards and National Tourist Organisation of Montenegro), to the tourist board in Berane is only slightly lower than the amount of contribution paid in Budva, despite widely known fact that these two destinations are

incomparable in terms of number of visits and tourist attractiveness. In addition, the Historical Capital Cetinje made a decision that set a higher membership contribution in that municipality than in Budva, a coastal town that stands for Montenegrin tourism metropolis.

In December 2013, the Government adopted the Analysis of Local Taxes and Fees, which was previously approved by the Council for Improvement of Business Environment, Regulatory and Structural Reforms. The Analysis identified, and actually confirmed the standpoints of MEF and other employers' associations, inter alia, that in certain segments (e.g. roads), the fee was collected on the dual basis, as well as that some municipalities at that moment charged different types of levies for the same activities or differently named levies for the same or different activities. Another conclusion was that regulatory framework should be altered in a way to establish universal principles for levies at central level, defining maximum amounts of each levy, which would directly correspond to real administration costs for provided services. On the other hand, the mechanisms for collection and monitoring of collection of levies at local levels should be strengthened, with an aim to ensure a complete coverage by extending taxation basis and increasing the number of tax payers.

Stable, well-created and clear regulations, supported by adequate, competent, efficient, rational and operative administration are the precondition for the promotion of new enterprises creation and their overall development. Despite the progress Montenegro made in this field, especially in terms of regulatory reform and company registration procedures all aimed at enhancing business climate in the country, there are still some barriers that need to be overcome. Moreover, complicated regulatory framework and expensive administrative procedures are identified as key business barriers for boosting the entrepreneurial activities in the country.

Regulatory reform project, financed by the World Bank ("*Guillotine of Regulations*") resulted in adoption of a special Action plan for implementation of the adopted recommendations for changes of regulations (laws and by-laws) and administrative procedures. Its implementation is complex in terms of financial and administrative capacities required, but the impression is that realisation of necessary changes could have been more dynamic.

A significant step toward improving the conditions for smooth business performance and improvement of business environment in Montenegro is made with the Law on Improvement of Business Environment<sup>16</sup>. In a very unusual way, this Law made amendments to 12 laws that were recognised as obstacles to doing business in Montenegro. Moreover, this law brought significant changes to regulations related to business entities and simplification of registration procedure; foreign investment; environment; construction; cinematography; administrative fees and charges for using roads; fees for protection and improvement of environment; electronic communication and patents.

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<sup>16</sup> *Official Gazette of Montenegro*, no. 40/2010

Despite introducing an obligation/a practice of carrying out the regulatory impact assessment – RIA (especially when adopting new or amending the existing laws), in reality these analyses are rarely carried out meticulously and comprehensively since the effects of certain laws are often the opposite of the goals that were desired.

Taking part in the cross-sectoral working group (formed by the Ministry of Finance), that worked on the Analysis of Effects of Progressive Taxation of Personal and Corporate Income and Property, MEF representatives pointed out the fact that personal income tax is one of the most prolific/effective taxation forms and the personal income tax rate itself in Montenegro was among the lowest compared to other countries. However, positive effects of such favourable tax rate for business and state are substantially annulled by the methodology of wage calculation and accompanying actions that ultimately make labour costs significantly high (accounting for about 70% of the overall business costs).

As laid out in the Analysis:

“The overall tax burden on labour which, apart from personal income tax includes contributions to mandatory social security insurance is relatively high in Montenegro compared to EU and OECD average. EU average is 35.5 per cent (meaning that out of 1 EUR of labour cost, 35.5 cents go to the state for taxes and contributions while 74.5 per cent makes an employee’s income), while in OECD countries the tax on labour is at 32 per cent. Compared to member states, i.e. to the average tax burden level, the tax burden in Montenegro is relatively high – 39.2 per cent, 4 percentage points higher than the EU average and 7 percentage points higher than OECD average.”

Having no intention to justify any sort of evasion of legal responsibilities, one has to point out the real causes that ‘force’ business entities into partial grey zones putting them at risk of being exposed to very high penalties. These lay in highly rigid labour legislation which, if added to the existing labour taxation, makes labour costs extremely high.

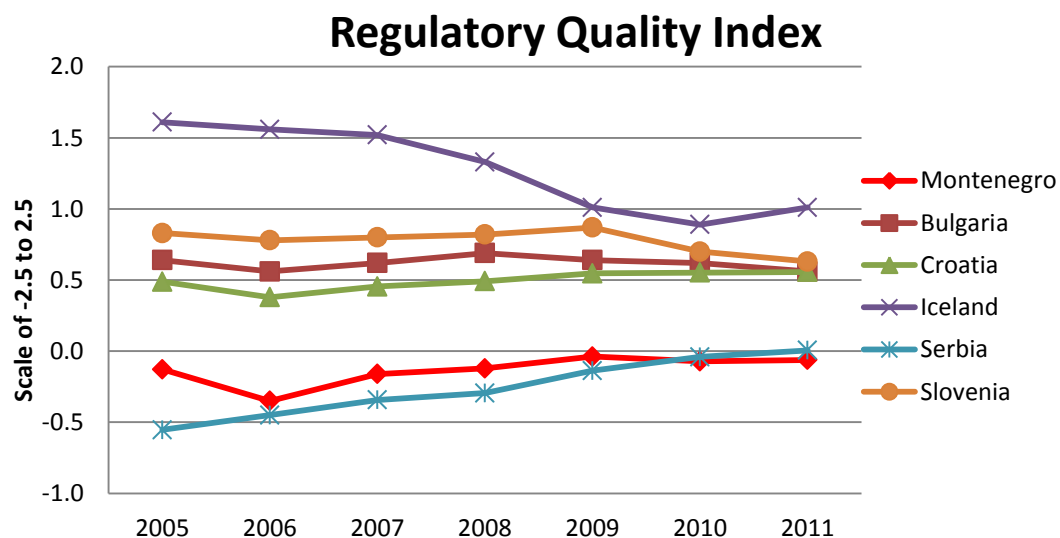
According to official data, labour costs in Montenegro amount to 39.2 per cent, which is the figure one has to consider with caution, since it represents a mere simple sum of income tax rate and social contributions. The methodology of recalculation of net into gross wages (which is a regular practice in real sector since workers are interested to have net salary indicated in their labour contracts i.e. the amount of money they will receive for the work done, but not the tax burden on labour paid by employer) makes labour costs higher. In recalculation of net into gross wages, personal income tax and corresponding contributions rates are applied, while the amount of taxes and contributions to be paid to the state is calculated by application of taxation rates on gross wage (logically, recalculated tax rates should be applied). For that reason, and taking into account all other legal responsibilities related to labour (contribution to Labour Fund, the Chamber of Economy, labour disability prevention contribution, special contribution to employment of persons with disability etc.), mandatory and real labour costs to employers are extremely high. It is why the total tax burden on net wages up to the level of the average is 62-63 per cent while the tax burden on net wages above the average (due to a “crisis” tax) e.g. on the net wage of 565 EUR is as much as 70 per cent. The tax burden increases

with the increase of wage, so the tax burden on net wages of 1000 and 2464 EUR is 75 and 81 per cent respectively.

If the Government intention (as we assume) is to increase the budget revenues on the basis of income tax and to reduce the “grey zone” in regards to the above, then the analysis (scenario) of significant reduction of such high tax burden is a must. The official government data reveal that almost 50 per cent of employees receive a wage up to 250 EUR, 46 per cent get between 250 and 1000 EUR, while only 3.23 per cent receive a salary over 1000 EUR (which adequately reflects the qualification structure of employed and economic situation). We believe that making significant reduction to the tax burden on labour would lead to equally significant wage increase, which would have multiplicative positive effects such as employment increase, elimination of phenomenon of having a part of the salary paid in cash, increasing thereby budget revenues received from this sort of taxation.

### 3. INTERNATIONAL COMPARISON

If considered from the perspective of the “Regulatory Quality Index” that measures the ability of a government to provide sound policies and regulation for the promotion of the private sector on a scale from -2.5 to 2.5 with higher values indicating better performance, Montenegro performed poorly and below 0 until 2012 though the country has experienced a consistent improvement since 2007, shifting from -0.16 in that year to -0.06 in 2011. Of the countries compared, this is the lowest score for 2011. Serbia registered the second lowest score (0.01) in that year, while Iceland achieved the highest score at 1.01.<sup>17</sup>



<sup>17</sup> Montenegrin Employers Federation, *The Enabling Environment for Sustainable Enterprises in Montenegro*, Podgorica, December 2013, p. 51 - 56: Source: the World Bank, *Governance Matters data base*

In spite of relatively poor performance of Montenegro in regards with regulatory quality, there has been notable progress in the creation of a more enabling regulatory and legal business framework in the country. The World Bank Doing Business survey indicator “Ease of Doing Business Index” ranks economies from 1 to 185, where a high ranking reflects a regulatory framework that is conducive for business operations. The data shows that Montenegro has improved in this regard over time, moving from 84 in 2008 to 42 in 2014. Of the other countries, in 2014 it is outperformed only by Bulgaria (36) and Iceland (11)<sup>18</sup>.

#### 4. IMPACT OF CURRENT POLICIES AND MEASURES

For the sake of public administration system structural adjustment to citizens and businesses, series of activities are being undertaken in legislative and practical regard.<sup>19</sup>

The Legislative Work Plan for 2014 of the Parliament of Montenegro included 201 laws for consideration and adoption, 47 of which are to be harmonised with EU *acquis*<sup>20</sup>. Another plan for 2014 is to adopt amendments to a set of laws directly related to business in the areas of labour relations, public procurement, sales tax on used motor vehicles, vessels and aircrafts, excise duty, tax administration, patents, health insurance, employment, courts, enforcement and security, pension and disability insurance, amicable labour disputes resolution, administration dispute, capital market, VAT, property tax, consumer protection, free trade zones, spatial planning and construction etc.<sup>21</sup>

In addition to a significant number of laws that are already in parliamentary procedure or in the procedure of establishing the draft law by the Government, already prepared at the moment is a Draft Analysis of Organisations Exercising Public Powers that identified certain weaknesses in this area and conveyed a set of recommendations with an aim to suggest the possibility of integration of regulatory bodies and other organisation exercising public powers in certain sectors. The findings of the analysis generated the activities on normative regulation of the scope of work of organisations exercising public powers along with establishing cross-sectoral

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<sup>18</sup> Montenegrin Employers Federation, *The Enabling Environment for Sustainable Enterprises in Montenegro*, Podgorica, December 2013, p. 51 - 56: Source: the World Bank, *Governance Matters data base*

<sup>19</sup> The Legislative Work Plan of the Parliament of Montenegro for 2014

[http://www.skupstina.me/images/dokumenti/akcioni-plan/Plan\\_zakonodavnog\\_rada\\_za\\_2014.godinu.pdf](http://www.skupstina.me/images/dokumenti/akcioni-plan/Plan_zakonodavnog_rada_za_2014.godinu.pdf)

The Report on Realisation of the Action Plan for Implementation of the Strategy for Public Administration Reform 2014-2015 (for I and II quarter of 2014)

<sup>20</sup> As indicated at the beginning of this document, there were 81 proposals of laws in parliamentary procedure at the end of 2014, of which 42 proposals were submitted by the Parliament members and 39 by the Government of Montenegro. There are the additional 121 proposals of laws to be established by the Government in 2014 in accordance with the Government Work Programme for 2014 and the Programme of Montenegro's Accession to European Union 2014-2018.

<sup>21</sup> The Legislative Work Plan of the Parliament of Montenegro for 2014, p. 5-11



working group in charge of preparation of the Draft Law on Public Agencies and the Draft Law on Public Funds (services).<sup>22</sup>

In regards to improvement of public finances system, the Law on Budget and Fiscal Responsibility has already been adopted, its solutions being directed towards strengthening fiscal responsibilities measures.<sup>23</sup> Furthermore, the activities on establishing centralised public procurement system in certain areas are undertaken along with the Law on Amendments to the Law on Public Procurement established by the Government on July 17<sup>th</sup> 2014.

In order to ensure the creation of optimal legal framework that will improve the administrative procedure, the Draft Law on Administrative Procedure has been prepared and sent to the Parliament for consideration<sup>24</sup>. In addition, the Ministry of Interior Affairs published the Draft Law on Administrative Inspection, in order to, inter alia; ensure conditions for more quality supervision of the efficient implementation of the new Law on Administrative Procedure provisions enabling thereby business entities to seek protection from the Inspectorate whenever they experience inefficient administration.<sup>25</sup> The adoption of the Law on Electronic Administration set grounds for efficient communication with public administration users over the universal e-portal at any time and at any place.<sup>26</sup>

In addition to significant progress made towards enhancing regulatory framework that was presented above, the practice will show real effects of the listed laws from the perspective of enabling citizens and businesses to exercise and protect their rights.

## 5. RECOMMENDATIONS

Current environment and activities centred on regulatory framework are compatible with recommendations conveyed by the Montenegrin Employers Federation in the document

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<sup>22</sup> The working group has started and it is consisted of representatives of the Ministry of Interior Affairs, the Ministry of Finance, the Ministry of Economy, the Ministry of Health, the Ministry of Labour and Social Welfare, the Ministry of Science and the Ministry of Education (*Official Gazette of Montenegro*, no. 20/2014)

<sup>23</sup> *Official Gazette of Montenegro*, no. 20/2014

<sup>24</sup> The text of the Proposal of Law after it was agreed with the Expert Team formed by the minister of interior affairs, SIGMA/OECD experts and competent national institution. On June 12th 2014, the Government established the Proposal of Law on Administrative Procedure and sent it to the Parliament for consideration and adoption.

<sup>25</sup> In order to complete the task, the minister of interior affairs formed cross-sectorial working group coordinated by the Ministry of Interior Affairs that, apart from representatives of relevant public institutions, included the representative of NGO sector.

<sup>26</sup> 11 new services were added to the e-government portal in 2014 by: the Ministry for Information Society and Telecommunications, Tobacco Agency, Tax Administration, Anticorruption Initiative Directorate, Prevention of Money Laundering and Terrorist Financing Directorate. Those are the services that may be fully provided in electronic form. The e-government portal contains a great number of informative services such as – information about where and how to submit/receive certain requests/services. Moreover, as from 2014, 4 ministries started to work with electronic documents in production environment: the Ministry of Interior Affairs, the Ministry of Human and Minority Rights, the Ministry of Defence and the Ministry of Justice.

*Strategic Framework for Enabling Business environment in Montenegro – 5 business killers*; they target the improvement of regulatory framework and represent partial realisation of MEF recommendations in regards to strengthening the capacities of public and local administration in terms of their transparency, efficiency and mutual cooperation; simplification of administrative procedures with the new Proposal of the Law on Administrative Procedure; employers protection from inefficient administration through mediation by the Administrative Inspection; more efficient procedures of monetary obligations settlement – The Law on Deadlines for Settlement of Monetary Obligations (“Late Payment Act”) (28/14); more efficient execution through the Law on Enforcement and Security Procedures (36/11; 28/14); taxation and customs-related benefits through the Law on Write-off of Interest in Tax and Customs Liabilities (61/13; 6/14) and other laws adopted in 2013 and 2014: The Law on Payment Transactions (62/13; 6/14), The Law on Spatial Planning and Construction (51/08; 40/10; 34/11; 40/11; 47/11; 35/13; 39/13) etc.

As pointed out by the Montenegrin Employers Federation, in order to eliminate the effects of inadequate regulatory framework, there should be a permanent endeavour to implement specific policies that are primarily related to:

- Achievement of stable and predictable regulatory framework and its codification especially in certain sectors so that regulations are applied in simpler manner;
- Adoption of systemic Law on Administrative Procedure that will eliminate procedures imposed by different sector-specific laws;
- Adoption of the law that will regulate the system of public agencies, public funds and public services;
- Creation of public policies that will make adjustments to (reduce) the amount and volume of public revenues (taxes, contributions, fees, excuse duties, customs, procedural and administrative costs etc.) that are burdensome for business;
- Flexible labour legislation;
- Creation of penalty policy and affirmation of the reciprocity principle – prescribe penalties that correspond to the type of violation and company’s financial capacity;
- Strengthening the capacities of public and local institutions by professionalising public servants and increasing the transparency and efficiency of their work;
- Improvement of judiciary authorities work and introduction of universal court practice;
- Affirmation of the *preventive actions principle* with inspection authorities;
- Ensuring active participation of real sector representatives in both creation of public policies that affect business environment and working teams for creation of legislative framework.

Within this context, and having in mind the presented legislative activities of the Parliament of Montenegro for the coming period, it is of crucial importance to have MEF even more intensely engaged in creation of legislation.

## 6. EMPIRICAL ASPECT – CASE STUDY

Starting from MEF documents listed above and the upcoming legislative and other activities, with an aim to have a more detailed overview of the problem, the author of this Report participated in the meeting with companies representatives that made up a focus group that discussed about the impact of informal economy and regulatory framework on business environment and the overall business development in the country.

At several hours' long meeting, focus group participants shared their views regarding the issues posed as discussion topics:

1. *To what extent does the regulatory framework encourage companies to expand their operations?*
2. *In your opinion, what key regulations are the major obstructions to business development?*
3. *How do you evaluate the impact of frequent changes on security and stability of business?*
4. *How do you evaluate the enforcement of laws by public and local authorities?*
5. *How do you evaluate the quality of services provided to companies by competent public and local authorities, especially in regards with effective decision making on your rights?*
6. *To what extent are the employers satisfied with their participation in the creation of laws?*
7. *How do you evaluate the actions and supervisory powers of public authorities that control your company's business operations?*
8. *To what extend do you think the training of staff in your companies is needed in order to enable them to adequately and professionally respond to unlawful actions by public authorities?*

Hours long focus group discussion on the questions listed above essentially confirmed the findings of secondary survey carried out by the MEF.

The majority of participants in the discussion reiterated what was said earlier – not only was the regulatory framework uncondusive to business, but it hindered the overall business development especially due to barriers and high imposts in the areas of public revenues such as taxes, fees, customs, administration costs (particularly at local level), inflexibility of labour relations and especially because of the tax burden on wages that went up to 70 per cent.

The key regulations recognised as impediments to the overall business development are those related to taxation and customs, labour relations, contributions for pension, health and social security, various administrative fees, public procurements, construction and spatial planning etc.

Frequent changes within regulatory framework are another generator of negative effects on stability, legal security and predictability of business, which to a large extent prevent companies from creating long-term business policies. The selective implementation of regulation is another highlighted issue, along with non-application of laws to illegal businesses that evade payments of taxes and other public revenues, underpinning the development of “grey economy” and ultimately creating unfair competition.

As a rule, the enforcement of laws by public and local authorities is selective and accompanied by long and complex procedures. When it comes to quality of services provided by public and local administration, companies still think they are inefficient with public at the level of competence below adequate. Very often, interpretation of laws and by-laws is unpredictable and inconsistent.

Companies’ engagement in the process of legislation creation should be at higher level, although such engagement is achieved through intensive participation of Montenegrin Employers Federation in the creation of laws with partial participation of certain members, when needed.

Concerning the procedures and supervisory powers of authorities, especially inspections, focus group participants have positive opinion saying that over 80 per cent of inspections are correct and professional when exerting control. Nevertheless, at coastal municipalities that in summers are overwhelmed with tourists, frequent inspection controls significantly hinder companies regular functioning.

Intensive regulatory activity reflected in frequent changes of regulations asks for additional efforts by companies if they want their business comply with new legislation. It requires continuing training of their staff in order to enable them to follow and apply numerous regulations and to adequately protect themselves from frequent administration incompetence.

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