

UNIJA POSLODAVACA
CRNE GORE

## STRONG ECONOMY – SUCCESSFULL MONTENEGRO!

*STRATEGIC POLICY FRAMEWORK FOR ENABLING BUSINESS ENVIRONMENT IN MONTENEGRO*

# 5 BUSINESS KILLERS



## *Foreword*

Montenegro is a lovely, little country with an open economy, having good geo-political position, abounding in natural resources and cultural-historical heritage as main prerequisites for its further development. Along with strategic policy set upon long-term goals, Montenegro can become one of the most developed and most attractive countries in Europe which citizens enjoy one of the highest standards in the region.

In the past 10 years Government of Montenegro made significant steps toward improving business environment. Unfortunately, as in many other countries, global crisis has dramatically worsened the economic situation and significantly reduced positive effects of initiated reforms. Therefore, the intention of Montenegrin Employers Federation in producing this document has not been (argumentative) critique but, having in mind the gravity of situation, a call for a joint action of all stakeholders relevant for shaping economic and social environment as well as for integration of all available resources, with an aim of reaching high-quality changes that will result in strong and successful Montenegro.

Montenegro needs successful enterprises – not only those already at the market but those that are to become such. Such enterprises generate economic growth, increase employment, improve living standards and contribute to the overall progress of the country. Therefore, Montenegro must not allow „the luxury" of experimenting with inadequate legal solutions and forced, and for economy - often counterproductive, measures.

In reform and EU integration processes, the state is expected to be strategic and proactive, especially in creating better environment for businesses to grow. It means that, along with creating regulatory framework and later on monitoring the implementation of legislation, the Government should be dedicated to relieving business operations (domestic and foreign) making Montenegro an attractive destination for investment and business start ups. Only then could we speak about competitiveness, development and growth of Montenegrin economy, investment and export oriented.

In order to provide conditions for the above, it is necessary to recognise and eliminate numerous problems characteristic for Montenegrin business environment – at national and at local levels. In extensive and complex survey, using globally accepted methodology of ILO, Montenegrin Employers Federation (MEF) identified the existing business barriers specially marking those which enterprises underlined as **5** key **business killers:**

- Inadequate regulatory framework
- Difficult access to financial resources
- High share of informal economy
- The existence of corruption at all levels and in all areas
- A mismatch between education system and labour market needs.

It is MEF opinion that these 5 killers hinder Montenegro in realising its primal goal toward success – building strong economy.

We also believe that the document will serve as a good guide to policy and decision makers, social partners, private and civil society sector in their joint efforts to tackle the current issues realising thereby a vision MEF set yet in the founding 2002:

***>>Business environment giving each citizen a possibility for permanent and stable employment.<<***

*Montenegrin Employers Federation*

# KILLER 1: INADEQUATE REGULATORY FRAMEWORK

Despite positive shifts, regulatory framework still creates difficulties in implementation which result in negative perception of Montenegrin business environement. It is confirmed by the survey findings whereby **97 per cent of companies consider regulatory framework not stimulating business growth**. According to respondents, the problem is not only in creation of legislation but also in its implementation as reflected in the statement coming from the trade sector: ***"We are simply the experts in non implementation of laws".***

Lawmakers often say that laws are made so that they comply with EU legislation and contributing to better business environment. However, the first years of their implementation reveal their flaws, vagueness of certain provisions but also different interpretations by relevant bodies competent for their enforcement. On the other side, one should also have in mind that certain situations (e.g. failures to meet deadlines for adoption of bylaws) significantly hinder prompt enforcement of certain provisions.

It is no wonder then that **only 5 per cent of companies think that interpretation and implementation of laws and bylaws is done in predictable and consistent manner**.

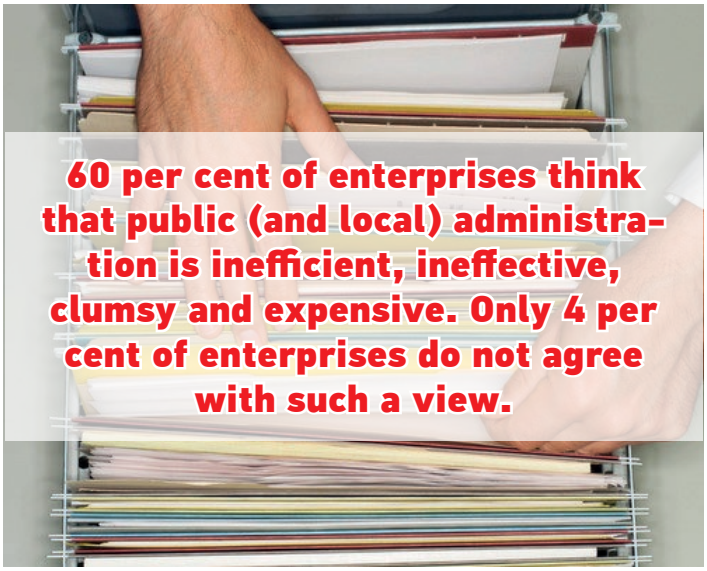
Multiple institutions in charge, submission of massive documentation, payment of different taxes and fees, waiting for administration "reply" etc. make public procedures complicated and ultimetely very expensive due to their negative effects to business.

One of the examples of slow administration, as stated by survey respondents is environmental permit which is to obtain in 2 to 3 months, further confirmed by a statement of a company representative from energy sector: ***"Submission of tender documents is a long and expensive procedure that discourages companies - interested bidders, in taking part in the process".***

Employers are especially interested in elimination of business barriers imposed by a public procurement process which is revealed by the findings whereby **only 3 per cent of companies consider the process to be utterly transparent.**

The next significant burden for all enterprises in general are high labour costs. In the past few months the situation is even worse due to increased income tax followed by very discouraging provisions of Law on Social and Child Care related to employment of women in reproductive age.

**Labour costs are extremely high**, as revealed by survey findings whereby only **11.2 per cent** of companies consider these costs as **NOT** causing problems in business operations.



| Labour costs | Problems arising in public procurement procedures |
|---|---|
| The amount of taxes and benefits makes 68% of gross wage of 720€. They get higher as the gross wage increases, reaching over 83% (e.g. net wages above 4.150 €). | Rigidity of the process in terms of eligibility criteria, copying the same documents for each tender position for the same tenderer, submission of documents already in possession of that or other public bodies, in case of appeal the payment of fees in the amount of 1% of the estimated public procurement value, imprecise requirements or the lack of documents specification in relation to the subject of procurement, inferior status of bidders with the State Commission which does not involve representatives of real sector etc. |

Frequent amandments of laws, including for example increase of income tax to wages higher than average, introduction of so called "crisis tax", increase of VAT (from 17 to 19 per cent), increase in number and level of fees and charges at local levels, resulted in an **unpredictable tax environment.**

Local governments mainly autonomously define levels of taxes, fees and charges as their revenues, disregarding current economic situation at local levels. Often these burdens vary in different municipalities.

One of the crucial problems is related to local governments' decisions addressing an increase of fiscal burdens which very often do not undergo the process of public hearing. There are also no positive examples of having those local governments' decisions (directly or indirectly) relating to business environment considered by local social councils being that this is one of their main roles.

Along with high fees for access to municipal infrastructure, the key constraints in the area of construction as seen by employers are the lack of detailed urban plans (DUPs) in many municipalities as well as often several months long procedure of obtaining necessary permits.

Disputes arising from debtor-creditor relations, insolvency, higher financial and fiscal indiscipline all point to the need for significant improvement and more efficient work of judges so as for shorter deadlines for completion of judical cases.

***„My congratulations to all those who start their own businesses at this time" – a representative of an enterprise in construction sector .***

# RECOMMENDATIONS 1 : REGULATORY FRAMEWORK FOR SUSTAINABLE ENTERPRISES

- Involve to a greater extent real sector representatives in policy making and legislation drafting related to business with an aim of establishing consistent and coherent legal system;

- Introduce rules for laws to be adopted in parallel with bylaws so that potential collisions, legal loopholes and ineffectiveness of laws are avoided;

- Make an inventory of all fiscal and parafiscal burdens at public and local levels in order to get insight into their mutual relations and ***their overall amount in terms of the burden imposed to businesses***. Closer analysis could precisely identify the cases of having the same economic category payed twice or more times under different names. In this sense, it is needed to evaluate the validity of certain local charges or adapt their levels to the local conditions, so as to the overall economic conditions in the country;

- Introduce equal practice at local levels which would mitigate business uncertainty when it comes to local revenues (so called principle of prior Government consent to local governments' decisions and/or having maximum amount of local revenues prescribed by law);

- Strengthen the capacities of public (and local) administration through increased transparency and efficiency and improvement of their mutual communication. Also, establish personal and institutional responsibilities for omissions and delays which will leave out economic entities from compensating the damage caused by public bodies and institutions;

- Simplify complicated and expensive administrative procedures and eliminate emerging forms of bureaucratic autocracy – especially at local levels. It is necessary in this sense to widen a one-stop-shop system to many other areas of business operations (e.g. to introduce a single procedure of issuing both working and residence permit to foreigners that are to employ in Montenegro);

- Apply a market principle in the process of urban plans creation which will shorten the time needed for their adoption and reduce their costs, ensuring the certainty of future investments;

- Have parties in the procedures not submitting the documents already in possession of other public or local bodies as legal provision of a special law (now regulated by Law on Administrative Procedure, but still not implemented);

- Reduce the costs arising from obtaining different licences and permits. Terminate the payment of fees in case of appeals to the procurement;

- Evaluate and reduce labour costs;

- Enact a Law on the Deadlines for Settlement of Liabilities which would set a regulatory framework for settlement of liabilities (not only between economic entities themselves but between economic entities and public sector as well) ultimately contributing to higher solvency and competitveness;

- Improve social dialogue – especially at local levels, introducing a rule of local governements' decision being considered by local social councils prior to their approval, especially if those affect business environment;

- Regulate the work of inspections, advocate for preventive rather than repressive measures – introducing the category of warnings which would ensure unbiased and equal treatment of all subjects of control;

- Set a penalty policy in a way that it corresponds with the economic power of enterprises or to the level of violation. This is due to the fact that majority of enterprises in Montenegro are micro, small and medium, operating at the edge of solvency. High penalties can therefore become a burden they would not be able to overcome which would subsequently make them terminate their activities. This principle should especially be applied with penalties concerning tax violations, wherby the amount of penalty should correspond to the level of unaccounted income or miscounted tax;

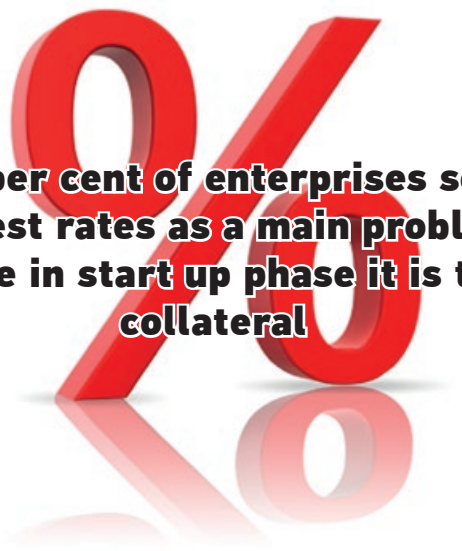
- Improve the work of judical institutions, especially in terms of shortening the time for completion of judical cases setting thereby personal and institutional responsibility for making illegal judgements the consequences of which are borne by enterprises and citizens.

# KILLER 2: DIFFICULT ACCESS TO FINANCIAL RESOURCES AND BAD LENDING CONDITIONS

Despite being recognised by the World Bank as a country which constantly imroves its position, Montenegrin enterprises face difficulties in their operations which has negative impact on their financial situation and solvency and ultimately undermines their sustainability.

Difficult access to financial resources and problems in debt collection are major threats to solvency and growth in terms of reduced opportunities for investment into new products/services and new technologies which would contribute to their competitiveness.

Lending conditions, especially of commercial banks, are not adapted to the needs of SME. Severe criticism is related to the level of colatteral which majority of enterpirses cannot afford. Access to financial resources is a main constraint in starting up a business, i.e. ensuring the funds needed for initial investments. This was stated by a representative of a company from tourism sector: ***"Apart from a state institution – Investment Development Fund – enterprises have no other options for getting necessary resources due to demanding conditions or limited available resources aimed barely for basic assets".***



**93 per cent of enterprises see interest rates as a main problem, while in start up phase it is the collateral**

Another obvious problem is a communication gap between financial institutions and eneterprises, as revealed by **98 per cent of enterprises which think that financial services are not adapted to their needs.** This is further confirmed by the existence of so called contracts on access, by lack of sensibility when it comes to individual enterprise's needs, by very demanding conditions of access (several years long positive experience, positive credit history, high collateral etc.)

Obscure loans and a lack of stimulating policies for some economic sectors make additional burden on already bad financial state of Montenegrin economy. Survey findings reveal that the highest percentage of enterprises (24.1) think there are no political and regulatory measures that would stimulate financial institutions to approve loans for SME.

Financial picture of Montenegro is further worsened by lack of information on and insufficient use of alternative financial resources which is confirmed by **92 per cent of enterprises thinking that the main source of financing is actually self-financing.**




***96 PER CENT OF ENTERPRISES IN MONTENEGRO FACE PROBLEMS IN ACCESSING FINANCIAL SERVICES***

# RECOMMENDATIONS 2: FINANCIAL RESOURCES FOR SUSTAINABLE ENTERPRISES

- Ensure stimulating lending policy in terms of more favourable lending conditions, lower interest rates, more diverse and acceptable collateral;
- Ensure reprogramming of current loans, whereby lending conditions i.e. interest rates remain the same;
- Better disseminate information on available financial services and lending conditions (potential collateral, reprogramming possibilities etc.);
- Create such loans that are aligned with individual enterprise's needs (e.g. loans for export and production oriented enterprises, especially food-processing companies; loans to support energy efficiency projects, innovative enterprises etc.);
- Create stimulating loans for individuals to start up their own businesses, which is one of the prerequisite for the recovery of Montenegrin economy;
- Strengthen the role of micro credit institutions and adapt their services to the real market needs in Montenegro as well as to the real potential of Montenegrin economy with an aim of making more of short-term financing 30 per cent of companies consider to be inefficient.
- Promote the opportunities offered by alternative financing sources. Raise the awareness of the significance and advantages of using these sources through good practices examples (from the region). In this context, MEF together with the Government and relevant institutions should create a team that should provide help and support to enterprises (information on the availability of sources, project design, application procedure etc.)
- Build the capacities of Montenegrin enterprises for using alternative financing sources. Promote innovative ideas and finance their application from available funds/sources.

# KILLER 3:
# INFORMAL ECONOMY

Inadequate and poorly implemented economic and social policies, the lack of appropriate legal and institutional frameworks, poor enforcement of regulation, reduced confidence into institutions and administrative procedures, along with economic downturn, decreased liquidity and productivity are the main reasons for a share of economic activity being moved into the "grey zone"- eighter by evading legal obligations or by complete shift to the "black market" whereby the economic activity/entity is utterly unregistered.

Althought no official evaluations on the scope of informal economy are available, **there is a recognition of a significant share of informal economy, calculated at around 23-31 per cent of GDP.**

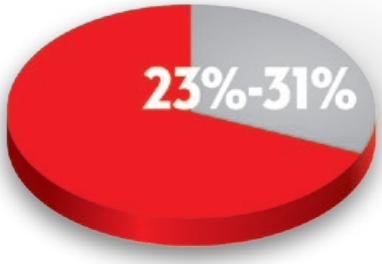



Insufficient level of knowledge and competences needed in the private sector together with a burdensome tax and social contributions system discourage formal employment imposing high labour costs (social contributions rates and relatively high minimum wage) which subsequently ends by high employment in the informal economy (employees working without contracts or contracted workers being payed social contributions only for the minimum wage while the rest of the payment they receive in cash).

Unregistered or illegal economic activity reflected in reduced tax collection (income tax, value added tax, contributions, surtax) results in part of the tax burdens being translated to those economic entities that comply with legal regulations through increase of current or introduction of new forms of taxation. It further diminishes the chances for enterprise growth and new jobs creation at the same time indirectly resulting in the termination of their formal work and move into the informal sector.

Some other reasons for informal economic activity in Montenegro are recognised through inefficient and biased work of inspections, high administrative burdens, inadequate business environment and legal insecurity and unpredictability.

A representative from services sector put it as: ***"New imposts, in fact, threaten healthier segments of economy pushing enterprises to "grey zone", distorting market competitiveness of liquid enterprises and eventually leading to unfair competition. Frequent amendments of legislation, with no prior announcement, boost the unpredictability of business operations and reduce the chances of defining long term business plans"***




***ANNUAL LOSS CAUSED BY INFORMAL ECONOMIC ACTIVITIES IS ESTIMATED TO BE 740 TO 997 MILLION EUROS.***

# RECOMMENDATIONS 3: TACKLING INFORMAL ECONOMY

- Make labour legislation more flexible;
- Reduce the number of administrative procedures and work on their simplification;
- Reduce the costs of regulatory procedures especially those reffering to obtaining permits, licenses and approvals;
- Establish a regulatory framework and stimulation measures for translation of informal economy into formal systems;
- Reduce tax burdens on wages;
- Introduce lower minimum wage for youth in order to stimulate their higher employment;
- Introduce regional differentiation of minimum wage in line with different costs of living;
- Ensure professional, timely and objective approach by inspections, extending their competences to unregistered businesses;
- Improve coordination and build better links bwtween different inspections;
- Prevent mediation i.e. advertising of unregistered businesses;
- Introduce stimulating measures for less cash payments and more non-cash payments;
- Stimulate entrepreneurship and self-employment through micro credits;
- Intensify public campaigns on negative effects of informal economy.

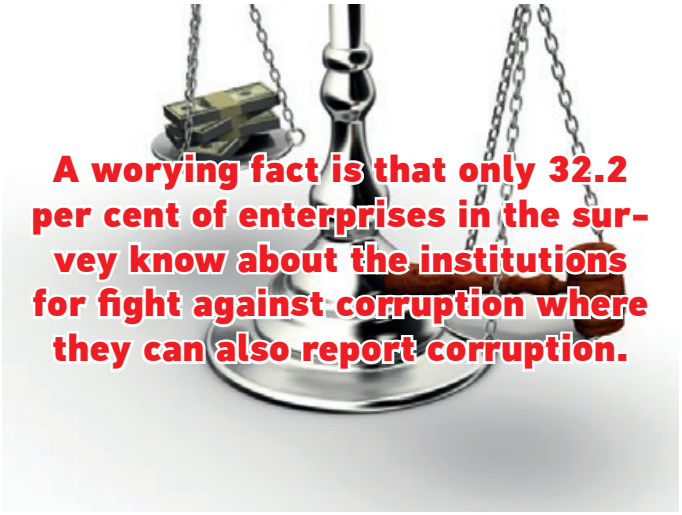
**NEGATIVE IMPLICATIONS OF INFORMAL ECONOMIC ACTIVITIES ARE SO GREAT THAT THEIR TRANSLATION INTO THE FORMAL SECTOR SHOULD BE AT THE TOP OF PRIORITIES!**

# KILLER 4: CORRUPTION

Regardless of established institutions for fight against corruption and a set of adopted anticorruptive laws, corruption is still present in all areas and at all levels in Montenegro.

From the perspective of economic entities, recognised **sources of corruptive activities are: complicated and burdensome regulation** often subject to changes, **clumsy state administration, imprecise interpretation of laws and their inconsistent and selective implementation, bureaucratic autocracy and abuse of entrusted power.**

World institutions evaluate **a financial burden due to corruption making up to 10 per cent of overall business operation costs**, which means that involvement in these unauthorised actions cause significant financial losses that impede or disable the development of an enterprise and the overall economy. According to World Bank Doing Business Report for 2013 **Montenegro is ranked 176 out of 185 countries in the ease of obtaining construction permits**. It is only one of examples that confirms the need for higher level of transparency in state administration work, especially in the areas where corruption is the most evident – local governments, public procurement, inspection controls, spatial planning, health system, education, etc.




Although enterprises unwillingly share personal and concrete experiences, due to their fear of repression, focus groups meetings and field survey reveal the following procedures as centres of corruptive activities: exempts from legally prescribed obligations (taxes, fees...), issuing of licenses, penalties avoidance (inspection controls...), benefits gain (agreements conclusions...) etc. i.e. requests for/offering of services with an aim of speeding up, postponement or suspension of numerous aministrative procedures.

As ways of realisation of corruptive activities/payments 42.7 per cent of enterprises reported them to be agreements with subcontractors, offers or agreements on consultancy services which is to a larger extent caused by non transparent administrative procedures, for example public procurement process.

Enterprises are often accused by institutions for low level of reporting corruption. **The most frequent reasons for them not doing so are their sense of insecurity and a fear of potential revenge**. It says even more about the inconsistent implementation of existing regulation, the lack of responsibility, independence and objectivity of institutions in exercising their competences but also about the inefficiency in realisation of control procedures and implementation of sanction mechanisms.




***FOR 61.6 PER CENT OF COMPANIES IN THE SURVEY CORRUPTION IS A PROBLEM FOR BUSINESS OPERATIONS.***

# RECOMMENDATIONS 4: FIGHT AGAINST CORRUPTION

- Create adequate regulation, ensure its proper interpretation and consistent implementation in fight against corruption;
- Improve cooperation of public and private sector and ensure higher level of transparency in the activities of institutions cooperating with private sector;
- Consider the possibilities of reducing taxes, fees and charges, as well as of simplifying administrative procedures at national and local levels – especially those that are recognised as significant causes of corruption;
- Improve the transparency of work and application of ethical principles by state administration;
- Promote the importance of applying ethical principles in business operations;
- Ensure greater efficiency, effectiveness and control of public institutions and bodies (inspectors, judges, customs officers...), increase reasponsibilities of institutions and bodies, as well as public officials and civil servants, promote preventive rather than repressive measures and ensure equal treatment of enterprises in procedures, processes and controls;
- Further promote current institutions for fight against corruption (along with report of corruption), ensure anonymity and confidentiality in report procedures as well as adequate and safe model of sanction mechanisms implementation;
- Improve the system of public procurement in a way that it ensures transparent and economical use of public sources, stimulates competition, applies objective and predefined criteria in decision making, leaving no room for abuse;
- Simplify tender documentation and conditions for taking part in tenders and adjust them to SME, provide equal conditions for all bidders and tenderers and ensure monitoring over contracts realisation;
- Encourage wider public participation in fight against corruption and support such initiatives taken by NGOs and media;
- Regularly inform public about all cases of corruptive practice and individuals taking part in it (print, electronic and online media).

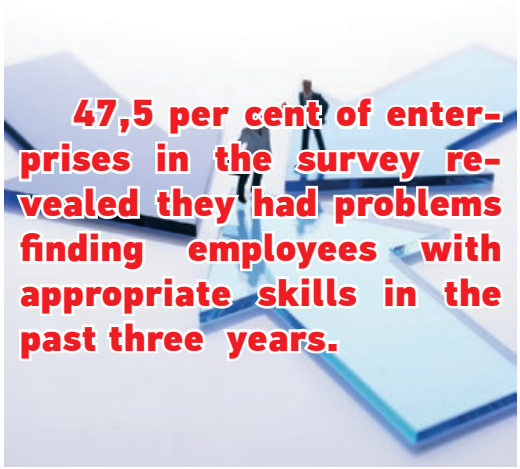
# KILLER 5: EDUCATION AND LABOUR MARKET MISMATCH

Education cannot be viewed isolated from economic and labour market developments. Transition caused large economic system disappear resulting in current 99.7 per cent of SME in Montenegro.

As most intensively developing sectors in Montenegro are tourism, construction, trade and agriculture, seasonal character of labour market is understandable. Combined with low regional workforce mobility, it remains one of the main challenges for the education system. In the aftermath of the economic boom and increased employment in 2008, we are now faced with higher unemployment especially of youth – **Statistical Office (MONSTAT) data say that the youth (15-24) unemployment rate in 4th quarter of 2012 was 45%**. Dicreepancy between education and labour market needs is reflected in structural unemployment whereby:

- supply produced by education system do not match labour market demand. This is particularly characteristic for profiles requiring III level of qualification or lower **(lower vocational and crafts profiles are demanded by employers but unpopular among youth whereby only a very limited number of children enrolls to such programmes)**.

- there is a demand for certain profiles and a sufficient supply of the same but vacancies are still not filled. This is not the first survey MEF did that confirmed employers' unsatisfaction by the quality of human resources (their skills and competences) generated by education system. Limited share of practical training in VET and a complete lack of it at the level of tertiary education contribute to the outcomes afore mentioned.




- demand for certain profiles is not high enough to match the supply. Inadequate enrollment policy, especially of higher education institutions, led to hiperproduction of graduates holding university degree. This is a group with a significant share in total unemployment **(in the 1st quarter of 2013 the unemployment of university graduates was 10% out of a total unemployment!)**.

Entrepreneurship, as one of seven key competences, is still underrepresented at the level of elementary school, gymnasiums and non-economic studies. Official records reveal negligible share of population aged 25-64 in lifelong learning programmes – **only 0,1 per cent**. This is far below EU 27 average of 8,9 per cent. Although MEF survey showed positive trends when it comes to enterprises' investment in staff training, insufficient commitment of the state to the concept of LLP is still evident. Trainings for SME are available only to a certain extent, and on the other side, HR sectors at company levels are very limited or even nonexistent. Important aspect of lifelong learning is also a validation of informal and nonformal learning. Despite its adoption in 2008, a Law on National Professional Qualifications has not yet been fully implemented, especially in terms of informal and nonformal learning validation.




***96 PER CENT OF ENTERPRISES REPORTED EMPLOYEES' SKILLS SHORTAGES AS ONE OF THE PROBLEMS IN DOING BUSINESS.***

# RECOMMENDATIONS 5: EDUCATION ALIGNED WITH LABOUR MARKET NEEDS

- Create enrolment policy in a way that it corresponds with employers needs and is based upon labour market analyses. Define annual quotas for admission to higher education institutions despite the fact of license being renewed every 5 years;
- Strengthen the role of employers and their representatives in policy making, creation of education programmes, the work of schools and higher education institutions but also in promotion of deficit profiles. This also means building capacities of sector commissions so that they become efficient in reporting and monitoring labour market trends;
- Include compulsory practical training into all education programmes at tertiary level;
- Ensure the quality of practical training, professional practice and practical training at tertiary level, clearly defining obligations and responsibilities of (high school/university) students and educating mentors at companies;
- Encourage employers to cooperate more with schools and universities in the delivery of practical trainings and professional practice through introduction of tax breaks or subsidies as well as through establishment of scholarship funds, especially for deficit occupations;
- Introduce entrepreneurship as elective and/or compulsory subject to all education programmes at tertiary level and strengthen the sense for entrepreneurship at elementary and general secondary education levels;
- Enable all that acquired competeneces out of a formal education system to get approval and validation of their skills and competences by getting nationally recognised sertificate;
- Ensure the quality of programmes realised by private education providers through regular monitoring and better functioning of examination commissions at the end of courses;
- Ensure transparency in the process of adopting education laws and bylaws, necessarily taking into account opinions of social partners and professionals in the fields.

# NOTES

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