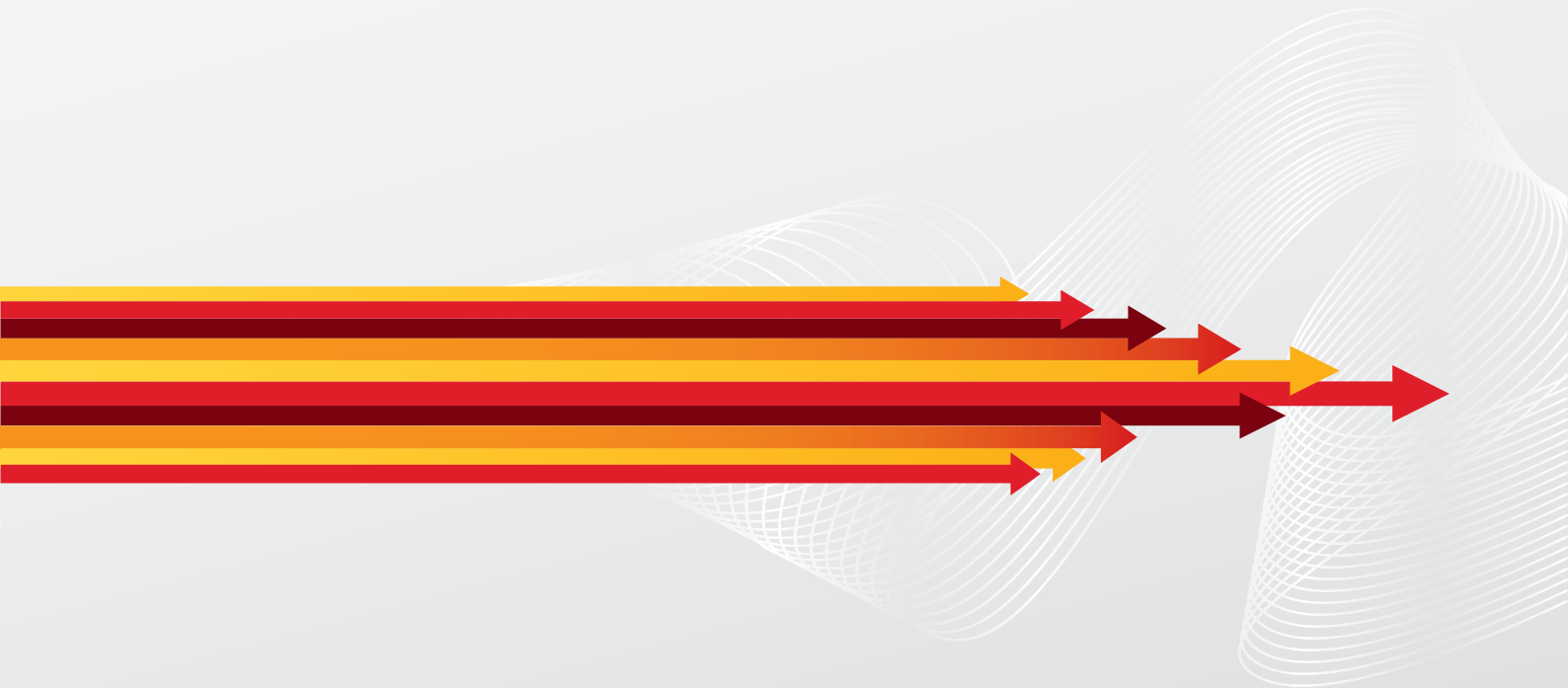




MFIC | Montenegrin Foreign
Investors Council

White Book 2011

Investment Climate in Montenegro – Opportunities and Chall



White Book 2011

Investment Climate in Montenegro – Opportunities and Challenges



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Foreword



The Montenegrin Council of Foreign Investors (MFIC) marks its third year of existence and operation by publishing its third annual edition of the White Book. The White Book expresses the opinions of foreign investors about the business climate and environment for doing business in Montenegro and extends recommendations for resolving some of the observed business barriers.

In the period since the previous edition of this document, Montenegro has made a significant step forward on the path to EU accession. The efforts of the Government in addressing and solving the existing problems were recognized by the European Commission, which recommended the opening of accession negotiations. Areas pointed to in the previous editions of the White Book requiring additional improvement have also been on the agenda of the Montenegrin Government within the chapters to be dealt with by EU representatives and have been duly addressed. The government has shown itself to be a good and responsive partner open to dialogue, while its approach to the problems that the economy is facing remains constructive.

The level of foreign direct investments (FDI) recorded a significant drop with some minor positive indicators heavily dependent on external factors. The Montenegrin economy has additional unused potential in the area of tourism, the energy sector and to some extent in agriculture where substantial investments should be exploited, and foreign investors are encouraged to explore these opportunities. We strongly believe that FDI is of vital importance for the further growth of the economy.

In the past year, significant improvement has been accomplished in the area of legislation with a number of laws being adopted. Still, our members found major gaps in the implementation and everyday practice. The main issues addressed in this edition of the White Book, apart from individual industries, are the labour market and employment, property development, taxation, corporate governance and the rule of law. These key segments selected by foreign investors operating in Montenegro encompass all the related issues.

For the first time in this edition of the White Book we have introduced the MFIC rating representing a perception-based evaluation of the ease of doing business in Montenegro. The overall rating is 5.8 (on a scale of 1 to 10) which provides additional room for further improvement in key areas, based on which the perception-based rating was compiled.

Indeed, the MFIC is committed to partnering with government officials in joint endeavours to contribute to an investor-friendly business set-up. The Council will continue being active in sharing its experience and providing recommendations aimed at establishing a competitive and attractive environment for both local and foreign businesspeople.

By Szabolcs Horváth, Chairman of the MFIC Assembly



About the MFIC



MFIC | Montenegrin Foreign
Investors Council

The Montenegrin Foreign Investors' Council (MFIC), an association of leading foreign investors in Montenegro, was officially established in January 2009 although informal activities regarding the formalization of cooperation between foreign investors started in the summer of 2007. Our aim was to implement an already well-established practice seen in other transitional economies in South East Europe, regarding the adoption of a nationwide formal association of foreign investors.

The MFIC is a non-governmental and non-profit organization, founded by five¹ foreign companies operating in Montenegro. It took us only a few months to grow to a total of 17 members with a tendency for further growth, representing various sectors, including banking/financial services, telecommunications, metallurgy and mining, hotel management, fast-moving consumer goods (FMCG), manufacturing, audit, transportation, energy and retail.

We plan to reach our goals through meetings and dialogue with high-ranking officials and government representatives; by putting forward initiatives to amend legislation that has proved to contain impediments for investors; through contact with local and international institutions and organizations; by providing relevant information to media representatives; by publishing the White Book which contains an overview of the most important issues and obstacles faced by our members and concrete proposals on how these could be overcome.

The MFIC will be working hard to foster dialogue between policymakers and investors in order to improve the Montenegrin business environment through both informal and formal events, such as forums, presentations, official meetings, etc.

Overall, it is our vision to make Montenegro a better place to live in and to work in as a result of our activities.

The MFIC's goals are to:

1. Improve the investment climate and support the business development in Montenegro;
2. Represent and express the opinions of its members for the purpose of promoting common interests and stimulating direct foreign investment;
3. Promote communication, cooperation and dialogue between the Council and the official authorities in Montenegro;
4. Promote interests of international business community in Montenegro;
5. Cooperate with the Montenegrin authorities for the purpose of overcoming possible problems and obstacles which may be faced by foreign investors, including those concerning economic relations with other countries;
6. Connect with other foreign organizations for investors within the SEE region for the purpose of:
 - a) Sharing benefits and experiences of best practice in the world; and
 - b) Analyzing specific tools in order to facilitate regional business and other activities.

¹Crnogorski Telekom, Kombinat Aluminijuma Podgorica (KAP), NLB Montenegro Bank, Montenegro Stars Hotel Group, Daido Metal Kotor.

MFIC's Montenegro Business Environment Index

The MFIC's Montenegro Business Environment Rating represents a perception-based evaluation of the ease of doing business in Montenegro. It is derived solely from the opinions of its members who grade individual industries which they represent on a scale of 1 to 10. This is the first time the index has been published, and the MFIC wishes to establish it as an annual ranking of the business environment which will from now on be published in the White Book. This will enable foreign investors and local decision makers equally to have a quantitative overview of how investors already running a business in the country perceive the business environment on the basis of several indicators (see below). It is divided into two categories: in the first, investors rate the industry in which they operate, and in the second, key areas that we identified on the basis of the inputs from our members. The index will be derived solely from the opinion of MFIC members about these two categories which are rated **on a scale of 1 to 10**, where 1 is the poorest score and 10 the best.

Overall rating

5,8

Industry rating

Telecommunications and ICT	8
Banking	5.6
Turizam	7
Production/Mining/Energy ²	N/A
Trade/Retail/Transportation/Logistics	5.7

The areas that the investors rate on a scale of 1 to 10 are the following:

Labour Market and Employment	4.4
Property Development	4.8
Taxation	6.3
Corporate Governance	5.5
The Rule of Law	4.8

²A rating for this area has not been provided for this year's edition. However, we plan to publish it from next year on.

← We would like to emphasize that there is no specific methodology behind this ranking; it only reflects the subjective perception of MFIC members and not generally accepted facts. →

When rating the **industry**, our members considered how easy or difficult their daily operations are due **to the general business climate and regulatory environment, and other factors such as:**

- administration,
- legal framework including laws and institutions,
- other business infrastructure areas like roads, education, etc.

These represent conditions as “provided” by the state, and should not reflect current conditions or other external factors such as an economic crisis.

For rating the **individual areas**, our members considered how much positive or negative impact on their business each of the categories listed has:

- **Labour market and employment** include several issues such as severance payments, fixed-term contracts, sick leave, etc.
- **Property development** implies for this particular purpose construction permits, registration, the cadastre, enforcing mortgage contracts, real estate appraisal, etc.
- **Taxation/contributions** refer to various fees, taxes, levies and the overall consistency and transparency in paying taxes/evasion of payments.
- **Corporate governance** includes financial reports, bankruptcy regulation, VAT harmonization with the EU, audit practices.
- **The Rule of Law** and provisioning of public services include the length of commercial disputes and court cases, permits and licenses, temporary residence and work permits, etc.

Summary

The Montenegrin economy, recovering from strong negative trends during the 2008-2009 crisis³ which was exacerbated by internal factors such as an unsustainable boom in real estate, remains fragile and highly susceptible to external influences. The economy remains dependent on FDI while adversely affected by a decreasing but still high current account deficit, a lack of robustness in the local economic structure and insufficient competitiveness.

The government is successfully continuing to implement business-friendly reforms, in an attempt to attract more investment. However, despite progress, there is still work to be done in order to make Montenegro's economy a fully functioning market economy able to fully realize what we believe to be huge potential.

The White Book 2011 covers several key issues identified by MFIC members:

- **Labour Market and Employment:** still not flexible enough, posing a threat to the economy in general in this highly sensitive period of recovery, first of all due to unlimited-duration employment contracts which are mandatory and high severance payments.
- **Property Development:** strong development potential, burdened by an inadequate regulatory environment and business barriers in administrative procedures such as obtaining construction permits.
- **Taxation:** a generally favourable tax regime at the national level, however, local taxes and fees charged by municipalities represent an issue of concern, along with the ad-hoc introduction of such levies.
- **Corporate Governance:** gradual improvements have been notable over the past few years, however, significant improvements are necessary in the area of financial transparency and accountability, and bankruptcy regulation and practices.
- **The Rule of Law:** this area is of perhaps crucial importance for further development of an economy which still suffers from issues such as lengthy and complicated judicial procedures and other administrative and public service provision procedures.

In the **Industry Overview** Chapter, the WB 2011 further details industry-specific issues that impede the everyday business operations of our members. These represent barriers that increase the costs of doing business and thus negatively impact the overall competitiveness of Montenegro's economy.

In the end, we discuss the MFIC's cooperation with the Montenegrin Government, evaluating it as highly successful, and conclude with an overview of education which we believe still does not correspond with the needs of a demanding global economy.

³ The impact of the crisis on the Montenegrin economy has been severe and fully unfolded during 2009, with annual GDP contracting by 5.7 per cent y/y.



Investment and Business Environment

Introduction

In the latest *Global Competitiveness Report 2011-2012* prepared by the World Economic Forum (WEF), Montenegro is classified as being "Efficiency Driven" with a score of 2 on a scale from 1 to 3, the same as last year:



This chapter gives an overview of where the country stands relative to its regional peers in South East Europe (SEE) and globally, drawing on a range of macroeconomic data and survey-based evidence, with a special focus on progress made year-on-year. We will argue that, notwithstanding the progress in recent years, there are still major challenges ahead that need to be addressed if the country is to continue to successfully compete for FDI and achieve sustainable levels of growth in the medium and long term.

"There is no reason why Montenegro should not be one of the successful European economies. It has enormous growth potentials, which—if fully unleashed—could generate dynamic rates of growth for decades to come. Granted, at current growth rates of 2.5–3 percent, about 1 percent in excess of average growth rates in the EU, it would take more than 100 years to reach the same income level. However, if growth rates could be increased to an average rate of about 5 percent, that is, to rates about 3–3.5 percentage points above those in the EU, Montenegrins (whose per capita income is currently about 35 percent of the EU average) would catch up with the EU in already about 30 years. This can be done—provided that structural reforms are implemented with a view to fostering private-sector activities, particularly those of small and medium-sized enterprises."

Jan-Peter Olters, World Bank Representative in Montenegro

During the past year we have witnessed the continuation of a trend of implementation of business and investment-friendly reforms that have enabled the country to continue attracting foreign investment in an increasingly cost-conscious and risk-averse environment. Since the previous White Book, new negative trends have emerged across Europe and globally. They have already affected Montenegro and the level of Foreign Direct Investment (FDI), and significantly slowed growth.

	2007	2008	2009	2010	2011*
<i>Direct investment, EUR million⁴</i>	568	581	1066	543	389

In order to return to the strong growth that characterized the post-independence period and continue development, enabling everyone to feel the benefits of progress, Montenegro now needs to focus even more on creating a competitive environment for FDI.

⁴Source: Central Bank, *preliminary data

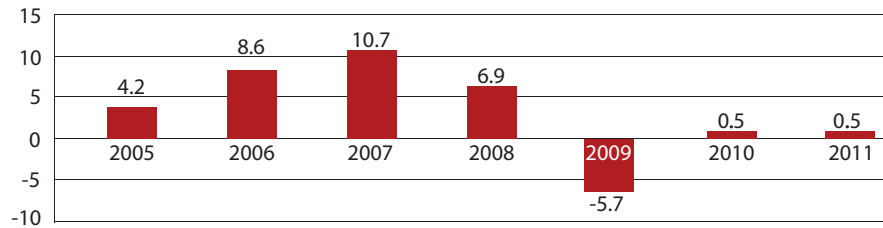


Figure 1: GDP growth (annual %) (Source: Monstat, 2011 Ministry of Finance estimate)

As research by the World Economic Forum (WEF) shows, Montenegro has kept improving its competitiveness over the past few years, to 2011⁵. According to the WEF's Global Competitiveness Index (GCI), Montenegro saw a drop year-on-year in two out of three groups of indicators covered by the research: Basic Requirements (a drop from 45 to 57)⁶, Efficiency Enhancers (an increase from 64 to 63)⁷, Innovation and Sophistication Factors (a drop from 56 to 59)⁸:

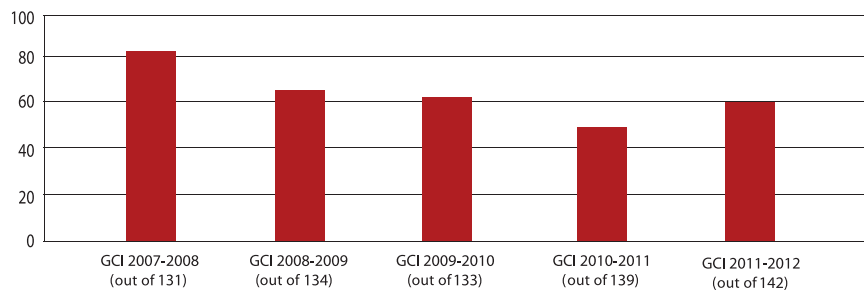


Figure 2: Montenegro's Global Competitiveness Index ranking (Source: the Global Competitiveness Report; World Economic Forum)

According to the results of the WEF's research, Montenegro saw a major drop in the macroeconomic environment indicator⁹. In addition, the number one most problematic factor for doing business, as identified by the WEF research, was "Access to financing", which replaced "Inadequate supply of infrastructure" from the 2010-2011 report¹⁰. This is a reflection of the issues of illiquidity and payment arrears which are severely affecting businesses in Montenegro, which only serves to demonstrate how important FDI is for Montenegro, and how costly a drop in the FDI level can be for the whole of its economy.¹¹

⁵ http://www3.weforum.org/docs/WEF_GCR_Report_2011-12.pdf

⁶ Subcategories used for assessment of this indicator with scores on a scale of 1 to 7: Institutions (4.5), Infrastructure (4.0), Macroeconomic Environment (4.5) Health and Primary Education (5.8).

⁷ As above: Higher Education and Training (4.6), Goods Market Efficiency (4.5), Labour Market Efficiency (4.6), Financial Market Development (4.6), Technological Readiness (4.0), Market Size (2.0).

⁸ As above: Business Sophistication (3.8), Innovation (3.4).

⁹The macroeconomic environment indicator is a part of the Basic Requirements group (see above), and according to GCI Montenegro is now ranked 97 in this area, as opposed to 37 in last year's report.

¹⁰This is opposed to the Doing Business 2012 report which ranks Montenegro in the area of "Getting Credit" at a very high 8th place. This discrepancy is, however, a result of different indicators used by the World Bank which are focused on a part of the regulatory environment only: Strength of Legal Rights index – 10 (0-10), Depth of Credit Information index – 4 (0-6), Public Registry coverage 26.4% (% of adults) and Private Bureau coverage 0% (% of adults).

¹¹The World Bank's Doing Business 2012



“...the number one most problematic factor for doing business, as identified by the WEF research, was “Access to financing”, which replaced “Inadequate supply of infrastructure” from the 2010-2011 report. This is a reflection of the issues of illiquidity and payment arrears which are severely affecting businesses in Montenegro, which only serves to demonstrate how important FDI is for Montenegro, and how costly a drop in the FDI level can be for the whole of its economy.”

Despite the obvious progress, the country continues to draw criticism from domestic and foreign investors and businesspeople. This is due to perceived inadequacies present in the legislative framework or rather its implementation and also due to occasionally intrusive bureaucracy and a lack of adequate infrastructure and related services.

The Heritage Foundation’s World Rankings for Montenegro from 2011 (out of 184 countries) per category, 2010 ranking shown in brackets (out of 183 countries)

<i>Business Freedom</i>	<i>77 (66)</i>	<i>Investment Freedom</i>	<i>77 (75)</i>
<i>Trade Freedom</i>	<i>51 (53)</i>	<i>Financial Freedom</i>	<i>72 (70)</i>
<i>Fiscal Freedom</i>	<i>22 (24)</i>	<i>Property Rights</i>	<i>72 (73)</i>
<i>Government Spending</i>	<i>151 (160)</i>	<i>Freedom from Corruption</i>	<i>70 (69)</i>
<i>Monetary Freedom</i>	<i>35 (82)</i>	<i>Labour Freedom</i>	<i>15 (4)</i>

The general message carried by our findings is, nevertheless, a mixed one: although many improvements have been made regarding the business environment that contribute to a much needed increase in the competitiveness of the Montenegrin economy, many challenges are still to be addressed. The Government of Montenegro demonstrated its commitment to continuing to improve the environment for business through concrete reforms. The MFIC welcomes this, and encourages the government to maintain the pace of reforms.

“The Government of Montenegro demonstrated its commitment to continuing to improve the environment for business through concrete reforms. The MFIC welcomes this, and encourages the government to maintain the pace of reforms.”

Macroeconomic background

Montenegro’s economy grew at an outstanding pace in the pre-crisis period with an average of almost 7 percent from 2004 to 2008. This has mainly been due to strong domestic demand especially in the area of real estate, fuelled by large FDI inflows and rapid credit growth. The growth proved unsustainable as demand contracted due to the impact of the global crisis and internal factors. The steep decline in demand was followed by a drastic fall in FDI, leading to an almost total freeze in the real estate market and a sudden liquidity shortage.

The impact of the crisis on the Montenegrin economy has been severe and fully unfolded during 2009, with annual GDP contracting by 5.7 per cent y/y from an already high 6.9 per cent. After contracting for almost two years, industry began to grow again in the second half of 2010. Nevertheless, industrial production at the end of 2010 was still considerably below its pre-crisis peak. Expected large-scale infrastructure foreign direct investment has so far not materialized and construction activity remains depressed.

In the banking sector, confidence has begun to return, as evidenced by increasing deposits, though they are still below their levels in the third quarter of 2007. However, credit growth reduced by 8% at the end of 2010, and had further reduced by 10% by the end of September 2011. Annual private sector credit growth is also in negative territory, and although confidence is slowly returning, the soundness of the banking sector has not yet been fully restored.

However, the sluggish growth at present is mostly caused by a lack of financing due to over-indebtedness. Additionally, non-performing loans have not yet levelled off and Financial Soundness Indicators have continued to deteriorate. Stagnant lending at the current juncture primarily reflects the dearth of creditworthy projects and increased risk aversion among the banks.

This is coupled with a decrease in FDI, all of which contributes to the existence of significant vulnerabilities in the economy, with a low level of diversification and highly prone to external influences. The outlook for the economy remains stable and slightly positive – the Ministry of Finance expects real GDP to be 2.0 per cent at the end of 2011 (2.5 per cent in 2010). The current account deficit remains high at around 25 per cent of GDP, according to International Monetary Fund (IMF) estimates, and public debt continues to increase¹².

Business environment

Montenegro has made significant progress relative to its regional peers in improving the business environment according to the World Bank’s Doing Business 2011 survey, which places the country in 56th position out of 183 economies surveyed.

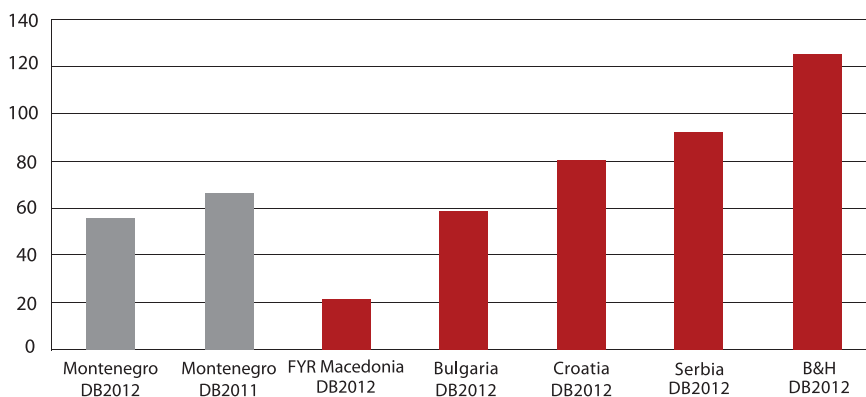


Figure 3: WB Doing Business 2012 – Overall rating, regional comparison

This is an improvement compared to the previous year, when it was in 66th place. According to the report, important advances have been made with regard to starting a business, cross-border trade and paying taxes. In March 2011 amendments to the Law on Administrative Fees were adopted in order to reduce or completely abolish payments for a number of administrative and customs documents. In addition, in May 2011 the government announced that a new one-stop shop registration procedure would soon be available at regional offices of the tax administration, in order to facilitate court and tax registration. Our members, however, note that this is still an area which requires further improvements.

As the World Bank noted, in spite of the positive developments with regard to dealing with construction permits, the area is considered a significant constraint to the business environment and illustrates the urgency of further reforms. The same conclusion can be reached when reading our findings regarding this area¹³. In addition, the report further emphasises the enforcement of contracts and the registration of property as two other main impediments to doing business in Montenegro.

¹²According to the Ministry of Finance, public debt was 45.3 per cent of GDP at the end of February 2012.

¹³ For details see the Property Development section (p. 22)



Doing Business 2012 pointed to three positive developments in Montenegro towards creating a better business environment:

<i>Starting a business</i>	<ul style="list-style-type: none"> • Montenegro made starting a business easier by implementing a one-stop shop.
<i>Paying taxes</i>	<ul style="list-style-type: none"> • Montenegro made paying taxes easier and less costly for firms by abolishing one of the taxes, reducing the social security contribution rate and merging several returns into a single unified one.
<i>Resolving insolvency</i>	<ul style="list-style-type: none"> • Montenegro passed a new bankruptcy law that introduces reorganization and liquidation proceedings, introduces time limits for these proceedings and provides for the possibility of recovery of secured creditors' claims and settlement before completion of the entire bankruptcy procedure.

Finally, corruption continues to negatively affect the business environment in Montenegro and remains a serious challenge to business operations. According to the Transparency International Corruption Perception Index (CPI) 2011, Montenegro scored 4 along with Croatia. This is a slight improvement from the previous year, when Montenegro received a score of 3.7. In a regional comparison both Montenegro and Croatia have the lowest perceived level of corruption.

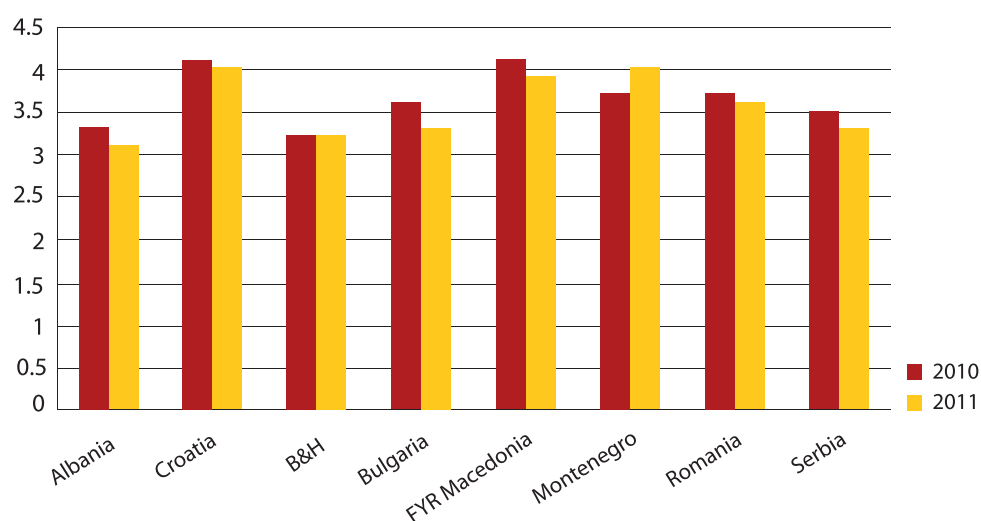


Figure 4: Transparency International's Corruption Perception Index, scores, regional comparison (CPI score is rated on a scale of 0 - 10, where 0 means that a country is perceived as highly corrupt and 10 means that a country is perceived as very clean)

Despite progress noted also in Transparency International's CPI, this area continues to draw criticism. And so, as concluded in the European Commission's Progress Report for 2011:

"...corruption remains a serious concern. Implementation of the new anti-corruption legislation is yet to start. Proper impact assessments need to be developed, including plans for the necessary human and financial resources and preparations for implementation."

Progress in transition

Montenegro has become an official European Union (EU) candidate. The decision by the European Council was made in December 2010 and reflects the progress of reforms over recent years. In October 2011, the European Commission (EC) recommended that accession negotiations be opened, and the European Council decided on 9 December to propose June 2012 as the tentative date. This is, however, conditioned by Montenegro's continued progress on issues such as judicial reform and the fight against organised crime and corruption.

While Montenegro has made substantial progress in reforms such as trade liberalisation and small-scale privatisation, deeper institutional reforms are needed in areas like corporate governance, competition policy, financial institutions and infrastructure services. Most of our members also emphasise that the implementation of laws remains an issue, especially when it comes to administrative procedures required for obtaining different licences, permits, approvals or registrations.

These points are brought out by comparing Montenegro's scores on the EBRD transition indicator scale with those of its regional peers. Figure 5 shows that Montenegro's average score is below all others in SEE except Bosnia and Herzegovina, reflecting low scores in a number of areas.

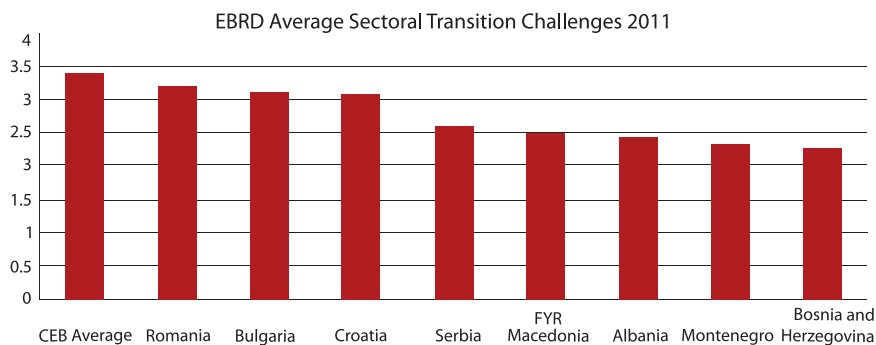


Figure 5: EBRD Transition Scores 2011 – SEE ¹⁴

Table 1 shows individual transition indicators used by EBRD to rank Montenegro as shown in Figure 5. As we mentioned above, Montenegro's scores were particularly low in Private Equity (1), Railways (2), Sustainable Energy (2), Water and Wastewater (2), Capital Markets (2) and others:

¹⁴ The EBRD scale goes from 1 (little or no reform) to 4.33 (standard for an advanced market economy).



2011 Sector Transition Indicators for Montenegro, EBRD Transition Report 2011

<i>Agribusiness</i>	2+	<i>Urban transport</i>	3
<i>General industry</i>	2+	<i>Real estate</i>	2+
<i>Roads</i>	2+	<i>Telecommunications</i>	3+
<i>Railways</i>	2	<i>Natural resources</i>	3+
<i>Banking</i>	3-	<i>Sustainable energy</i>	2
<i>Insurance and other financial services</i>	2+	<i>Electric power</i>	2+ ↓
<i>MSME finance</i>	2+	<i>Water and wastewater</i>	2
<i>Private equity</i>	1	<i>Capital markets</i>	2

Table 1: Montenegro's Sector Transition Indicator scores on a scale of 1 to 4+ according to EBRD's Transition Report 2011

Challenges ahead

The future for the Montenegrin economy is somewhat uncertain at present. Noting the importance of strengthened competitiveness for securing external stability, structural reforms should remain a top policy priority. Greater flexibility in wage setting and employment protection would support job creation in the private sector, while addressing unemployment and poverty traps would boost labour participation and market attachment. Improvements in the business environment and investment climate are also part of the unfinished agenda. Several measures have been introduced in the past year to tackle business climate problems, but, as the surveys above show, licences and permits, enforcement of contracts and corruption are still seen as the main obstacles affecting businesses.

One sector where much remains to be done is infrastructure. Montenegro suffered from a decade in the 1990s of limited investment and widespread neglect of vital infrastructure such as roads, railways and power supply. These needs are being addressed, but it will take time before standards are brought up to those that typically characterise EU countries. Power sector restructuring is a priority reform to improve the electricity supply and support economic activity.

In only 2½ years, the stock of public debt has doubled as a share of GDP. It is not the level per se but the ease and speed with which public debt levels have increased that is concerning.

Finally, one aspect of the investment climate that remains critical for future prospects is macroeconomic stability. Unlike several other countries in the region, Montenegro has not sought a programme with the IMF. Indeed, the fact that the Euro is the sole legal tender eliminates much of the need for balance of payments support, since there is no local currency to defend. However, unilateral Euroisation has its downsides as well, since it effectively eliminates any possibility of independent monetary policy. Furthermore, the growth of credit has slowed dramatically in the wake of the global economic crisis and the banks' reduced appetite for risk. Maintaining the necessary supply of credit to the private sector, especially to small and medium-sized enterprises (SMEs), will continue to be crucial to the crisis response. It is precisely due to all of these reasons that FDI is especially important and will determine the general growth levels.

The MFIC considers that in general, a more pro-active role by the government and its institutions would be welcome. In the current circumstances and negative trends, we believe that the state must play a more active role through various assistance programmes, such as interest rate subsidies for strategic industries or loan guarantees for important infrastructure projects and production capacities.

As tourism is one of the strategic industries for Montenegro, its highly seasonal nature is an issue requiring more involvement and initiative from the government. In order to reap benefits throughout the year, the country needs to encourage development of golf courses and similar year-round facilities, such as conference centres in order to extend the season. In addition easy, cost-effective access from major European capitals needs to be encouraged.



Review of 2010 Recommendations and Remaining Issues

Overview

In a second review of the recommendations and issues, we again note an improvement and excellent progress. However, this is generally speaking an area that is constantly evolving, and can never be fully “solved”. And so, by going through several specific areas that have been highlighted by our members in previous years and some that have surfaced recently, we have listed the problems and issues, noting which ones were eliminated and which still persist.

Labour Market and Employment

Our members consider that the new Law on Labour is a step backwards on the road to a modern labour market in Montenegro. It increased inflexibilities leaving a number of important issues that took the labour market in the wrong direction. If Montenegro is to compete with EU countries for investment and business in general, and thus reach the living standard of those countries, regulation in this area will have to be more flexible than it is at the moment.

In the previous White Book we discussed the draft Labour Law which has been adopted in the meantime¹⁵. Most of the criticism of our members and other investors and business owners was directed towards a lack of flexibility in the Law, primarily relating to the issue of the duration of employment contracts. Having rigid labour regulation in a challenging environment that necessitates flexibility makes business operation increasingly difficult and risky.

Our members agree that the new Law on Labour is a step backwards on the road to a modern labour market in Montenegro. There are still a number of important steps to take to reach that goal. If Montenegro is to compete with EU countries for investment and business in general, and thus reach the living standard of those countries, regulation in this area will have to be more flexible than it is at the moment.

The new legal provisions promote the principle of employment agreements being concluded for an indefinite period, while employment agreements on a definite period can be concluded only in exceptional cases. According to comparative legislation, countries which have employment contracts for indefinite periods, as a rule also have a simple procedure of termination of those contracts. This is not the case in Montenegro.

We see the currently offered solutions with regard to contract duration as a compromise between a backwards and obsolete artificial protection of labour which in the end does more damage than good and a forward-looking model that would enable both the employers and employees alike to negotiate contracts more freely and in accordance with individual needs. However, the MFIC considers this compromise to be insufficient to promote new employment and enable investors to overcome the challenges brought about by the current economic slowdown.

If an employer and an employee agree on having an employment contract for several hours' work, provided all other legal requirements for the employer are met, we see no reason why they should be forbidden to do so.

As we noted in the White Book for 2010: “There is a general understanding that the institution of definite contracts was abused and the MFIC expresses regret for such socially irresponsible behaviour on the part of some employers. However, the MFIC considers that it would be counterproductive to punish all employers because of the irresponsible behaviour of some of them.”

¹⁵ <http://www.sllistcg.me/PravniAktDetalji.aspx?tag={576D1EFE-DC14-49B9-B21D-F57450BAE285}>

Other issues and recommendations

Last year we noted several issues that were affecting the activities of our members. Some have been positively changed, and we list all of them citing comments we received from the Government's Council on Regulatory Reform:

- Regulation limiting the duration of the **disciplinary procedure** has been abused to avoid possible consequences of such a procedure.¹⁶ According to the Council, the role of the disciplinary procedure is eliminated by the new Law on Labour through defining a more simple procedure for individual layoffs.
- **Suspected abuse of the right to sick leave** is still an issue on which our members are reporting some or no progress at all. This remains a latent problem, to which an employer has no means of responding. Although it needs to be viewed in a broader perspective that includes its background and cultural specificities, this can by no means be considered a justification for this issue.
- Related to the above, **controlling issuance of sick leave certificates** has, despite announcements by government officials, remained a problematic area as employers do not have the legal tools to dispute such certificates in administrative or litigation procedure even in cases when it is obvious that the right to sick leave is being abused by an employee.

In addition, our members noted that provisions such as those from some collective agreements on 24 months' severance pay make adjustments to changing market conditions very hard and expensive. Like the other inflexibilities in this area this only makes new employment more restrictive.

- We noted last year that in order to reduce bureaucracy and wasteful use of resources, it would be advisable to **merge leave for giving birth and maternity leave**. According to the Council for Regulatory Reform, "in the Labour Law and the procedure followed for refunding the earnings of a person on maternity leave there is no additional procedure for parental leave, as a continuation of leave for giving birth. The actual length of maternity leave is 393 or 410 days depending on whether a mother begins the leave 28 or 45 days prior to the determined date of giving birth."¹⁷
- White Book 2011: **Article 92, which deals with redundancy issues is not specific enough** and creates room for different interpretations. It also fails to name the legal document necessary for the procedure. According to the response by the Council for Regulatory Reform, the new Law gives additional guidelines for redundancy, thus decreasing the probability of varying interpretations. "In addition, since the Law on Labour is a systemic law applicable to all employers, it defines the general framework, while the employers are to define legal documents through normative acts which regulate their business operations (which is primarily the statute) and are used to implement any procedure including the redundancy procedure. Depending on an individual employer, this can be a resolution, decision or another type of official act."

¹⁶Disciplinary procedure is regulated through the Collective Bargaining Agreement.

¹⁷According to the Labour Law, Article 111, paragraph 2: Parental/maternity leave can be used up to 365 days after birth. The period before giving birth is treated as sick leave and varies in length depending on the particular situation (between 1 and 9 months). Article 111a stipulates that employed women may commence maternity leave 45 days (or a minimum of 28 days before delivery). This maternity leave (between 45 and 28 days) before giving birth is considered in practice as sick leave, not maternity leave.

Property Development

This chapter will combine several areas related to property development that affect business across a range of industries. These include construction permits, the cadastre, enforcing mortgage contracts, real estate appraisal and others.

The MFIC believes this area to hold huge potential in contributing to the overall growth and development of Montenegro, but there is a lot of work left to be done to create an environment that would facilitate and encourage further investment. Property development will continue to be a crucial sector for attracting investment. Real estate investment also continues to play a key role in expanding Montenegro's tourism sector.

Construction Permits

As we noted in the previous two editions of this annual publication, most of the issues related to the issuance of construction permits and real estate development lie with the local administrations. Noting some improvements, our members consider this still to be one of the areas demanding additional attention by the central authorities. In a regional comparison according to the findings of the World Bank's Doing Business 2012, the only country in the region ranked poorer than Montenegro is Serbia. In addition Montenegro fell three places from the previous Doing Business research, as shown in Figure 6:

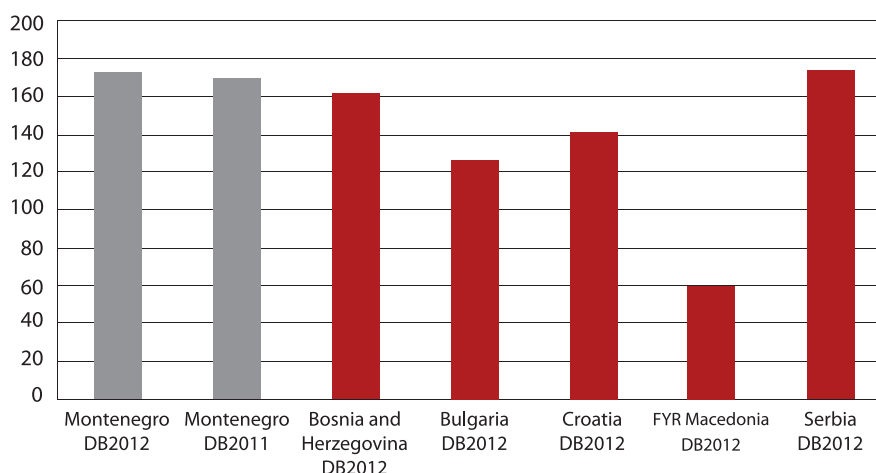


Figure 6: Doing Business 2012; Rankings for Dealing with Construction Permits.

- In the two previous White Books we noted that: *“perhaps the most challenging issue is the one related to restitution. Procedures with former owners last far too long from the perspective of a potential investor.”* This year, unlike the previous one, our members reported some progress, although not sufficient to make our warning from last year outdated: *“...[the process of restitution] poses a threat to further real estate development.”* The Government's Council for Regulatory Reform noted that this process is on-going with 10 721 requests from former owners in process. According to them if an investor is interested in a piece of land currently under restitution procedure, such a case would be given priority.
- We previously noted that the new Law on Spatial Planning and Construction stipulated an obligation to produce a website that contains the so-called Spatial-Technical Requirements (UTU), listing all that these requirements include. The government's website now contains a list of all issued UTUs: <http://www.mrt.gov.me/rubrike/dozvole/dozvole/103139/Urbanisticko-tehnicki-uslovi.html>

- **Utility connection fees remain high**, sometimes high enough to render whole larger development projects unviable.
- MFIC's objection from two previous White Books regarding **unequal conditions for issuing construction permits in different municipalities** is still valid. However, there have been improvements, as some municipalities look to attract more investors, and the decision of Budva Municipality to decrease the communal infrastructure fee charged to potential investors in four and five-star hotels in the so-called "exclusive zone" by 75 percent is a welcome move in that direction¹⁸. In addition, the government has committed itself to tackling the issue on the basis of the one-stop-shop principle.
- In a comment by the Government's Council for Regulatory Reform on our objection last year that **cadastre plans are not harmonized with detailed spatial plans (DUP)**, an explanation is given related to provisions of the Law on Spatial Planning and Construction governing this area (Article 57). **The Council, however, concludes this has not yet been resolved and no timeframe is offered.** For details see the text box *Harmonization of cadastre plans with spatial planning documents*.

Harmonization of cadastre plans with spatial planning documents

The essence of the problems is in defining the boundaries of a parcel of land as defined by the spatial plan in comparison to boundaries of cadastre land parcels or ownership.

In some of the best international practices the ownership of the land is taken into account in the process of defining a land parcel in spatial plans, which means avoiding wherever possible the situation in which two or more cadastre land parcels owned by two or more different owners lie within one land parcel as defined by the spatial plan.

In this way the principle of ownership and efficiency is respected. Practice in Montenegro has shown that this sometimes poses an insurmountable obstacle to real estate development when one of the owners of the land in question asks for unrealistic price for his property.

It would be recommendable to introduce the institution of urban reparcelling, and an obligation of the planners to, wherever possible, match the boundaries of land parcels in spatial planning documents with boundaries of ownership.

- According to the new Law on State Surveying and Cadastre of Immovable Property, as pointed out by the Council for Regulatory Reform, the new deadline for property registration is 15 days. Last year we recommended that a property should be registered within a deadline of a maximum of 15 days instead of 60 (for further details see the text box *Cadastre plans not updated due to inefficient property registration*). Even though 15 days is still a long period, it is nevertheless an improvement although only at the level of legal provisions, as in practice this deadline is not implemented.

Cadastre plans not updated due to inefficient property registration

It would be recommendable for the Real Estate Directorate to hire private, licenced geodetic companies, to make changes in the cadastre records on behalf of the Directorate. This would contribute to increasing the limited capacities of the Real Estate Directorate.

The second recommendation, as we noted in the section on Construction Permits, is to introduce a "pending index", a note informing any interested party that there is an on-going procedure. See the 'Improving of Cadastre Practices' section below for more details.

¹⁸<http://www.vijesti.me/vijesti/budva-komunalije-hotele-sa-4-5-zvjezdica-75-odsto-manje-clanak-57946>



- For the last two years we have pointed out a serious issue: **the obligation of investors to buy the land necessary for the completion of a land parcel as defined in the spatial plan**¹⁹. Our recommendation is explained above, while the commitment expressed by the Council for Regulatory Reform to consider a solution for this issue is welcomed.
- In many municipalities, there is a **lack of either or both detailed and general urban plans**. Creating comprehensive zoning plans and implementing plans at a faster pace would provide a clearer picture about what can be built in specific municipal areas. It would also promote consistency and transparency in the permission process. Further **development of staff members at municipal offices and other government agencies** in order to work with sophisticated development projects such as golf course development is necessary.
- **The goal for the country should be to work towards having all the urban planning documents online, accessible to everybody**. The benefits of this are far-reaching, and the cost is small when compared to possible gains.

Two additional issues that we mentioned last year are worth mentioning again, accompanied by suggestions and comments by the Council for Regulatory Reform:

- **Market principles and their implementation in the process of developing spatial plans.** The Government's Council, commenting on this matter, cited Article 56 of the Law on Spatial Planning and Construction according to which interested buyers are entitled to provide funds for development of the spatial plan. However, the established zoning system in Montenegro is such that even when an investor finances development of a planning document, those urban spatial parameters that would meet the investor's requirements in accomplishing project feasibility often cannot be introduced due to limitations of a planning document of a higher rank, limiting urban parameters. This is why it is necessary precisely and in great detail to standardize and regulate economic and market analysis which would be designed during the stages before adopting a planning document of a higher and lower rank. Such an analysis is mentioned in the Law and accompanying rulebook, but it has not been standardized. In this way economic and market analysis would become a standard for the market valuation of the planner's solution, making planning documents and the projects therein more competitive and attractive for investors. In addition, it is even more important to accomplish a realistic basis for a quick start-up of projects planned in such a way. The basic condition for this is to provide for implementation of this approach in practice through higher-rank plans.
- **Real estate valuation.** Last year we noted: *"There are currently no standards implemented in practice, due to a lack of regulation in this important field. Introduction of internationally recognizable standards would enable a better foundation for further growth and development in the real estate market."* The government has committed itself to look into international standards in this area and consider introduction of a model that would incorporate these. For further details see the text box below.

It is important to emphasize that using international standards in this area is important as a framework that would open up the possibility of having Montenegrin real estate internationally recognizable. It is also important to emphasize that real estate valuation does not mean price determinism but a set of rules and methods according to which the procedure of valuation should be done. At present in Montenegro there is an NGO, Licensed Estimators, but there is no legal framework on the basis of which they could be licensed or be accountable for their valuations. This NGO is also not certified by any of the internationally recognized bodies which create standards in this area (RICS, IVSC, TEGOVA). In addition there are court experts who are also not bound by any international standards of valuation. Lack of internationally recognized valuation of real estate brings several issues: completion of land parcels as defined by the spatial plan is challenging since the possibility of reaching an

¹⁹The investors are required, when filing for issuance of a UTU, to assume the ownership of the whole parcel as defined by the spatial plan, although some parts of it may not have any influence on construction of the planned facility, or generally speaking, making the parcel fit the purpose intended for it by the spatial plans.

agreement is minimized as all parties bring their own estimators. This in turn makes other issues even more challenging, such as issuing construction permits, restitution, tax fraud, increasing risk in mortgage lending which produces higher interest rates, more expensive insurance, transaction costs in developing investment projects and lack of recognition of the value of Montenegrin real estate abroad.

Improving Cadastre Practices

MFIC recommends that a “pending index” should be introduced in a property deed in Cadastre procedures as a sign that there is a procedure in progress:

The MFIC noted that a regulatory loophole enables mortgage borrowers to avoid their obligations. There are cases in which clients of banks provide a property as mortgage security to more than one bank within a short period of time. In addition, what sometimes also happens is that a person sells a property and shortly after uses it as collateral for a loan, since the change of ownership has not been recorded by the Cadastre. For reasons of legal transaction safety, banks are forced to wait for confirmation of the mortgage registration in order to pay out a loan, which can cause significant delays. In order to improve the situation in this regard, it would be advisable to consider the introduction of electronic registration of pending requests. In this way each property deed issued would contain a note on possible pending registration requests before the Real Estate Directorate.

Furthermore, it would be beneficial if the online property deeds were updated daily to include the pending request notes.

These steps would have the immediate impact of creating a better business environment in terms of facilitating a more effective and efficient loan payment, extension of overdraft agreements and guarantees, loan rescheduling as well as real estate transactions. Legality and the rule of law in this area is important for a modern and market-oriented economy and this goal cannot be reached without precise and accurate land registries.

The MFIC would like to point to the related practice in Hungary: after a request for changes in the land registry is submitted, the cadastre officer immediately enters into the database a short subject of the request (property rights change, mortgage registration...), the reference number under which the request is filed, the name and the ID of the person requesting the change (the new owner or the beneficiary of the right which is the subject of registration) as well as accurate information on which part of the real estate the request is related to. Immediately after the entry is made, the data shows up in the form of a note at the top of property deed. In this way any interested party interested will be informed about any pending requests as well as the type of request. The cadastre staff member entering the input does not need to know the details of the request, only the type of required cadastre change which needs to be specified in the standardised application attached to the other relevant documents. If required, the beneficiary of the request could immediately receive a new property deed containing the request note.

Infrastructure

Infrastructure remains one of the most important limiting factors for the further development of Montenegro. We believe that more resources should be dedicated to building and maintaining roads and the transport infrastructure, improving electrical grids and electrical capacity and expand water networks and sewage treatment facilities. Projects such as the regional waterworks at the coast are a remarkable achievement – the MFIC is hopeful other such projects will come to fruition.

“Projects such as the regional waterworks on the coast are a remarkable achievement – the MFIC is hopeful other such projects will come to fruition.”

Infrastructure, as well as development in general, must contain the component of environment protection in order to make Montenegro more attractive and develop a reputation as a credible ecotourism destination. Polluted waterways and beaches are commonly witnessed, particularly in the summertime. Such evidence of pollution is a direct contradiction to Montenegro’s positioning as an ecological tourist destination.

Taxation

As we mentioned in last year’s White Book, Montenegro’s tax regime has become competitive with a 9% corporate profit tax rate. Nevertheless, as we also noted before, this is just part of the story, as ad-hoc introduction of taxes and various fees at the local level hamper the government’s efforts in creating a business-friendly environment²⁰. The MFIC saw the new Law on Local Administration as a step forward. However, the issue of **frequent changes of legislation, especially at the local level still exists**.

One of the issues that we keep repeating from one White Book to the next is a systemic issue which takes time to be improved:

“The understanding of the needs of businesses and investors decreases as one goes from the top levels of the national government to the lower levels, and is almost non-existent in many local-level institutions. This is a serious issue for the general level of Montenegro’s competitiveness, and the MFIC welcomes any action taken to remedy this issue.”

Additionally, the issue of **high utility connection fees** (see section Property Development for details) **which frequently vary from municipality to municipality**, from project to project, is another matter of concern. The cost of such connections should be standardized in order to promote consistency and transparency.

Despite the high fees and taxes levied on investors, our members frequently report that they encounter **slow response from municipalities when building the necessary supporting infrastructure for new construction projects**. This includes access roads and connection to the utility networks. In order to make towns and cities more attractive, more should be invested in public spaces (i.e. building parks, playgrounds, green spaces, public squares, sidewalks, etc.)

²⁰For example the income tax surcharge, levied by municipalities at a maximum rate of 13 per cent. Other examples include tax on alcoholic and non-alcoholic beverages, agricultural tax, festival fees, property tax, tourist residence fees, tourist fees and seasonal import duties. For details please see MFIC’s White Book first issue from 2010.

Corporate Governance

Financial reports

The quality of financial reports is an area with huge potential for improvement. Although some progress has been achieved in recent years, the quality is still not at an acceptable level, with several exceptions. The MFIC considers it would be crucial for the relevant authorities to improve its control and enable not only banks but all other businesses to make informed decisions based on reliable financial statements, such as opting for a particular supplier.

In some examples from their experience, our members from the banking sector have even witnessed balance sheets that do not balance. To make matters worse, this happened even after the financial report in question had been audited.

For this reason, **making the list of companies with blocked accounts publicly available** would also be beneficial in increasing transparency in this field. The effects of improvements in this area would be extensive, and would make any investment in it more than profitable for both the businesses and the government²¹.

Audit Practices

Amendments to the Law on Accounting and Auditing were adopted by Parliament in June 2011. An independent public oversight body for auditors and a quality control system need to be clearly planned and established.

Our members from this industry reported three areas which they consider to be important for future development of this important part of the economy: Corporate Income Tax (CIT), Value Added Tax (VAT) harmonization with the EU, and the financial reporting framework.

Corporate Income Tax (CIT) issues and recommendations:

- **Montenegrin transfer pricing rules are not aligned with OECD Transfer Pricing Guidelines** and best international practices in this area. The provisions governing transfer pricing are too vague and are rarely implemented in practice. The lack of legislative guidance and any reliable practice in this area have caused significant uncertainties as to the way taxpayers should handle their related-party transactions. We recommend that the CIT Law be amended to endorse application of OECD Transfer Pricing Guidelines.
- **Tangible assets that have individual value below the threshold (EUR 300) prescribed by the CIT Law do not qualify for tax depreciation**, but there is no rule in the CIT Law allowing tax deduction for these assets as an expense in the current year. As a result, companies operating with a large number of small-value assets suffer additional CIT costs. We recommend amending the CIT Law to allow tax deduction for such assets in the year that they are purchased, or tax depreciation of the whole group of such assets as a single asset.
- **Taxable profit for the purpose of assessment of CIT is determined by adjusting profit determined by applying International Financial Reporting Standards (IFRS) in accordance with CIT Law rules.** There is a high dependency of taxable profit on accounting treatment of income and expenses under IFRS. Due to the lack of rules in the CIT Law, unintended excess taxation or non-taxation may occur in specific types of transactions (e.g. property measured at a fair value, recognition of income, etc). We recommend introducing additional rules into the CIT Law to further align the CIT Law with IFRS.

²¹While the White Book 2011 was being prepared for printing, the government made an important step in this direction by adopting the Amendments to the Law on the Payment System which would enable the Central Bank of Montenegro to publish the names of the companies with blocked accounts. The Central Bank would be able to publish the names of the companies with accounts blocked for more than 30 days and with more than EUR10 000 blocked. The list will be updated once a month, and published on the Central Bank's website.

- **Rules relating to permanent establishments of non-resident entities are very general** and many uncertainties exist with respect to invoicing, financing and taxation. Additional rules should be introduced to increase the clarity and certainty of tax and accounting treatment of permanent establishments.
- **Rules regarding tax treatment of liquidation of a company and corporate restructuring (mergers, spin-offs, etc.) are too general and unclear.**
- Currently **there are no rules regarding tax treatment of joint ventures and joint operations** (arrangements where two parties conduct business activity under joint control, with or without establishing a separate company), resulting in a high level of uncertainty.
- **Rules regarding withholding tax on royalty payments to non-residents are general** and according to our members the current approach of the Montenegrin tax authorities is that withholding tax on royalties is payable on licenses for the use of software. Such an approach is not consistent with best international theory and practice. We recommend amending the rules on withholding tax in order to align them with international practice.

Value Added Tax (VAT) harmonization with EU

- As the **VAT Law** has not been updated since its introduction, there are **significant discrepancies with the latest EU VAT amendments and common business practice**. On a practical level, this process will solve the issue of double taxation or non-taxation of certain transactions as a consequence of different rules applied in Montenegro and the EU.
- According to our members, **Montenegro did not improve its VAT system as much as the current business practice requires**. As an answer to numerous questions and Law understatements, there are a significant number of Opinions and Interpretations issued by the Montenegrin Ministry of Finance and Tax Administration. However, still **certain aspects require to be regulated by the Law** and, on the other hand, the number of opinions / requests itself indicates the need for legislative amendments in order to adjust it to current business needs and to support and attract new FDI.

Financial Reporting Framework

- **The issue of a relevant financial reporting framework in Montenegro remains**, even though several years have passed since the International Financial Reporting Standards (IFRS) were introduced into the Law. The Law says that IFRS should be applied when preparing a set of financial statements even though the standards have not been translated or officially adopted by the relevant authorities. There is generally some confusion as to whether the legislators mean IFRS as adopted by the EU or IFRS in general, which can make a large difference in the case of financial reports, especially in the financial sector.
- **In practice**, according to the information our members have, **certain departures from IFRS are clearly exercised but not admitted by companies or the relevant authorities**. The examples are corrections of prior-year errors, sub-consolidations and consolidations, just to name a few.
- The MFIC recommends that the authorities in this area should aim towards **defining which standards are applicable** and who (if need be) is responsible for the adoption and translation of the standards.

Bankruptcy Regulation

An issue that continues to be a source of abuse without offering any additional value is a lack of regulation for establishing new companies by managers or owners of companies undergoing bankruptcy procedures. A lack of appropriate regulation in this matter has led to many abuses, giving the owners of bankrupt companies a way out of their obligations towards their creditors, be they banks or suppliers or other business. This issue is partially currently

treated by Chapter XXII of the Criminal Code, while the MFIC recommends that the authorities consider the option of introducing this restriction through the Law on Companies which would be more comprehensive and applicable than criminal proceedings.

A new Bankruptcy Law came into force in January 2011. The new law significantly shortens deadlines and enables the submission of a legally enforceable restructuring plan together with the bankruptcy petition, against which the creditors' claims are to be settled. Another novelty is the possibility for the debtor's company to be sold as a single legal entity, which increases its chances of survival.

As stated by the EC Progress Report:

"...the new Bankruptcy Law adopted in January is aligned with, and partly transposes into Montenegrin legislation, the relevant directives and regulations on settlement finality in payment and securities settlement systems. In the cases of Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims and Directive 2009/44/EC amending the Settlement Finality Directive and the Financial Collateral Arrangements Directive there is no progress and the relevant legislation is still under discussion."

However, the issue that we mentioned is not regulated by Montenegro's legislation. In the example from below, we cite a part of the relevant laws²² from Hungarian legislation that deals with the issue:

23. § (1) A person previously convicted to an enforceable jail sentence shall not be a senior officer (CEO, Director) in a company until all the legal consequences have expired.

(2) A person who has been removed from the position of a senior officer in a company by means of an enforceable court decision shall not cover such a position until the decision is valid. If a person was removed from another official position by means of an enforceable court decision, until such decision remains valid, he shall not cover a senior officer position in a company in which he performed an assignment from which he was removed.

(3) A person covering a senior officer position in a year preceding the year when a company was removed from the company registry due to introducing bankruptcy proceeding, shall not be assigned to a senior officer position in another company.

(4) A person in a senior officer position or an owner - on the basis of a majority stake in a company - shall not be a senior officer of another company if a court, on the basis of the Law on Bankruptcy, determines that he was liable for indebting the company and failure to meet its financial obligations occurred as a consequence of such indebtedness. The prohibition shall remain valid 5 years from the day the executive procedure was established as unsuccessful.

104. § (1) A shareholder leaving the company, including shareholders transferring their share to another person, shall be held liable for any debts towards third persons incurred prior to revoking shareholder status for 5 years from the day of losing the right to hold shares, in the same manner as it was the case while the right to hold shares was valid. This provision shall apply to a legal successor of the company who was not a member of the company.

²²CXCVII (197-es) from 2011, and the Law on Companies IV (4.-es tv) from 2006.



The Rule of Law

Judiciary

European Commission Montenegro 2011 Progress Report: "...weaknesses in the rule of law and prevalent corruption continue to have an adverse effect on the business environment and remain a major challenge."

An issue we discussed in the previous White Book, despite some progress, continues to trouble investors - the effectiveness of the rule of law in terms of the length of the proceedings before the courts. As we noted previously: *"Lengthy court proceedings can render the intent of the petitioner completely pointless, thus jeopardising the very foundations of the rule of law."*

This issue is affecting all our members, but also the economic and social environment in Montenegro. More precisely these are **lengthy commercial disputes and court cases**, which in some instances are known to even last several years.

Permits and Licenses

One of the most criticised areas of administrative procedures required for business operations is the area of issuing permits and licences. As in the previous two White Books, we have to commend the government for the progress achieved. However, a lot remains to be done in terms of streamlining the procedures and making them more cost-effective.

The example of Licences for Conducting Business is notable. Apart from the fact that the procedure is far too long, the legal provisions guiding this procedure are scattered in numerous pieces of regulation. This creates confusion and causes unnecessary delays with starting a business. The one-stop-shop principle is in this area almost non-existent.

Our recommendation on **introducing the principle of 'silence is consent'** is still valid. Even the Amendments to the Law on General Administrative Procedure from July 2011, introduce the principle of 'silence is consent' (Article 212a) but the practical value of this provision is still questionable. As noted in the White Book 2010:

"Modern business practices, increasing internationalization of business, frequent changes in technology and effects of globalization require businesses, and also the authorities, to be flexible at all times. Should the administration fail to follow up on such changes, this may endanger Montenegro's economy in general."

In spite of welcome changes and improvements in the area of **temporary residence and work permits**, particularly when it comes to cost reduction and streamlining the procedure, obtaining work permits for foreigners continues to be a source of frustration for our members. They reported long waiting times and repeated, perhaps unnecessary, obligation to appear before the competent authorities in person. Expressing satisfaction that most of our objections and recommendations were taken into account, at the same time we urge the authorities to consider further streamlining of the procedure.

The MFIC is hopeful that new regulation in this field would further facilitate this process. As the Ministry of Finance wrote in its Bulletin number 24: *"Regulating the area of employing foreigners, two amended laws come into force: the Law on Employment and Work of Foreigners and the Law on Foreigners, while the Rulebook on Approving Temporary Residence and Permanent Stay and Issuing Travel Documents and Other Documents, and the Rulebook on Issuing Working Permits for Foreigners are being drafted. These documents reduce the number and types of working permits; they eliminate procedures for reporting the beginning and discontinuing of activities carried out by foreigners registered in Montenegro; deadlines for issuing work permits have been reduced; timeframes for submitting a request for issuing approval for temporary stay to a public authority body in charge of foreigner affairs have been determined; the timeframe for submitting a request for extension of working permits for movement of a person within a foreign-owned company has been specified."*

Execution Procedures

In this area we previously noted the following:

“In general, the MFIC recommends a solution that has already been implemented in the region – that execution procedures should be outsourced to private executors. This would reduce the burden unnecessarily placed on the courts, thus making them more efficient. Apart from this, procedures would also be facilitated, and what is perhaps most important, the incentive to cheat would be removed and the rule of law strengthened. As this procedure is new, lawmakers may choose the option of adopting a parallel system – private and court executors, to gradually introduce the new system.

“In order to solve the issue of locating bank accounts, we recommend introducing changes to the law in order to make it compulsory for people to submit their birth certificate number instead of their bank account number.”

The newly adopted Law on Public Executors introduced the institute of public executors in a way similar to that which we recommended. The Council welcomes very much this decision, looking forward towards its implementation.

Notaries

The newly established institution of Notaries affects businesses across the board, regardless of their niche and industry, which is why we would like to offer our opinion on this important part of reform of the rule of law. Notaries, being a new institute, have received a lot of attention and criticism from the public, some justified, while some less so.

Practice has pointed out issues such as when a client of a bank applies for a loan with several collaterals, such as real estate. In this case several agreements need to be concluded while a fee is charged for each of these agreements.

When the institution of notaries was established, they initially interpreted the Law on Notaries to mean that they could make notary acts only for real estate situated in the jurisdiction of the notary. Thus, in a case in which these real estates are in different municipalities, the client and the bank’s representatives have to go to notaries in each of those municipalities. Now, their standpoint is that they can make a notary act for real estate which is not in their municipalities under one condition: one of the real estate properties needs to be in the municipality where the notary has its head office.

the buyer approximately two to three average monthly salaries. In this economic environment this is inappropriate. The increased transaction costs incurred in this way will have spill-over effects on prices in general and will negatively affect primarily small and medium-sized businesses and citizens.

MFIC members pointed to several issues which can be grouped into two categories which they believe should be given additional consideration. These are unjustifiably high fees, and a prolonged procedure in some cases.

Fees

MFIC members all agree that the currently applicable fees charged by public notaries, which can go as high as EUR 5 000, represent a significant business barrier. Even the new Notary Tariffs, adopted in January 2012, bring quite a small reduction in fees²³. Earlier, while the courts performed this duty (even though the courts and notaries do have different roles), the maximum fee was EUR 300, while there are cases in which they are as much as 100 times higher than before. This is not just in theory, as our members have faced in practice such drastically higher fees.

A good illustration is a contract for the transfer of ownership of, for example, a medium-sized apartment. Fees charged by the notaries will cost

²³http://notari.me/images/stories/tarifa_sl_u_beni_list_27_01_2012.pdf

Even though the institution of notaries was designed to offer additional legal security to parties to an agreement, corporate clients in most cases receive less added value in comparison to individual clients since they already have legal departments which prepare contracts and other legal acts.

Procedures

Besides the expenses, one of the issues related to the procedure is the obligation to make appointments, which can be done several days in advance. Another few days are then required by the notaries to make the notary record. This has made planning and daily business operations significantly more complex, especially for some types of businesses.

Some of our members reported having issues with mistakes in notary records, due to which the whole procedure needs to be repeated.

According to the Law on Notaries, the notaries guarantee for the contents of the legal acts they prepare with their property. In practice this is going to be difficult to enforce as they often do not provide assurance of their guarantees for the legal acts they prepare.

Law on Foreign Investment

Several issues that we pointed to last year remain outstanding, while some are incorporated into the Law on Foreign Investment. Generally speaking, it does represent a step forward in comparison to the previous law; however, it still can be improved to offer additional protection.

- Last year we noted that: *“foreign investors are not fully equal with local business and residents when it comes to property rights. In particular this relates to some limitations regarding the acquisition of real estate (Article 415 of the Law on Property²⁴)”*. This is why we suggested that the Law on Foreign Investment should state that national treatment should be applied if other laws do not limit the rights of foreign nationals. This has not yet found its way into the Law, however, as the Government’s Council for Regulatory Reform reported, since the Stabilisation and Association Agreement (SAA) between the European Union and Montenegro signed in October 2007 entered into force on 1 May 2010, and according to Article 63, paragraph 3 of the SAA, Montenegro is obliged to provide national treatment to EU citizens when it comes to acquiring real estate.
- As we noted previously: *“It would be advisable for the government to pass relevant secondary legislation in order to define in detail the basis and manner of procedures and compensation payment deadlines. This deadline for damage compensation should be no longer than six months from the day of expropriation, or the day the foreign investor ceased to operate. Furthermore, the amount of compensation payable in case of expropriation should be determined with regard to the value of any expropriated property at the time the decision on expropriation is taken.”* As the Government’s Council for Regulatory Reform informs us, based on Article 22 paragraph 3 of the Law on Expropriation (“Official Gazette of Montenegro”, numbers 55/00 and 28/06), the Ministry of Finance adopted the Guideline on Methods and Procedures for Payment of Funds from the Deposit Account for Expropriation (“Official Gazette of Montenegro”, number 78/06 from 22 December 2006), which defines the methods, procedures and deadlines for compensation payments.
- We also recommended that *“...Chapter V on the Registration and Promotion of Foreign Investments should also contain a provision which states that foreign investments which are not registered in a way defined by law will not be protected”*, which was also not included. However, the MFIC encourages the government to consider taking further steps in providing additional protection to foreign investors, in accordance with recent trends in this area. This could be conducted within the future considerations of the amendments to the Law on Foreign Investment, or through other legal instruments.

²⁴http://www.skupstina.me/cms/site_data/23_%20SAZIV%20ZAKONI/ZAKON%20O%20SVOJINSKO-PRAVNIM%20ODNOSIMA.pdf

Regulatory Framework in Banking

Most of the issues related to the regulatory framework in this area are mentioned in general in the Banking chapter. Our members emphasize the improvements they have experienced over the course of the last three years since this White Book was first published. However, implementation of the International Accounting Standards and mortgage-related regulations including the enforcement of collaterals continue to hamper banks' business operations.

Below is a list of issues specifically related to implementation of mortgage regulations that we prepared for the previous White Book, the 2010 edition, accompanied by the Government's Council for Regulatory Reform and Improving the Business Environment's comments:

Issues related to implementation of mortgage-related regulation	Comments by the Government's Council for Regulatory Reform
<p>We noted earlier that mortgage contracts should be enforceable documents, however, according to the Law on Notaries, mortgage contracts are under the exclusive competence of notaries. Mortgage contracts can be enforceable documents if parties made an agreement on this issue (Article 54, the Law on Notaries). The Legal Affairs Directorate insists on the enforceability of mortgage agreements in all agreements made by notaries.</p>	<p>The Council pointed to another direction: the Draft Law on Enforcement and Securitization (Article 18, paragraph 1, point 3) stipulates that mortgage contracts are also to be enforceable documents: "The mortgage contract, or the statement of mortgage made in accordance with the regulations on mortgage".</p>
<p>In order to shorten procedures from initiation of a settlement to the point of executing an out-of-court sale, mandatory registration of the Notice on the Initiation of Settlement with the Real Estate Directorate should be revoked – thus the timeframe within which the sale of real estate can be conducted would be shortened by the duration of an entire administrative procedure.</p>	<p>The notice requirement on the initiation of settlement is defined by the Law on Property Ownership passed in 2009. This law is a systemic law, which requires a two-thirds parliamentary majority in order to be amended. It is not possible to specify a date at which this law could be amended.</p>
<p>Deadlines given to administrative bodies to implement requests by banks, or for making relevant decisions related to mortgages – for example regarding deadlines for urgent procedures should be shortened from 30 days to 15 days.</p>	<p>The Law on State Surveying and Cadastre of Immovable Property, Article 120, stipulates registration in a shortened procedure.</p> <p>According to the Law, the deadline for this is eight days.</p> <p>Article 122 stipulates: Approval of requests for registering property rights in the cadastre. The law says that the cadastre must decide on the issue no later than 15 days from the day of receipt of the request.</p>



<p>Harmonizing positions of competent cadastres with regard to changes in cadastre records.</p>	<p>Registration in the cadastre is defined by the Law on State Surveying and Cadastre of Immovable Property. In the procedure of registration in the cadastre, the state body decides on registration on the basis of the documentation relevant for registration and the registration conditions in the cadastre.</p> <p>Changes in cadastre records are made after a decision is final and executive.</p> <p>The Ministry of Finance made a commitment to monitor the implementation of the provisions of this Law.</p>
<p>Make decisions by competent bodies in the second instance both final and executive, without the potential for either complaint or legal appeal.</p>	<p>The Law on General Administrative Procedures stipulates that an appeal can be made before the Administrative Court against a decision in the second instance.</p>
<p>Enable the involvement of a competent body from Internal Affairs to provide any necessary assistance in order to conduct settlement procedures, on the basis of a decision on the registration of a ‘notice of sale’ or ‘contract of sale’ for a mortgaged property.</p>	<p>The Draft Law on Public Executors in Article 16 defines the authorities of a public executor (trustee), while Article 21 defines the co-operation with the police and authorities and organizations in conducting the public executor’s affairs.</p> <p>The Law on Construction in Article 64 does provide for the assistance by the police:</p> <p>“The Court or a public executor is authorized to remove a person who interferes with enforcement, and when necessary to request police assistance...”</p>
<p>Define a price for which a mortgaged property can be sold out-of-court.</p>	<p>The price is set by authorized estimators.</p> <p>This has been regulated by a new provision in the Law on Construction (provisions in Chapter XIV “enforcement of immovable property” Articles 154-201).</p> <p>Article 201 – Application for out-of-court sale of mortgaged real estate.</p> <p>Article 173 – Price of sale and sale procedure</p> <p>Article 166 – Methods of estimating value</p>
<p>Define the rights of the mortgage creditor to acquire ownership of the mortgaged property in a more precise manner.</p>	<p>The Law on Property Ownership passed in 2009 defines the rights of the mortgage creditor, or the right to collect debts. The creditor is required to inform the debtor that a deadline for enforcing an obligation has expired (Article 333).</p>

The Council would like to express its appreciation for the reforms the government is implementing in this area. We view the steps taken thus far as relevant and in the right direction. We hope the regulation that is being prepared would contribute to strengthening the rule of law in the area of enforcing decisions related to mortgage contracts. We do, however, have to note a certain amount of **discrepancy between what is written in the law and what happens in the daily conduct of business**, listing a few examples:

- In the field of **issuing construction permits**, in which the one-stop-shop principle is recognized by the law, in reality a lot remains to be done in order for this principle to be fully implemented;
- The situation is similar with the issue of **collateral enforcement** (see below for details);
- Our members report cases of a **bankruptcy petition pending for more than three months** although the legal limit is 30 days;
- An **enforcement procedure**, in six different instances, was **pending for more than eight months**, although, according to the law, the court is required to decide within 30 days.

“The Council would like to express its appreciation for the reforms the Government is implementing in this area.... We do, however, have to note a certain amount of discrepancy between what is written in the law and what happens in the daily conduct of business ... [M]ore attention needs to be paid to enforcing the law. In regard to this the commitment by the Ministry of Finance expressed in the above quoted comments of the Council for Regulatory reform, that the ministry would monitor the implementation of the Law on State Surveying and Cadastre of Immovable Property, is a welcome move.”

Therefore, more attention needs to be paid to enforcing the law. In regard to this the commitment by the Ministry of Finance expressed in the above quoted comments of the Council for Regulatory reform, that the ministry would monitor the implementation of the Law on State Surveying and Cadastre of Immovable Property, is a welcome move.

Collateral enforcement remains an issue in banking. Based on the current practices of registration, activation and enforcement of mortgages, MFIC members from the banking industry consider that the legal framework and its implementation need to be further improved. The legal loopholes witnessed in practice, have led to many abuses by borrowers and their legal representatives by delaying the whole process indefinitely. In this area the MFIC is hopeful that the new Law on Contracts on Financial Collateral, which is according to the Government’s Council for Regulatory Reform based on the EU Directive 2002/47 EC, on financial collateral agreements, will, arguably, lead to a more efficient and simpler procedure of execution of financial collateral. However, **this is only a small fraction of the problem, as financial collateral makes up an almost negligible portion of all collaterals used.**

*“...the MFIC is hopeful that the new Law on Contracts on Financial Collateral, which is according to the Government’s Council for Regulatory Reform based on the EU Directive 2002/47 EC, on financial collateral agreements, will, arguably, lead to a more efficient and simpler procedure of execution of financial collateral. However, **this is only a small fraction of the problem, as financial collateral makes up an almost negligible portion of all collaterals used.**”*

The situation in practice, as we mentioned, is currently complex and collection of collateral remains very slow and inefficient. The primary concern is related to lengthy court procedures, which are particularly evident in procedures for blocking accounts with the Commercial Court, lasting up to several months, or in some instances even more than a year. In order to make any use of this important tool this cannot be longer than 5 working days, which should be introduced by means of regulation.

Besides the observations we listed above, several others issues need to be emphasized:

- It would be advisable to enable the **Out-of-Court sale of a mortgaged property to be initiated by means of a public bid or direct agreement**, which should be decided by the creditor;
- To revoke the **obligation of a creditor to post a notice of sale** on the real estate which is for sale;
- The Real Estate Directorate should **respect the legally prescribed timeframes in deciding upon the requests of creditors.**

It should be noted that in 2011 several new laws and amendments to the existing laws were adopted: the Law on Enforcement and Securitization ("Official Gazette of Montenegro", No.36/11), Amendments to the Law on General Administrative Procedure ("Official Gazette of Montenegro", No. 32/11), and Amendments to the Law on State Surveying and Cadastre of Immovable Property ("Official Gazette of Montenegro", No. 32/11). The MFIC welcomes these increased legislative activities, hoping that they will help increase efficiency in handling these administrative issues.

Industry overview

Sectoral value-added as a share (%) of GDP²⁵

Services	70
Non-Manufacturing Industries	14
Agriculture	10
Manufacturing Industry	6

Telecommunications and ICT Sector

Introduction

The telecommunications industry today faces numerous challenges as technology develops and demand gradually shifts from traditional services offered by this industry into broadband access and especially wireless data. Globally, this was a key driver fuelling growth in the ICT industry in 2011 and beyond, while similar trends have also been recorded in Montenegro. This dynamic sector continues to contribute to the overall growth, still facing some of the challenges from the previous period.

Developments

Despite the announcements that the frequency tender by the Agency for Telecommunications may bring new mobile operators to Montenegro, this has not happened. The mobile market has very high levels of penetration, and is at a mature stage with very limited potential for growth.

The mobile telephony market in Montenegro is highly competitive, with three incumbent operators, Telenor, owned by Norwegian "Telenor Mobile Communications AS", T-Mobile, which is a part of Crnogorski Telekom and M:Tel, owned by Telekom Srbija and Telekom Republike Srpske. Penetration levels are among the highest in the world, reaching 187 percent at the end of 2011. Similarly to global trends in fixed telephony, the number of subscribers in Montenegro is also stagnant or somewhat dropping due to the effects of fixed-mobile substitution. Broadband access continued its expansion, increasing year-on year by 12.56%. There is a similar situation with cable television, which was introduced in Montenegro in 2007. The total number of users had reached two-thirds of the total number of households at the end of 2011.

On the other hand, fixed liberalization has brought favourable conditions for light-asset market entry of regional service providers. Potential investors can take advantage of further market (TV) or industry consolidation (IT).

The infrastructure remains an obstacle to realising the full potential of the Montenegrin market. Further development of the ICT sector requires investing additional efforts through joint action of all stakeholders.

²⁵Source: *Global Competitiveness Report 2011-2012, World Economic Forum*



Remaining challenges and obstacles to further development

Our members, drawing on their earlier negative experiences, expressed concerns that the difficulties that the Montenegrin economy is facing, partly influenced by the global crisis and a lack of FDI and external funding and bank loans, may lead the authorities to tap deeper into the profits of successful companies by introducing ad-hoc taxation which may significantly impact their business.

Several general issues that have been an impediment to the further development of this sector in Montenegro have already been mentioned in this document, whereas in this section we would like to list a few industry-specific recommendations, of which some remain the same as in the previous White Book. In addition, we are pleased to announce what we consider to be notable improvements in the industry:

- **Infrastructure development** via public/private partnerships needs to be continued. However, the current price for infrastructure leases set by the Agency for Telecommunications is far too low, which represents a significant barrier for further development.
- **Simpler regulations.** Some procedures according to the new Law on Improvement of the Business Environment which were meant to be streamlined, caused the opposite to happen in practice. They are now even more complex, as the deadlines for telecommunications companies for resolving users' appeals has been reduced from 15 to 8 days, just like the deadline for resolving appeals filed by users of telecommunications services to the Agency for Telecommunications, as the second instance, was reduced from 30 to 15 days.
- **Cooperative national and local authorities** when it comes to licenses and permits for network development. This is one of the areas where our members report more progress every year. The government at the level of ministries showed willingness to help with barriers caused by municipalities. It is at the local level where more improvement is still needed.
- Last year we noted that a **lack of dialogue and exchange of information** between the stakeholders – the ministry, agency and the operators – was a matter for concern. Our members report that the situation has changed significantly and that now it is at a satisfactory level. However, there is still room for an **increase in administrative capacities**, when it comes to the relevant ministries.
- In an industry as dynamic as telecommunications, **government bodies and independent agencies** have to keep up with the pace. We note improvements in this area, especially when it comes to the regulatory agencies.
- The **lack of understanding of the specific features of the telecommunications industry** can also be a challenge when it comes to appeals before the Montenegrin authorities. In this area our members have unfortunately registered no improvement.
- Implementation of certain remedies prescribed by **market analysis in the Law on Electronic Communications** may discourage further infrastructure investment.
- In order to fully take advantage of electronic commerce, **provisions of the Law on Electronic Commerce relating to distance selling need to be aligned with the Consumer Protection Law.** According to the current legal framework, in order to execute a transaction, there has to be written agreement between the parties. It would be recommendable here to utilize the potential the electronic signature has.
- Currently the **Law on Construction has overly demanding provisions for telecommunications business.** It does not recognize the specifics of this industry, and our members are faced with a cumbersome task of acquiring a construction permit in order to lay cables for their infrastructure. This is further exacerbated by a lack of good cooperation with certain municipalities.
- The sensitive area of **protection of personal data protection requires alignment with the whole legal system.** At present, the provisions are scattered in various legal acts and our members are sometimes faced with different interpretations of an individual case by different agencies.
- **Burdensome local/municipality taxes as well as high notary fees** that cause extremely high costs in day-to-day business. Notary fees are in some instances as much as several hundred times higher than before (for details see section on notaries).

- Lengthy **commercial disputes and court cases, which in some instances can last up to several years.** This is a consequence of a lack of administrative capacities, i.e. a lack of staff with expert knowledge on issues specific to the telecommunications industry.

Banking

Overview

The CBCG Council adopted a set of significant decisions in March 2011 in the area of monetary policy, aimed at furthering the recovery of the banking sector which should in turn contribute to the economy in general.

Confidence in the banking industry is gradually returning and foreign parent banks have maintained their commitment. The comprehensive set of financial sector laws introduced recently should further support financial stability. Thus, the banking system as a whole reported an annual profit of EUR 9.5 million for 2011. However, the sector remains volatile and exposed to non-performing loans (NPLs), and higher levels of

liquidity and solvency are required, although according to Montenegro's Central Bank's data (CBCG) the share of non-performing loans in December saw a year-on-year decrease of 39%²⁶. Total assets and liabilities of banks amounted to EUR 2 857.3 million at the end of November 2011, recording an annual decline of 3.7%.²⁷

Members of the Council consider that a step forward has been made with the introduction of more flexible policies by the Central Bank, which are now less conservative than was the case in the previous period.

The issue of payment arrears and illiquidity combined with a lack of funding continued to be one of the key drivers of negative tendencies in Montenegro's economy over the previous period. According to data from Montenegro's Central Bank, total bank deposits amounted to EUR 1 831.1 million at the end November, which is a 2.3% increase year-on-year.

Total loans amounted to EUR 1 937.7 million at the end of November 2011, which is a year-on-year decline of 13%. The loans/deposits ratio amounted to 1.06 in November 2011, showing an improvement in relation to the end of November 2010 when it was 1.24.²⁸

Category	Amount	% change, year-on-year
Total assets and liabilities	EUR 2 857 million	-3.7%
Total bank deposits	EUR 1 831 million	2.3%
Total loans	EUR 1 937 million	-13%
Loans/deposits ratio	1,06	17%

²⁶ Report of the Governor of the Central Bank of Montenegro, December 2011.

²⁷ Bulletin of the Central Bank of Montenegro, December 2011

²⁸ Ibid.

The Decision on Open Market Operations prescribes that the purchase of securities may be executed as a permanent transaction and repo transaction, the conditions to be fulfilled by banks in order to participate in open market operations, whereby individual operations are subject to the Council's decision in accordance with the goals and tasks of monetary policy. The Decision on Detailed Conditions for Granting Liquidity Loans to Banks prescribes the possibility of granting intraday, overnight and short-term liquidity loans for a period of 15 days. The Decision prescribes detailed conditions to be fulfilled by banks in order to obtain short-term loans, as well as the lending procedure. The Decision on Granting Last-Resort Financial Assistance prescribes the possibility of providing credit support to banks and financial institutions for the purpose of preventing the jeopardizing of safety and the soundness of the banking system if a financial institution fails to provide support from other sources. The implementation of this function stipulates the commitment of a bank to refrain from lending, paying dividends, investing in other legal persons, or increasing its operational costs while using this assistance. The Guidelines on the Allocation of Funds for the Implementation of Monetary Policy Instruments prescribe that the funds that may be used for these purposes are: CBCG cash assets, bank reserve requirements up to the amount of the allocated assets of the bank in question, and exceptionally, funds borrowed from international financial institutions or foreign central banks.

Remaining issues

- Last year we remarked that the new instruments stipulated by the Law on the Central Bank need to be developed, speaking primarily about **open-market operations and the lender of last resort**. Our members assess that there is improvement in this area, since these instruments have been institutionalized through the legal framework²⁹. Nevertheless, we look forward to seeing this regulation practically implemented in 2012.
- When it comes to **Implementation of International Accounting Standards (IAS)**, our members welcome the progress in the regulatory framework. In July 2011 the Central Bank adopted a new Decision on Capital Adequacy. According to the Central Bank, this decision is in harmony with internationally recognized standards in banking and fully implements the standards established by the Basel principles. However, it was announced that the application of **International Standard 39** (regulating provisions) **will not be implemented**. The CBCG stated that the preparations of this regulation are on-going, while implementation is planned for 2013. MFIC members consider this to be an important area and encourage the CBCG to reconsider the dynamics of introducing the IAS 39, in order to be implemented during this year.
- Last year it was announced that the activities of the Council for Financial Stability will be aimed at preventing and moderating potential systemic risks in the financial system. Thus far the Council has adopted a Draft project proposal for Design and Implementation of the System for Evaluation and Monitoring the Financial Stability, aimed at creating an analytical basis for the identification of indicators of early warning in the financial system.
- We noted previously that the **Council of the Central Bank of Montenegro does not have a banker on its board**. We still consider that it would be beneficial for the banking system in general in Montenegro to have someone from the banking practice to be involved in the activities of the Council of the Central Bank, either as a member or an observer in some sessions, for example a representative of the Association of Banks. However, the Council for Regulatory Reform has rightly pointed to a possible conflict of interest, but this could be resolved by opting for the second proposal, by granting observer status to a representative of the Association of Banks.
- **The quality of financial reports** is an area with huge potential for improvement. Although some progress has been achieved in recent years, the quality is still not at an acceptable level, with several exceptions. The MFIC considers it would be crucial for the relevant authorities to improve control and enable not only banks but all other businesses to make informed decisions based on reliable financial statements. To this end, **making the list of companies with blocked accounts publicly available** would also be beneficial in

²⁹Decision on open-market operations ("Official Gazette of Montenegro" No. 15/11); Decision on last-resort financial assistance ("Official Gazette of Montenegro" No. 15/11).

increasing transparency in this field³⁰. The effects of improvements in this area would be far-reaching, and make any investment in it more than profitable for both the businesses and the Government.

In some of the examples from their experience, our members from the banking sector have even witnessed balance sheets that do not balance. To make matters worse, this happened even after the financial report in question had been audited.

- **A high level of fees for queries in the Regulatory Credit Bureau (RKB)**, increased without any justification and without prior coordination with stakeholders. The other important issue is **the requirement for authorization from customers, which makes it impossible for the bank to have an overview of customers with non-performing loans.**
- **The establishing of new companies by managers or owners of companies undergoing bankruptcy proceedings should be restrictive.** A lack of appropriate regulation in this matter has led to many abuses, giving the owners of bankrupt companies a way out of their obligations towards their creditors, be they banks or suppliers or other businesses. This issue is currently treated only by the Criminal Code, while the MFIC recommends that the authorities consider the option of introducing this restriction through the Law on Companies.
- A creditor needs to **initiate a court procedure in order to claim possession of a property** that is in his ownership already.
- Our members reported that in some instances the Commercial Court does not respect the **legally prescribed timeframe for submission of the decision to Central Bank for collateral enforcement**, even though the appeal to the court decision by the debtor does not delay the enforcement of the ruling. Also, there were cases of **Basic Courts not respecting the timeframes for submitting the ruling to the debtor.**

Tourism

Overview

Montenegro is becoming a worldwide tourism destination with high potential for further development. Tourism holds special significance for Montenegro's economy and is considered to be of strategic importance for the country's development.

Montenegro has exceptional revenue opportunities in tourism and travel, according to the report by the World Travel & Tourism Council³¹. In the next 10 years, Montenegro could become the leading economy in the field of travel and tourism and could take second place in the real annual growth of consumption of foreign tourists, especially capital investments in travel and tourism. According to the WTTC report, Montenegro could earn up to EUR 2 billion in the next 10 years. And during the same period, travel and tourism will encourage an additional 36 000 jobs, a total of 62 000 by 2021.

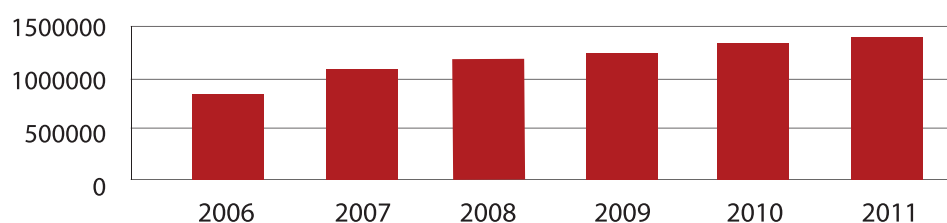


Figure 7: Number of tourist arrivals 2006-2011 (source: Monstat)

³⁰While the White Book 2011 was being prepared for printing, the Government made an important step in this direction by adopting the Amendments to the Law on a payments system which would enable the Central Bank of Montenegro to publish the names of the companies with blocked accounts. The Central Bank would be able to publish the names of the companies with accounts blocked for more than 30 days and with more than EUR 10 000 blocked. The list will be updated once a month, and published on the Central Bank's website..

³¹http://www.wttc.org/site_media/uploads/downloads/montenegro.pdf

GDP: Direct Contribution

The direct contribution of Travel & Tourism to GDP is expected to be EUR 278.3m (8.1% of total GDP) in 2011, rising by 10.9% p.a. to EUR 782.1m (14.8%) in 2021 (in constant 2011 prices).

GDP: Total Contribution

The total contribution of Travel & Tourism to GDP, including its wider economic impacts, is forecast to rise by 12.4% p.a. from EUR 593.8m (17.2% of GDP) in 2011 to EUR 1 915.1m (36.3%) by 2021.

Employment: Direct Contribution

Travel & Tourism is expected to support directly 12 000 jobs (6.9% of total employment) in 2011, rising by 8.0% p.a. to 25 000 jobs (13.3%) by 2021.

Employment: Total Contribution

The total contribution of Travel & Tourism to employment, including jobs indirectly supported by the industry, is forecast to rise by 9.4% p.a. from 26 000 jobs (15.1% of total employment) in 2011 to 62 000 jobs (33.2%) by 2021.

Visitor Export

Travel & Tourism visitor exports are expected to generate EUR 633.8m (44.8% of total exports) in 2011, growing by 12.4% p.a. (in nominal terms) to EUR 1 558.8m (46.3%) in 2021.

Investment

Travel & Tourism investment is estimated at EUR 192.1m or 33.4% of total investment in 2011. It should rise by 16.4% p.a. to reach EUR 876.4m (or 50.8%) of total investment in 2021.

World ranking (out of 181 countries):

Relative importance of Travel & Tourism's total contribution to GDP

- 133 – ABSOLUTE size
- 36 – RELATIVE contribution to national economy
- **1 – GROWTH forecast**

Remaining Issues

- Our members from this industry consider that the new **Law on Labour**³³, which we mentioned in the previous White Book separately in this chapter, saw positive progress. We emphasized that when employers face extensive barriers to lay-offs, the natural reaction would be to increase caution and decrease hiring rates in general.
- As previously noted: **ad-hoc introduction of new taxes, such as the additional taxes on labour costs from last year, is harmful for businesses**, especially in the tourist industry which is labour-intensive. Our members saw no improvement in this area, with taxes still high and some new increases affecting this industry in particular introduced, such as an excise tax on beverages and coffee. Additionally, the new total smoking ban (see below), is yet another blow for this industry.
- Last year the investors noted that **the work of inspections is below par**. According to the Government's Council for Regulatory Reform, the Strategy of Public Administration Reform adopted by the Government in March 2011, one of the reform directions would be an improvement of the inspection system. The various inspections would be brought under a single agency. Although this is a welcome move, so far our members reported no improvements in this area.
- In the previous White Book, investors mentioned two smaller issues: lack of an option **for a guest using a credit card to pay a tip** and the necessity of introducing the possibility of **issuing fiscal receipts only after the guest asks to settle the bill**. This has also not been changed.

³²<http://www.wttc.org/research/economic-impact-research/country-reports/montenegro/>

³³For further details see the section on the Labour Law.

← The MFIC members noted also that the proposed amendments to the *Coastal Zone Law* according to which long-term leases will be categorized as concessions while the government will have pre-emption rights to buy off private buildings developed on the leased land within the coastal area, would significantly undermine investor confidence and make **existing and planned long-term leases commercially unviable**. →

- **The total smoking ban** introduced in a controversial piece of legislation, although with the best of intentions, in its present form caused many problems for the tourist industry. Our members report significant losses in revenue since the introduction of the new law. In order to find a compromise from which everyone one would benefit, the MFIC recommends that the choice should be given to owners of commercial properties up to 70 m², while larger properties should have zones. In addition, for spaces equipped with air-conditioning systems with 6 air changes per hour smoking should be allowed.
- The so-called “**grey economy**” in tourism according to the MFIC’s own estimates may account for as much as EUR 300 million in total revenue annually. This represents a huge loss for the national and local budgets alike, and creates unfair competition for businesses that abide by the law.
- **The tourist potential in Montenegro is strongly affected by seasonality.** In order to extend the season, it is necessary to develop golf courses and similar year-round facilities, such as conference centres. In addition **easy, cost-effective access from major European capitals needs to be encouraged.**

According to a survey by a local consulting company E3 Consulting on the effects of the smoking ban on the tourist and hospitality industry among members of the Association of Montenegrin Caterers, during the period from December 2010 until December 2011, total revenues have decreased by an average of 45.2 percent, the number of employees reduced by 31 percent, and the number of guests by almost 39 percent. From September last year, when application of the law began, 78.6 per cent of the members of the Association reported an additional drop in revenue.

Production/Mining/Energy

Overview

In a service-based economy, such as Montenegro's, the export potential of heavy industry has special significance. Montenegro possesses significant natural resources necessary for its bauxite-alumina industry which remains one of its core industries. The main player in this area is the aluminium factory "Kombinat Aluminijuma Podgorica (KAP)" and its related industries, which together account for a vast 40% share of Montenegrin exports.

The Energy Sector of Montenegro is the backbone of the economy, because the country is rich in energy resources. At the same time, there is a need for an advanced energy infrastructure as a prerequisite for development of other priority industries (e.g. tourism). The development of the Energy Sector is defined by the Energy Development Strategy of Montenegro until 2025, from December 2007. The Strategy is a key document identifying the main investment needs and opportunities in the energy sector of Montenegro.

Research has demonstrated a strong potential for finding oil and gas reserves in the Adriatic. Oil reserves are estimated at an amount of approximately 7 billion barrels, and potential natural gas reserves at 425 billion m³. In case of the discovery and commercial exploitation of natural gas and crude oil resources, the system of natural gas supply in Montenegro would develop much faster than in any other option which presumes the need to import these energy sources. On the other hand, since the investments in the development of a gas-supply network are costly and local natural gas consumption is limited, at least at the beginning, the Strategy foresees development of several smaller gas network systems using liquefied petroleum gas (LPG) as a natural predecessor of natural gas. The introduction of LPG systems for heating purposes in tourist facilities along the Adriatic coast would extend the tourist season. The LPG supply systems are also planned in other larger towns in Montenegro.

Remaining Issues³⁴

Most of the issues we mentioned in the previous White Book remain valid:

- Our members pointed to **inflexibility in the Labour Law**³⁵ and other regulations in this field. These seriously hamper Montenegro's potential in the real sector, and impede the initiated restructuring process.
- As mentioned last year, with an increased focus in this year's report³⁶, foreign investors frequently have problems in **assessing the creditworthiness of local companies** they cooperate with. Insufficient data in this field, especially when it comes to a lack of financial data, which should be mandatory, creates an environment in which transparency is an issue.
- **Municipal taxes** – remain costly and are not transparent.
- **Liquidity and access to capital** continue to hamper efforts of investors to develop at the desired level. Although this is presently a global issue, it is even more pronounced in Montenegro.

³⁴This section remains largely unchanged from the previous year, mostly due to the fact that the barriers and difficulties noted earlier continue to affect this industry.

³⁵For more details see the section headed "Labour".

³⁶See section "Corporate Governance".

Trade/Retail

Overview

Unequal implementation of the law and weak enforcement by institutions, especially at the local level in some municipalities, unfair competition, generally slow bureaucracy and imprecise laws continue to be a matter of concern in this sector of the Montenegrin economy.

Figure 8 shows how Montenegro compares to countries from the region in the 2011 and 2012 World Bank's "Doing Business" Reports in the area of cross-border trade. It shows the ranking (from approximately 180 countries) that each country achieves in terms of the difficulty they face in cross-border trade

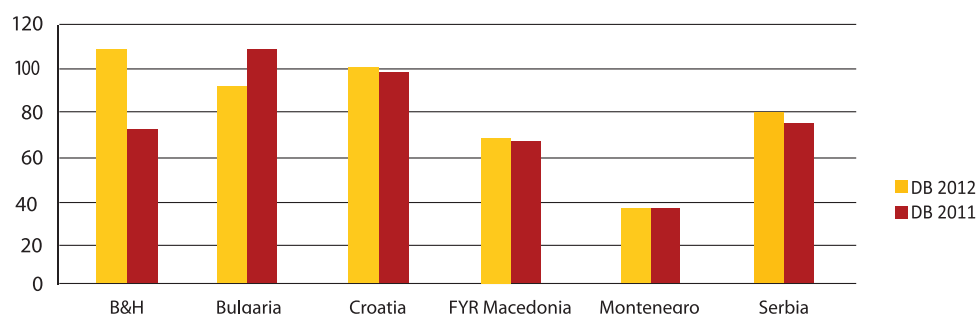


Figure 8: Doing Business 2012: Trading Across Borders – Regional Comparison

Remaining Issues

- Last year we noted that according to information that our members have, allegedly some **larger retail chains do not pay social, pension and health insurance and contributions for their employees**, which comprise some 40 per cent of the employee-related costs. The situation here remains the same. According to the Council for Regulatory Reform, the announced reorganization of the inspection system should contribute to dealing with this issue as well.
- According to our members, the alleged practice of **price dumping** present in Montenegrin market is rather easily established, although this has not yet happened. The Government's Council noted that the newly enacted Law on Protection of Competition deals with this issue also.
- When it comes to **unnecessarily complicated and long import procedures**, no progress is reported by our members.
- Also, the practice of importers being charged for all the mandatory procedures and analyses has not changed. Unfortunately this only becomes a part of the retailers' expenses and **unnecessarily raises the prices of products sold**, which is eventually paid for by the consumers.
- The situation with **procedures for the implementation of particular laws not being clear enough** has remained unchanged, leaving room for making discretionary decisions, thus creating an unstable and unpredictable business environment.
- **Lengthy procedures for issuing sanitary permits** for importing goods pose a challenge especially prominent during the summer season.
- Some MFIC members consider there is a certain kind of **protection of local retail chains** in comparison to those owned by foreign investors. According to their information, there is a silent consent for inspections to pay fewer visits and issue fewer fines to local retailers when compared to foreign ones, which have many more visits.
- In addition, our members are reporting **favouring of local retailers which is not based on price competitiveness**.
- Last year we noted that: *"In dealing with municipalities, investors encounter numerous problems, ranging from **high and non-transparent fees, complicated bureaucratic procedures, to unreasonable, rigid and out-dated regulation and a general lack of understanding of business.**"* No improvements have been registered by our members.

Transportation/Logistics

In the World Bank's "Doing Business" 2012 Montenegro is ranked 34th, making it the best ranked country in the region in this field. Below are the indicators used to evaluate this area of business operations:

Documents to export (number)	6
Time to export (days)	14
Cost to export (US\$ per container)	805
Documents to import (number)	6
Time to import (days)	14
Cost to import (US\$ per container)	915

Overview

Integration into the European Union is bringing about a profound change in the sector. Local markets are coalescing into a single platform, with competitors operating on a European or even a global scale. In combination with customers' growing service expectations, the new competitive situation is increasing pressure on costs and performance, but at the same time potential markets are expanding.

In import intermediation, cooperation with customs is one of the essential parts of the business, determining, to a large extent, efficiency and thus affecting the success of business operations. Our members emphasize that this cooperation in Montenegro is good and the problems in daily operations are being solved to mutual satisfaction as they arise.

Nevertheless, there are still issues that require attention, mostly related to implementation of laws and regulations. The legal framework in place is satisfactory, but enforcement requires more effort.

Remaining Issues

- **Unfair competition** still exists. Some companies in the sector offer unrealistically low prices and the general manner in which they handle business gives rise to suspicions that they are not registered and thus avoid paying taxes. This distorts the market and puts legal businesses in an unfavourable position. MFIC members consider that the authorities need to step up control in this area. They reported cases of competition being informed beforehand that an inspection is on the way, enabling them to leave. The inspectors then inspect MFIC members simply because they are the only remaining companies.
- **Liberalization and shortening of customs procedures should be continued.** For example, fruits and vegetables and similar products should not be kept for customs procedures for more than one hour when exporting. Since exporters face enough non-tariff barriers outside Montenegro, at least the procedure in Montenegro should be as streamlined as possible.
- Customs branch offices should consider expanding the tool of **"in-house customs clearance"** to more companies. This reduces costs and the time required for completing customs clearance.
- **Different interpretation of the same regulation** by different branch offices of the same institution sometimes represents a challenge. In most of the cases this is resolved during the course of normal business operations, although it unnecessarily consumes resources. This is especially significant for logistics businesses, as it unnecessarily consumes precious time.

MFIC Cooperation with the Government

Overview

During the past year, the excellent cooperation that the MFIC has established with the government has been resumed and brought to an even higher level. Representatives of the MFIC held several meetings with Ministry of Finance representatives in which they had the chance to present their views and concerns.

In addition, The Government's Council for Regulatory Reform and Improvement of the Business Environment reviewed the MFIC's second White Book at its session held in October last year. Following the session, the Ministry of Finance prepared a detailed report on the recommendations and issues pointed to by our members in the White Book on the investment climate.

←
"We would like to extend our appreciation of the Government's efforts in this regard, and especially to those of the Ministry of Finance, led by Minister Milorad Katnić. His personal commitment is remarkable, while the response of his ministry to our initiative surpassed all our expectations and is not something usually seen elsewhere."

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Business and education

In the third edition of the MFIC's White Book we revisit the issue of Business and Education with a general sense of positive developments, but considering the long-term nature of education, more significant results are still missing.

Good education is at the heart of economic growth and development. However, defining good education can be an issue. Its relevance is certainly one of the considerations that the policy should take into account. As noted in the World Bank's study "Skills, Not Just Diplomas"³⁷, to start with "the education systems need to 'turn the lights on' and take seriously the measurement of what students actually learn, as opposed to measurement of the inputs into the education process on the implicit assumption that learning follows".

This year we would like to emphasize the importance of initiatives such as the Programme for International Student Assessment (PISA) (see below for details)³⁸. Measurable indicators are great tools that can be used to provide policy makers with the information needed to design better policies. In order to do so, experts at the World Bank proposed several steps:

- Continue participation in international assessments (e.g. TIMSS³⁹ and PISA).
- Expand the use of national assessments of students, placing more emphasis on identifying strengths and weaknesses of the education and training systems as opposed to only testing students (e.g. are there groups of students that systematically fail to acquire the desired level of competencies?).
- Introduce graduate tracer studies to track whether graduates find jobs.
- Introduce tests of the skills of tertiary students.

It is, however, clear that more data alone will not result in better policies; information has to be analysed, disseminated and used for policy making.

PISA

*"The OECD Programme for International Student Assessment (PISA), created in 1997, represents a commitment by the governments of OECD member countries to monitor the outcomes of education systems in terms of student achievement, within a common internationally agreed framework. PISA is a collaborative effort, bringing together scientific expertise from the participating countries and steered jointly by their governments on the basis of shared, policy-driven interests. Participating countries take responsibility for the project at the policy level. Experts from participating countries also serve on working groups that are charged with linking the PISA policy objectives with the best available substantive and technical expertise in the field of internationally comparative assessment. Through involvement in these expert groups, countries ensure that the PISA assessment instruments are internationally valid and take into account the cultural and curricular context of OECD member countries. They also have strong measurement properties, and place an emphasis on authenticity and educational validity."*⁴⁰

³⁷http://siteresources.worldbank.org/ECAEXT/Resources/101411_FullReport.pdf

³⁸www.pisa.oecd.org

³⁹Trends in International Mathematics and Science Study.

⁴⁰PISA 2009 Assessment Framework, <http://www.oecd.org/dataoecd/11/40/44455820.pdf>

	On the overall reading scale	On the reading subscales					On the mathematics scale	On the science scale
		Access and retrieve	Integrate and interpret	Reflect and evaluate	Continuous texts	Continuous texts Non-continuous texts		
OECD average	493	495	493	494	494	493	496	501
Croatia	476	492	472	471	478	472	460	486
Serbia	442	449	445	430	444	438	442	443
Bulgaria	429	430	436	417	433	421	428	439
Romania	424	423	425	426	423	424	427	428
Montenegro	408	408	420	383	411	398	403	401
Albania	385	380	393	376	392	366	377	391

Figure 9: The OECD Programme for International Student Assessment (PISA) scores, regional comparison

The results clearly point to the challenges in education which Montenegro faces, and due to which Montenegro has the second lowest score in the region.

Noting that, however, Montenegro is investing significant effort in this area, we would like to emphasize that still more will have to be done to reach the standards that would enable the country to compete in an increasingly global environment.



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Kosta Radonjić, Consultant

Acknowledgements

The MFIC would like to thank all of its members who contributed to the making of the 2010 White Book.

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