

2. LABOR MARKET REFORM FOR GROWTH AND COMPETITIVENESS

2.1 Montenegro has had high unemployment rates throughout the past decade– over 20 percent. This is mainly because to date very few employment opportunities have been created in the emerging private sector. Owing to the low demand for labor, a significant share of the able-bodied population is “forced” to stay out of the labor markets. The lack of demand for labor in turn stems from a business environment which is not conducive to investment and job creation, and from the impact of current labor regulations, which hinder private sector activity and encourage informality (see Chapter 4 on private sector development). Government policies that would send people back to work, including the promotion of private investment as well as further improvement to the labor market regulations, would significantly help the growth and competitiveness of the economy.

2.2 During 2000-2004, Montenegro’s real wage grew by much more than the productivity growth, thereby undermining the growth and competitiveness of the economy. The prime source of productivity growth is technological change, but sources of productivity growth also depend on macroeconomic institutions and regulatory factors. Since 2000, the Montenegrin economy has experienced a cumulative labor productivity growth of 18.2 percent (2000-2004).²¹ That productivity growth has derived largely from a reduction in the degree of underemployment among workers who are primarily within Montenegro’s formal sector, associated with enterprise restructuring and privatization. On the other hand, average net earnings doubled (growing by 103 percent) between 2000 and 2004. The rapid increases in labor costs in the last few years have reduced competitiveness, growth, and employment.²²

2.3 Montenegro’s labor market is characterized by a relatively high level of job protection and rigidity, a high degree of unemployment, and a high share of employment in the informal sector. The legacy of the “self-management” system for enterprises has, to a large extent, shaped the high level of job protection and the overall rigidity present in the economy. Although the 2003 reform of the Labor Law made dismissal procedures less complex and less costly (for example, minimum severance payments were reduced from an extremely high 24 months’ wages to 6 months’ wages), firing procedures are still fairly inflexible and costly. Second, unlike many other socialist countries, the former Yugoslavia had open unemployment as early as in the 1960s which increased even further during the turbulent mid-1980s and 1990s. Finally, during the 1990s, informal employment was tolerated by the Government since it was one of the key survival strategies. About one-third of total employment is estimated to be in the informal economy, which in turn has reduced the Government’s ability to collect various tax and social insurance revenues.

²¹ Labor productivity is calculated using the employment data from annual labor force surveys as a proxy for employment dynamics, and the reported real GDP growth rates.

²² In the short term, productivity and employment stand in inverse relation to one another.

A. KEY CHARACTERISTICS OF THE LABOR MARKET

*Participation and Employment*²³

2.4 **The labor supply in Montenegro is affected by many demographic factors, including the still relatively high fertility rates.** In 2002, the total fertility rate in the Republic equaled 1.66, which is high compared to other transition countries, excluding the Central Asian states. In the coming years the number of new labor market entrants will have a significant impact on the labor supply.

2.5 **Despite the growth in the working age population, the labor force has not increased, which suggests that the more able-bodied population is becoming inactive** (see Table 2.1).²⁴ In the next five years, around 25,000 people will leave the working age bracket but the number of new entrants the reaching working age will be around 44,000. The country also has relatively modest old- age dependency burdens among the Central and Eastern European transition countries: the population share of those 65 years and older is only around 12 percent of the total population. The labor supply is also affected by the recent inflow of refugees from the neighboring countries, although the number of refugees is rapidly declining. At one time (January 1993), over 64,000 refugees were living temporarily in Montenegro. By the latest estimates (September 2004), 8,474 refugees and 18,047 IDPs were still registered in Montenegro.²⁵

Table 2.1. Labor Force Growth and Employment-to-Population Ratios, Transition Economies

	Annual labor force growth rate (%)	Employment-to-population ratio (%)
	1998-2003	2003
Transition economies	0.7	53.5
Central and Eastern Europe	0.4	49.1
Montenegro*	0.0	40.6
Baltic States	-1.1	50.8
Commonwealth of Independent States	0.9	55.6

* - MONSTAT: Labor Force Survey Data.

Source: ILO 2004.

2.6 **Montenegro's labor force participation rate, defined as the share of employed and unemployed in the total working age population, also remains among the lowest in the region** (Table 2.2). According to the 2004 Labor Force Survey, about 52 percent of the population at age 15 years and older are economically active but the relatively high participation rate masks the high unemployment rate among the able-bodied population. By age group, youth (especially young females) have the lowest participation and employment rates, more than four times below the average employment rate for EU-15 countries. More than half of the youth of age 15-24 in the labor force are unemployed.

²³ Montenegro has several sources of labor market data: first, the official data of MONSTAT on employment and unemployment derived from the labor force survey conducted regularly in October each year; second, the registered unemployment data published regularly by the Employment Service; third, the household survey data which are collected, published and analyzed regularly by the ISSP. For analytical purposes, the labor force survey data (ILO methodology) tend to be the most reliable source of labor market information.

²⁴ By the labor force survey data, there were 180,400 employed and 50,700 unemployed individuals in 1998, and 187,300 employed and 71,800 unemployed individuals in 2004.

²⁵ UNDP (2004). Household Survey of Roma, Ashkelia and Egyptians, Refugees and Internally Displaced Persons. Podgorica; Government of Montenegro (2005). Strategy for permanent solution of refugees and IDPs issue in Montenegro. Podgorica.

Table 2.2. Employment/Population Ratios, Participation, and Unemployment Rates in 2003-04

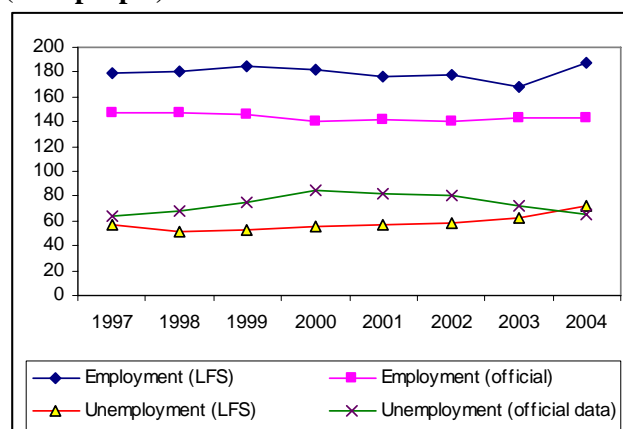
Age	Montenegro	Serbia	Czech		Hungary	Poland	Slovakia	EU-15	OECD
			Macedonia	Republic					
		LFS 2004	2003						
Employment/Population ratios									
15-64	40.6	53.5	38.5	57.0	64.9	51.4	57.7	64.8	65.0
15-24	10.3	18.6	12.1	26.7	31.4	19.6	27.6	42.6	43.6
25-54	56.6	68.2	50.7	73.7	81.7	67.6	76.0	76.9	75.1
55-64	20.6	38.1	28.5	29.0	42.3	28.6	24.6	42.3	50.8
Labor force participation rates									
15-64	65.1	66.6	61.3	60.0	70.4	64.2	70.0	70.3	69.8
15-24	34.1	36.3	35.3	30.8	38.1	34.4	41.2	50.0	50.3
25-54	82.6	82.4	76.4	77.8	87.8	81.7	89.5	82.6	79.9
55-64	40.0	42.0	35.8	29.8	44.2	32.2	28.5	44.9	53.4
Unemployment rates									
15-64	23.0	19.5	37.1	5.9	7.8	20.0	17.6	7.8	6.9
15-24	51.5	48.8	65.7	13.4	17.6	43.0	33.1	14.7	13.3
25-54	20.1	17.2	33.7	5.3	7.0	17.3	15.1	7.0	6.0
55-64	8.1	9.3	20.5	2.8	4.4	11.2	13.6	5.7	4.7

Source: OECD Employment Outlook 2004. Paris, Serbia and Montenegro: MONSTAT. Labor Force Survey data.

2.7 As a result, Montenegro has the lowest overall employment rate in the region, with only about 40.6 percent of Montenegro's working age population being employed. Limited job opportunities in Montenegro have led to discouragement and massive labor force withdrawal, especially among younger and older cohorts as well as women. The combined effect of unemployment and labor force withdrawal was a substantial fall in the employment to population ratio: out of an aged 15-64 working age population of 413,000 (by the 2003 population census data), only 167,700, or around 40.6 percent of the total, are employed. The average employment rate of the able-bodied population for the transition economies is 53.5 percent, (Table 2.1). The existence of high unemployment not only translates into higher poverty and lower economic growth but also indicates the low ability of the Montenegrin economy to create jobs.

2.8 According to the Labor Force Survey data, employment has declined in Montenegro since 1999 (Figure 2.1). This is another indication that for various reasons discussed below, the economy is not generating jobs. In the last four years (2000-2004) the elasticity of employment with respect to output in Montenegro was negative of -1.30, i.e. each percent of output growth resulted in 1.3 percent of employment cut, indicating that the job

Figure 2.1. Trends in Employment and Unemployment in Montenegro, 1997-2004 ('000 people)



*LFS=Labor Force Survey Data.

Source: MONSTAT; Labor Force Survey data; ISSP 2004.

market has not responded to economic growth and in that fact we have the phenomenon of “job-loss economic growth.”²⁶ GDP growth is thus largely due to a labor productivity growth attributed to enterprise adjustment and restructuring (Table 2.3). Jobless growth is quite widespread in CEE and SEE countries, although there seem to be some exceptions such as Hungary (which experienced only one year of jobless growth), the Czech Republic (which experienced two episodes of more than 3 percent growth with modest job destruction) and the Slovak Republic. According to the preliminary 2004 labor force survey data, employment at age 15 years and over has rebounded to 187,300 individuals.

Table 2.3. GDP Growth and Employment Dynamics, 2000-2004

	Actual			Estimate	
	2000	2001	2002	2003	2004
GDP, million euro	1022.2	1244.8	1301.5	1433.0	1535.0
GDP, real growth rate	3.1	-0.2	1.7	2.3	3.7
Employment LFS (thousands)	181.7	176.6	177.6	168.5	187.3
Employment dynamics (% of previous year)	-1.7	-2.8	0.6	-5.1	11.2
Labor productivity growth rate	8.1	2.2	5.3	6.0	0.3

Source: MONSTAT.

2.9 The public sector continues to be the main employer in the Montenegrin economy. From the 2003 labor force survey data, 59.2 percent of employment took place in the public sector (including in Government-provided public services, such as the civil service, the health and education sector, and social protection), 25.7 percent in the private sector, and 0.8 percent in firms of mixed ownership. By sector, agriculture, trade and tourism related services are the key employers in the economy. More than 64 percent of total employment is in the services sectors. Compared to other transition countries in the region, the share of self-employed in Montenegro is higher – 9.7 percent of total employment. In Hungary and Poland the share of self-employed was above 5 percent of total employment, while in Croatia the ratio was close to three percent (end-1990s; EBRD, 2000). The share of employment in SMEs, in contrast, is a low 20 percent out of the total employment. Therefore, large enterprises still dominate in the formal sector of the economy.

2.10 Flexible forms of employment (part-time and temporary work) are almost entirely absent in the Montenegrin economy (with some exception in the tourism sector). Only 2.0 percent of the employed had part-time jobs, indicating that there are constraints on part-time employment (see Section 2B). In comparison, in Poland 11.5 percent of jobs is part-time work, as are 16.6 percent in the EU-15 countries (Table 2.4).

²⁶ The employment elasticity (which shows the responsiveness of employment to economic growth) can be calculated by dividing the net new-job growth rate by the economic growth rate. The official GDP should be treated with caution. In particular, MONSTAT calculates only 8.8-9.8 percent of GDP as originating from the informal sector while other sources (ISSP, for example) estimate that at least 30 percent of GDP is produced in the informal sector.

Table 2.4. Incidence and Composition of Part-time Employment in 2003 (percent)

	Part-time employment as a proportion of employment			Women's share in part-time employment
	Total	Men	Women	
Montenegro	2.0	1.5	2.7	54.9
FYR Macedonia	5.7	5.2	6.5	45.5
Czech Republic	3.2	1.6	5.3	71.9
Hungary	3.5	2.1	5.1	69.0
Poland	11.5	7.1	16.8	66.2
Slovak Republic	2.3	1.3	3.6	69.1
EU-15	16.6	6.3	30.1	78.5

Source: OECD (2004); Montenegro: Labor Force Survey data. Data on Macedonia refers to age group 15-64 only.

Unemployment

2.11 **Perhaps the most important characteristic of the Montenegrin labor market is its high unemployment rate.** According to the 2003 Labor Force Survey data, 71,800 unemployed at age of 15 and over were registered, with the unemployment rate of 27.7 percent out of total labor force.²⁷ In April 2005, the Employment Agency had 58,000 registered unemployed on the roster, which is a 23.5 percent decline compared with the same period in 2003. Despite these positive developments in the last year, the unemployment rate in Montenegro remains well above the average for CEE countries, which in 2003 stood at 13.8 percent.

Table 2.5. Duration of Unemployment in Montenegro

Duration of unemployment	Employment Bureau data		Labor force survey data
	2000	2003	2003
Less than 6 months	12.0	26.6	7.6
6-9 months	6.2	5.1	0.9
9-12 months	7.1	3.7	7.0
1-3 years	25.1	18.0	21.4
3-5 years	16.2	12.3	23.0
5-8 years	14.0	12.3	16.8
More than 8 years	19.4	22.0	23.3
Total	100.0	100.0	100.0

Source: MONSTAT; Employment Bureau.

2.12 **Montenegro's unemployment is of long-term duration, as more than one-fifth of the registered unemployed is in the roster for more than eight years** (Table 2.5). About 85 percent of the registered unemployed are out of job for more than one year, and this is a much higher percentage than that for other regional countries and is almost twice the level for EU-15 countries (Figure 2.2). The skills and work habits of many of the long-term unemployed have eroded and to a large extent their reintegration into the labor market is complicated, at least without an upgrading of their human capital.

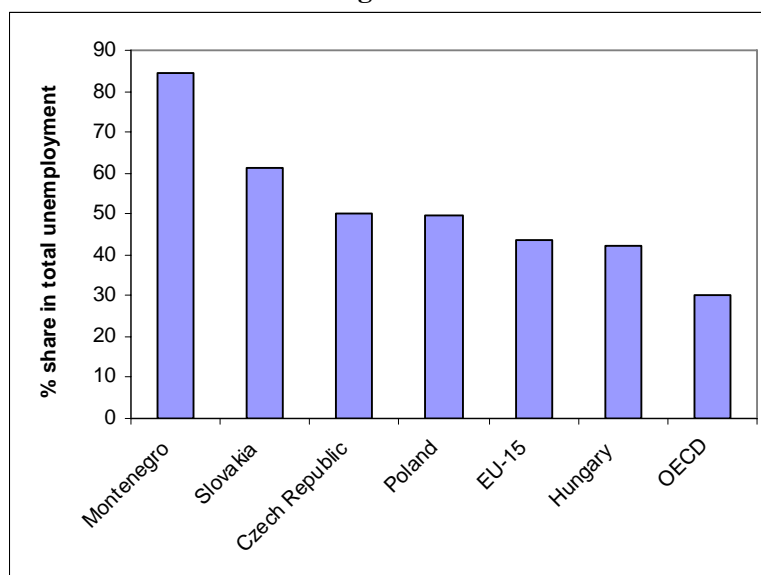
²⁷ In Montenegro, the registered unemployment is rather close to the actual number, due to incentives in the form of health and pension insurance entitlements provided to the registered unemployed. By the 2003 labor force survey data, more than 90 percent of the unemployed had registered themselves at the Employment Agency thus making themselves available to various employment services.

Long-term unemployment constitutes an additional burden on the social funds and the families of the affected. The persistence of high unemployment and growing under-employment even after more than a decade of economic growth is worrisome. For the reality of a rather stagnant unemployment pool with a high incidence of long-term unemployment is at odds with the idea of a rapid reallocation of workers across firms and sectors. Many households have turned to subsistence agriculture and petty trade, to stave off poverty, while jobs in the formal sector have continued to disappear.

2.13 **As in other SEE and CEE countries, unemployment mainly affects the young (those below 25 years of age) and females.** According to the 2003 Labor Force Survey, about 50 percent of those aged 15-24 years are unemployed (Table 2.2). International experience shows that low levels of youth employment and participation often reflect lengthy schooling and/or the high costs of hiring and firing.²⁸ New entrants in particular face more serious impediments in accessing employment than other groups of workers.

Almost two-thirds of the registered unemployed (66.4 percent) are first time job seekers, and one-quarter (23.4 percent) are youth at age 24 years and less; 52.7 percent of the registered unemployed in 2004 were females (in 2000 the share was 58.4 percent). In contrast, older workers have high recorded employment and participation rates, lower levels of unemployment, but very long durations of unemployment once they lose their jobs.

Figure 2.2. Long-term Unemployment in Montenegro Relative to Other Countries in the Region



Source: OECD 2004; MONSTAT: Labor Force Survey Data.

Wage and Productivity Dynamics

2.14 **Despite high unemployment, Montenegro's average net earnings more than doubled between 2000 and 2004** (Table 2.6).²⁹ The average gross wage³⁰ increased from 150.9 euros in 2000 to 302.6 euros in 2004, while average net earnings increased from 96.4 euros to 195.3 euros over the same period. In 2004 alone, real wages increased by 12.3 percent.

²⁸ See Garibaldi and Mauro (1999).

²⁹ There are no officially reported statistics on wages, other than the household survey data. By the household survey data, there are only around 110,000 employed in the country (extrapolating the data from the survey to the whole country) (ISSP 2004). The surge in wages could have in part been due to price and trade liberalization, which occurred in 2000-2002 in Montenegro.

³⁰ Gross wage contains a significant share of non-wage (cash and in-kind) compensation on a non-taxable basis, established according to the General Collective Agreement. The most significant from the fiscal standpoint are food allowance and compensation for transportation, and seniority (wage) premium and additional holidays associated with the service length of the employee. This shifts compensation away from wages to non-taxable incomes.

Table 2.6. The Dynamics of Average Wages in Montenegro, 2000-2004 (euros)

	Minimum wage	Average gross wage	Total contributions and taxes	Average net earnings **	Ratio of minimum wage to net earnings	Annual CPI, %	The dynamics of real net earnings, % 2000=100	Labor productivity, 2000=100
2000	37	150.9	55.5	96.4	38.4	36.1	100	100
2001	42	176.2	68.5	108.0	38.9	21.8	92.0	102.2
2002	50*	229.2**	87.1**	142.2**	...	16.8	103.7	107.9
2003	50	271.0	97.2	174.0	28.7	6.8	118.9	114.1
2004	50	302.6	107.5	195.3	25.6	3.2***	129.3	...

Note: Since the new Personal Income Tax Law was applied in July 2002 (the tax base was broadened to cover all payments to employees), MONSTAT has changed the methodology for calculating the average wage.

* Since July 2002. ** An average for 1-6/2002 to 7-12/2002, ISSP data. MONSTAT reported data on gross wage in 2002 was euro 251.3 *** Estimate by the Center for Entrepreneurship and Economic Development.

Source: ISSP 2004; MONSTAT.

2.15 **The growth in net wage earnings has been much higher than that of many other countries in the region** (Table 2.7) (with the exception of Serbia, where the data suggest that net monthly wages grew fourfold since 2000). Ultimately, wage growth must be compatible with productivity. If the wage increase is not justified by productivity, employment will fall until the resulting increase in unemployment exerts enough downward pressure on wages (see Layard, Nickell and Jackman, 1990; Gilles, 2004).

Table 2.7. Net Monthly Wages in Euros, 2000 and 2004

	2000	2004	Wage growth in 2000-2004, %	Gross National Income per capita, US\$
Albania	99.1	169.3	70.8	1740
Bosnia and Herzegovina	191.2	258.2	35.0	1540
Bulgaria	94.9	122.6	29.2	2130
Croatia	435.4	556.6	27.8	5350
Macedonia, FYR	172.4	201.0	16.6	1980
Montenegro	96.3	195.9	103.4	1910*
Romania	107.2	147.2	37.3	2310
Serbia	45.4	193.0	425.1	1910*

Notes: Albania – public sector wages only; Bosnia and Herzegovina – average in Republika Srpska and Federation of B&H; Bulgaria – data for 2004 are for Q4 only.

* Data for Serbia and Montenegro (excluding Kosovo).

Source: Bank calculations; GNI – World Bank Atlas 2004, Washington, DC.

2.16 **Montenegro has one of the highest labor taxes among the transition countries.** There are two alternative indicators of the wage tax burden: the non-wage labor cost and the tax wedge on the labor market.³¹ By our calculations, in 2004 the tax wedge—taking into consideration all the social contributions (pensions, health insurance and employment contribution, as well as fees and surtaxes established according to the General Collective Agreement, the Law on Communal Taxes and Compensations and other laws—is estimated at 52 percent of the labor costs.³² Non-wage labor costs

³¹ The non-wage labor cost is defined as the ratio between payroll taxes and gross wages. The tax wedge on labor is the difference between the labor cost to the employer and the take home pay (net wage) expressed as a percentage of total labor cost.

³² In 2005, this legal basis for compensation (tax) for the use of goods of common interests of 3 percent of gross wages was replaced by the Law on Local Self-Government Financing, which allows the municipalities to introduce a surtax of 13-15 percent of the calculated personal income tax.

were estimated in 2004 at 35 percent. In OECD countries, the total burden on the labor market is 51.8 percent among European member countries and 37.3 percent for non-European member countries, (ISSP, Montenegro Economic Trends, 2004).³³ Labor taxes lower the labor demand by raising labor costs. But they also lower labor supply by reducing the real consumption wage. The high wage tax burden has contributed to lower employment, higher informalization, and higher (long-term) unemployment.

2.17 Most recently, the Government of Montenegro has reduced the amount of tax and social contributions payable by employed persons, to stimulate employment creation and formalization. According to the Decree on Tax Relief for New Employees, from April 2003 to December 2004 all newly employed workers were registered under favorable conditions, which means that companies that, within a business year, will hire new employees for a contract of at least two years will be allowed to reduce their tax base by the amount of gross salaries paid to these employees, augmented by the employer's portion of the social contribution. By official estimates, this measure led to a shift of 30,000 jobs currently in the gray economy into the official economy and helped to create more than 5,000 new jobs (see Government of Montenegro, 2005).

2.18 In addition, the decree on Employment of Nonresident Persons, which established a relatively low "tax" of EUR 2.5 per day for employing non-residents, has resulted in the registration of around 50,000 nonresident workers and has made it possible to collect additional revenues of 1.7 million euros.³⁴ Local employers are interested in hiring foreign workers, especially for seasonal employment. For example, on average, the cost of labor for construction workers from Serbia and the Republic of Srpska is 20-30 percent less than that of Montenegrin workers because of lower taxes for non-resident persons and lower bargaining power.

2.19 Still, Montenegro's new General Collective Agreement imposes additional non-wage (cash and in-kind) and non-taxable costs to employers,³⁵ thereby effectively preserving some of the rigidities removed through reforming the labor law in recent years. Compared to the previous 1995 Collective Agreement, the 2003 Agreement expanded the list of supplementary benefits, which has significant fiscal cost implications for all employers including the Government. In particular, the housing allowance and the collective insurance of employees were added to the already extensive list of additional benefits to workers (see Table 2.11). Among other benefits, an employee is entitled to paid absence from work in the course of a calendar year of up to 7 days for various family events, allowances for annual leave, transport and meals, seniority (wage) premiums, and additional annual leave for years of service. In addition, employers have to pay 0.7 percent of gross earnings to the Housing Fund for employees (see Table 2.9). This will significantly increase non-wage labor costs, which are especially burdensome for SMEs.

³³ In addition to personal income tax, PIO contribution and contribution to the Health Fund, the employees have to pay from their wages also unemployment contribution, 0.5 percent of gross wages; the employers, in addition to the PIO contribution and the contribution to the Health Fund, have to pay an unemployment contribution 0.5 percent of gross wages; fee to the Chamber of Commerce - 0.32 percent of gross wages; fee to the Confederation of Independent Trade Unions - 0.20 percent of gross wages; payment to the housing fund for employees - 0.7 percent of gross wages; compensation for use of public goods - 3.0 percent of gross wages (replaced in 2005 by 13-15 percent of personal income tax (PIT); meal allowance 50 percent of the minimum wage (EUR 25), and transport allowance 25 percent of the price of gasoline per km. (See Table 4.15 for details.)

³⁴ The actual result might be slightly lower due to the double-counting of non-residents changing work places and asking for new work permits.

³⁵ The most recent General Collective Agreement was signed by the Chairmen of the Council of Union of Independent Trade Unions of Montenegro and Managing Board of the Chamber of Commerce of Montenegro, and the Prime Minister of the Republic of Montenegro on December 19, 2003.

2.20 **The minimum wage is moderate and in late 2004 equaled 50 euros per month, or around 17 percent of the average gross wage** (Table 2.6). However, the 2003 General Collective Agreement increased the minimum wage coefficients depending on a person's education and qualifications. For employees with a university or higher education degree, the minimum wage is set at 165 euros, or a high 54 percent of the average wage. This may have an impact on employers' hiring decisions, especially regarding new entrants with a higher education. Empirical evidence indicates that the minimum wage set at a moderate level usually does not have a substantial dis-employment effect, but at the same time it has only a limited and often transitory impact on the earnings of low-wage workers.

B. HOW RESTRICTIVE ARE THE LABOR REGULATIONS?

2.21 **A flexible (adaptable) labor market facilitates economic restructuring, promotes productivity growth and competitiveness, and helps the economy adjust to supply and demand shocks.** Employment protection legislations (EPLs), especially on hiring and termination, are often hotly debated for good reasons. On the one hand, they define the job security of workers and as such are very important; on the other hand, they typically make it harder for certain groups, including women and displaced older workers, to enter or re-enter the labor market. They also strengthen labor market "insiders," and increase long-term unemployment. In addition, by discouraging hiring and firing, EPLs may slow down adjustment to shocks and impede the reallocation of labor, with potentially significant efficiency losses. Recent studies also indicate that greater flexibility in the host country's labor market relative to that in the investor's home country is associated with larger foreign direct investment flows.³⁶

2.22 In Montenegro, the general framework of labor regulations is determined by the Labor Law of 2003 (as amended in 2004), and the General Collective Agreement of 2003, which applies to employees with an employer headquartered in the Republic of Montenegro, employees sent by an employer to work abroad, public officials and employees in public administration bodies, and local self-government units—i.e., to all hired employees. The social protection of the unemployed and the provision of employment services are regulated by the Law on Terms and Conditions of Employment, approved in 2003.

2.23 **Montenegro's current labor regulations, although significantly improved in 2003, still hinder the efficient reallocation of labor and provide incentives for informality.** The Government improved the labor regulations significantly through the 2003 key amendments to these regulations, but the Labor Law continues to over-regulate employment relations and discourage hiring. The Law is still highly directive and prescriptive. It reaches into the direct relationship between the employee and the employer – even prescribing the scope and nature of the disciplinary action that an employer may take when an employee transgresses (USAID, 2004). This has contributed to a stagnant formal sector labor market, with high unemployment and limited opportunities for new entrants, and a large informal sector. Thus, it has also hampered the required labor reallocation, thereby wasting a potential for economic growth.

2.24 **The share of undeclared work in Montenegro is estimated by the Institute for Strategic Studies and Prognoses (ISSP) as at least at 30 percent of GDP and is among the highest in the region** (Table 2.8). The recent EU report shows that former socialist economies with the most protective labor laws and the most rigid labor policies also have the highest level of shadow economy/undeclared work. Conversely, it shows that economies with liberal labor regimes have low levels of undeclared work. When there are fewer job opportunities in the formal sector, inequality often rises as people turn to the informal sector, which offers lower pay and no health insurance or social benefits.

³⁶ See Javorcik, Beata and Mariana Spatareanu. Do Foreign Investors Care About Labor Market Regulations? World Bank Policy Research Working Paper 3275. April 2004.

Table 2.8. Undeclared Work in CEE and Baltic States and in EU Member States (pre- May 1, 2004)*

CEE States and Baltic States	% of GDP	EU Member States (pre-May 2004)	% of GDP
Montenegro**	30	Austria	1.5
Bulgaria	22-30	Belgium	3
Czech Republic	9-10	Denmark	5.5
Estonia	8-9	Finland	4.2
Hungary	18	France	6.5
Latvia	18	Germany	6
Lithuania	15-19	Greece	20+
Poland	14	Italy	17
Romania	21	Netherlands	2
Slovak Republic	13-15	Portugal	5
Slovenia	17	Sweden	3
		UK	2

Source: European Commission 2004. * Undeclared work is defined as “productive activities that are lawful as regards to their nature, but are not declared to the public authorities, taking into account the differences in the regulatory system between Member States.” European Commission 2004. **ISSP 2004.

2.25 Employment protection measures refer to hiring and firing arrangements, and can be thought of as distributed on a continuum of rigidity/flexibility. These measures include the kinds of contracts that are allowed, the conditions under which contracts can be terminated, occupational standards, and rules for mass layoffs (Betcherman et al. 2001). They include hiring procedures, probation, fixed-term employment relationships, the supplying of labor by third parties, so-called atypical employment relationships, and last but certainly not least, termination of employment and protection against unjustified dismissal. A labor market with strict rules to protect job security – for example, with rules that restrict nonstandard forms of employment -- has more stable jobs but also more long-term unemployment and non-participation than labor markets without these protections.

2.26 The present Labor Law places obstacles in the way of employing persons for fixed-term, second or third jobs and places restrictions on the type of work that can be considered “temporary work.” Fixed-term employment contracts, currently limited to a set of pre-determined activities, could be useful for expanding employment in certain sectors, occupations and activities. According to the Law, employers have to involve the Employment Fund when recruiting or selecting employees. If these very strict regulations were enforced they would protect jobs for incumbent employees while limiting opportunities for the unemployed and new entrants (e.g., youth, women re-entering the labor market).

2.27 The Labor Law still imposes a very rigid regime of working hours. Full working hours should amount to 40 hours per working week, and overtime is allowed only in exceptional cases associated with earthquakes, floods, fires, etc., but may not surpass 10 hours per week. Requirements to notify the Labor Inspectorate of overtime working, and to take annual leave in a specific way, are outdated and unnecessary.

Table 2.9. Comparison of Additional Benefits to Workers Provided by the 1995 and 2003 General Collective Agreement (GCA)

Benefits	GCA, 1995	GCA, 2003 (based on current basic minimum wage levels)
Allowance for annual leave	3 minimum wages	3 minimum wages (€150)
Retirement of workers	6 minimum wages	6 minimum wages (€ 300)
Compensation for work stoppage If the worker is not responsible the employer shall pay	50 % of the employee's wage	Not regulated
Transport allowance	Half of the cost	25 % of the price of gasoline per km
Meal allowance (per month)	50 % minimum wage	50 % minimum wage (€ 25)
Contribution to unions	0.20 % of gross wage	0.20 % of gross wage
Awards	Employees are entitled to awards after 10, 20 and 30 years of service, not less than 2 minimum wages. Also annual leave shall be increased according to the length of service: 1-15 years - by 1 working day; 15-30 years - by 2 working days; over 30 years - by 3 working days; disabled person - 3 working days; a parent of a child with physical and mental problems - 3 working days.	No obligation for monetary awards. Annual leave shall be increased according to the length of service: 1-15 years - by 1 working day; 15-30 years - by 2 working days; over 30 years - by 3 working days; disabled person - 3 working days; a parent of a child with physical and mental problems - 3 working days.
<i>Housing allowance</i>	<i>No obligation</i>	<i>Compulsory payment to the housing fund for employees, 0.7 % of gross earnings</i>
Seniority (wage) premium for each year of service	Up to 10 years – 0.5 % of wages; 10-20 years – 0.75 %; Over 20 years – 1.0 %	Up to 10 years – 0.5 % of wages; 10-20 years – 0.75 %; Over 20 years – 1.0 %
Additional annual leave	Marriage – up to 5 business days; birth of child – up to 3 business days; moving – up to 2 business days; severe illness of the immediate family member – up to 7 business days; work examination – up to 3 business days; emergencies due to natural catastrophes – up to 3 business days; participation in competition in work or production – up to 2 business days; personal reasons – up to 2 business days.	Birth of child – up to 3 business days; severe illness of the immediate family member – up to 7 business days; voluntary blood, tissue and organ donation – up to 3 business days; care of child with physical and mental retardation – up to 3 business days; emergencies due to natural catastrophes – up to 3 business days; participation in competition in work or production – up to 2 business days.
Minimum wage coefficients depending on the group of jobs (based on education and qualification)	Between 1.0 and 3.2 of the basic minimum wage	Between 1.0 and 4.0 of the basic minimum wage of €50.
<i>Collective insurance of employees</i>	<i>No obligation</i>	<i>An employer shall provide employees with collective insurance from accidents at work and outside work, and risks of death due to illness.</i>

Note: – in italics – newly introduced benefits and entitlements.

Source: General Collective Agreement 1995 and General Collective Agreement 2003.

2.28 Dismissal costs in Montenegro are still high. Employment may be terminated through notice, owing to economic, technological, structural or similar transformations, but the process is unnecessarily cumbersome and costly to employers. In such an environment firms are not able to easily adjust to market changes. Despite recent significant improvements (compared to pre-2003), mandatory minimum severance payments are still capped at six monthly salaries with no regard for length of service. Moreover, the base wage for severance pay calculation should not be lower than the average wage in the Republic. This adds an undue cost to the dismissal of workers who have short periods of employment.³⁷

³⁷ This is still a step forward compared to the pre-2003 Labor Law, in which severance pay was established at up to 24 monthly wages based on the wage level of the previous month prior to dismissal. Invalids could have stayed until

By making dismissal for economic reasons more difficult or costly, these employment protection rules are intended to increase job security. However, the trade-off again is that employers may be reluctant to hire workers if they face constraints in dismissing them for business reasons down the road.

2.29 **Dismissal of disabled workers is still costly.**³⁸ The 2003 Labor Law prohibited the dismissal of disabled employees, irrespective of whether there was work for them. In 2004 the Law was amended and now the labor contract with the disabled employee can be terminated on par with other individuals, except that the severance package was established in the amount of not less than 24 average monthly wages in the Republic if the disability was caused by injury out of work or disease, or not less than 36 average wages, if the disability was caused by injury at work or occupational disease. This is a step in the right direction, but nevertheless these provisions, together with the restrictions on female workers with young or disabled children, make it harder for these groups of job seekers and new entrants to find jobs.

2.30 **Montenegro has one of the longest maternity leaves in the world of 365 days from the beginning of exercising the right to it.** According to the existing Law on Social Protection, the maternity leave benefit should be paid by the employer, and then at the request of the employer it will be reimbursed by the state. Since the state budget does not have sufficient funds for reimbursement, the payment of maternity leave benefits is in arrears. Moreover, such generous entitlements have already had an impact on the labor market. According to the latest available labor force survey data (October 2004), 46.5 percent of males at age 15 years and older were working while among the females, the employment rate was 28.8 percent. The employment rate of females is traditionally lower than for males but this gap to a large extent reflects the rigidities associated with female labor (see also Box 2.1)

Box 2.1. Maternity Leave and Women's Labor Market Participation

Under the 1992 EU Maternity Leave legislation, EU Member States are required to provide at least 14 weeks (98 days) of paid maternity leave. Currently in Europe the duration of paid maternity leave varies from less than 100 days in Germany, Ireland and Portugal to 365 days in Slovenia and Albania, and 270 days in Macedonia. The most typical duration in transition countries is 126 days, and the basis for benefit calculation is average monthly wages for at least the last three months of work. In many countries, only half of the wages is paid in maternity benefits, and wage limits for benefit calculations are also established.

Extended maternity leave can potentially adversely affect women's labor market participation by leading to an actual or perceived erosion of skills. Extended leave entitlement, especially if accompanied by a decline in childcare places, may also enforce the notion of women as second earners, and diminish their economic and social roles in favor of their maternal functions. Thus, it is important to create a flexible and widespread network of childcare options to ensure equal opportunities for women in the market economy, and relieve an unsustainable financial burden from the Government related to maternity leave transfers (UNICEF 1999). Many transition countries have established a partially paid parental (childcare) leave of up to two to three years, a flat rate benefit paid from the state budget. This is much less burdensome to the budget and employers, if they are paying the benefit, and can avoid discrimination against female labor in the formal labor market.

2.31 **In sum, the Labor Law should ease the conditions for concluding fixed term contracts, contracts for temporary, casual and seasonal employment, and full-time and part-time labor contracts.** Labor market rigidities are especially burdensome for private small and medium enterprises

they retired or were willing to accept any other job offer. If the worker had less than 5 years to retire, the employer had to pay a severance for the period up to 5 years.

³⁸ It is estimated that there are around 12,000 disabled workers in the formal sector, or around 11 percent of the workforce.

(SMEs), which have been a dynamic source of new job creation in many transition countries in the region. Changes in the Labor Law should create a more favorable environment for SMEs.

C. HOW WELL DO THE COLLECTIVE BARGAINING AND SOCIAL DIALOGUE FUNCTION?

2.32 Collective bargaining can play an important role in determining wages and other conditions of work. The representation of the worker's voice through unions and collective bargaining can reduce discrimination. In addition, by instituting dispute resolution mechanisms, it can reduce arbitrary management decisions, increase job tenure and investment in training, and improve work safety conditions. These positive effects of unions would contribute towards greater labor productivity. Another major issue for social dialogue will be the introduction and widespread use of so-called atypical employment relationships, such as part-time and fixed-term contracts, triangular arrangements or probationary contracts, which could serve the interests of both employees and employers. The role of serious and continuous dialogue should be that of striking the right balance between the interests of the two parties in the industry.

2.33 Montenegro's recent trends in wage dynamics may indicate a strong voice on the part of Montenegrin unions in putting pressure on wage levels. It is well known that, *ceteris paribus*, unions can raise wage pressures, and that wages bargained collectively are generally higher than those bargained individually. In Montenegro union membership is very high compared to most other transition countries. On average, 75,000 workers and employees pay their trade union membership fees (depending on the month, between 71,000 and 82,000), which means that the union density rate is around 68 percent of the formal sector employment and 45 percent of the total employment.³⁹ For comparison, the weighted average trade union density of 10 new EU Member States is 22 percent. (USAID, 2004). In addition to high union density, bargaining coverage in the formal sector of the Montenegrin economy is close to 100 percent.⁴⁰ It is estimated that wage coefficients introduced in the 2003 General Collective Agreement were on average increased by 19 percent (Government of Montenegro, 2005), in part owing to the strength of trade unions. The Confederation of Independent Trade Unions of Montenegro is the main representative of workers and employees.

2.34 In contrast, employers are not well represented in collective bargaining and wage negotiations. Until 2004, the Chamber of Commerce was the only authorized body to represent employers in collective bargaining and to sign mandatory agreements binding all employers.⁴¹ The ILO Conventions state that the social partners can only be the voluntary organizations of workers and employers, and not the chambers of commerce that exist on the basis of the legal obligation of the companies to be registered with the chambers and to pay the contribution to them (see ILO Convention No. 144 and Recommendations No. 113 and 152 on tripartite consultations). In Montenegro, membership in the Chamber of Commerce and the payment of relevant fees (0.32 percent of gross wages of their employees) is mandatory for all legal entities. Thus, this practice of representation contradicts the ILO Conventions.

2.35 In 2004 an important amendment was made to the Labor Law to define the criteria for the representativeness of employers' associations. According to this amendment, the authorized association

³⁹ Serbia and Montenegro is an ILO member since 2000 and has so far ratified 68 ILO Conventions (67 of them are in force).

⁴⁰ Union density refers to the proportion of workers who are members of a union. Union coverage refers to the proportion of workers who are covered by collective agreement bargaining.

⁴¹ Since September 2005, a government decree has established that the Union of Employers of Montenegro must be a party to all collective bargaining and other negotiations at all levels of the social dialogue.

of employers shall be the one whose members have a minimum of 25 percent of employees in the economy of the Republic and that participates in the gross domestic product of the Republic with a minimum of 25 percent. Two of the newly emerging associations of employers, such as the Montenegrin Union of Employers (around 2,000 registered members) and the Montenegro Business Alliance (around 400 registered members), may thus qualify for the status of nationally representative employers' organizations.

2.36 The current system of labor agreements takes little account of the individual employer's circumstances or of individual sector circumstances. Currently, according to the Labor Law, the General Collective Agreement shall be negotiated for the territory of the Republic and shall apply to all employees and employers. In this way, it sets the framework for measures on social protection at work, supplementary benefits, and other aspects of labor relations. In most other countries in Europe and elsewhere, the majority of collective agreements is at the sector or company level (or even for the public sector and the private sector). Although the Montenegrin Labor Law provides for collective agreements at national, branch and employer levels, there are very few collective agreements at the firm level in practice. Moreover, while all collective agreements are typically effective for a fixed term, and while negotiations should be carried out in a tripartite manner with representative participation of each party, the General Collective Agreement in Montenegro is concluded for an indefinite period of time. There are almost no articles in the General Collective Agreement indicating the process of labor bargaining on some core labor market issues, such as wage adjustments (except minimum wage), working time, or atypical work arrangements (i.e., on labor issues and situations that may change annually or even seasonally).

2.37 Regular social dialogue at the national level with representative social partners is not functioning. Montenegro's Social and Economic Council, established by the Government Decree of February 1, 2001, consists of 38 members, including 7 representatives of workers appointed by the Union of Independent Trade Unions of Montenegro, 7 representatives of the industry appointed by the Chamber of Commerce, 7 renowned experts and public figures appointed by the Government, and 5 representatives of labor, education and health, nominated by the Ministry of Labor. However, the Council has had only occasional meetings and has not become a player in social dialogue. Moreover, other associations of employers, such as the Montenegrin Union of Employers and the Montenegro Business Alliance, are not represented in the Council.

2.38 Montenegro's Labor Inspectorate has been constructive in resolving individual labor disputes (complaints from over 800 workers were submitted in 2004) and in enforcing the legislation on legalizing the informal activities. The Labor Law and other related laws in Montenegro call for labor arbitration in the resolution of labor disputes, the composition, procedure and method of which shall be defined in the collective agreement. This is in line with international best practices of moving away from court-based procedures and adversarialism and towards alternative non-court approaches that emphasize fact-finding, conciliation, and arbitration.⁴²

D. INSTITUTIONS DEALING WITH HIGH UNEMPLOYMENT

2.39 The Employment Bureau of Montenegro is the main institution providing employment services to job seekers (see Table 2.10). As noted above, there were 58,000 registered unemployed in the

⁴² Effective dispute resolution relies on three key principles. First, prevention is always better than resolution, and adequate enforcement of labor laws goes a long way toward preventing labor disputes. Second, if a dispute is unavoidable, the parties to a dispute ought to attempt to resolve it themselves. Third, if a dispute cannot be resolved, third party intervention ought to involve the disputing parties as much as possible (Heron and Vandenabeele 1999).

roster of the Bureau by April 2005.⁴³ In Montenegro, employers are obliged to report to the Employment Bureau on the available vacancies and the related working conditions. On an exceptional basis, the employer may enter a labor agreement without a previous public announcement of vacancies. The Bureau publishes job vacancies within five days from the day on which the employer submits the application. The requirement for actively seeking employment and accepting adequate employment is applied only to recipients of the unemployment benefit. The right of the unemployed person to financial compensation ceases if, among other reasons, the person, without justification, fails to contact the Bureau for two subsequent months, or refuses to participate in the program of active employment policy, or does not respond to a vacancy announcement, as instructed by the Bureau.

Table 2.10. Main Activities of the Employment Bureau of Montenegro in 2004 (January-October)

Activity/Indicator	No of individuals
Average number of registered job seekers	66242
Newly registered job seekers	29550
Recipients of unemployment compensation	42439
Number of advertised vacancies	27388
Number of job seekers individual employment plans	60127
Number of participants of information and motivation seminars	2980
Participants of training programs	2075
Number of employed interns	852
Employment of non-resident individuals	28062
Provision of information to unemployed youth	20000

Source: Employment Bureau of Montenegro.

2.40 **Montenegro's unemployment benefits (UB) are quite modest and therefore not a limiting factor to job creation, but the program is under-funded** (see Table 2.11). In the 2004 budget for the Bureau, 4.3 million euros was allocated for the benefits, but by December only 1.2 million euros was received. Currently, the benefit payment is in arrears for one year on average. This erodes the ability of the unemployment benefit system to act as an effective social safety net and drives people into the informal sector. The insured person whose employment was terminated without his/her request, consent or fault, and who has been employed full time for a minimum of 9 months continuously, or 12 months with interruptions, in the past 18 months, has the right to financial compensation if that person registers with the Employment Bureau within 30 days from the day that the employment ceased. The financial compensation (unemployment benefit) is equal to 60 percent of the minimum wage, or currently 30 euros. The duration of the unemployment benefits payment is 3 months if the insured has had unemployment insurance for 9 (12) months, and up to 12 months if the insured person has paid insurance contributions for 20 to 25 years. The unemployed person with over 25 years of insurance contributions has the right to financial compensation until that person finds new employment. The low coverage and generosity of benefits may have reduced the otherwise adverse impact of unemployment benefits on job creation.

2.41 **In contrast, Montenegro spends significant resources on active labor market programs (ALMPs), amounting to 0.55 percent of GDP** (Table 2.11).⁴⁴ There are two main characteristics of Montenegro's public employment service (PES). First, around half of the budget on ALMPs is spent on activities related to different counseling and job search assistance programs. Second, in recent years Montenegro spent significant resources on micro-credit programs. The structure of expenditures confirms that, compared to some other countries in the region, Montenegro has a much higher level and share of

⁴³ According to the Law on Terms and Conditions of Employment, high school and university students and farmers at age 15-64 who are actively seeking employment cannot be considered as unemployed.

⁴⁴ Calculations are based on the 11 months' actual spending of the Employment Bureau and estimated GDP for 11 months.

public expenditures on ALMPs, spent mainly on in-house services such as counseling and job search assistance as well as on youth and direct job creation measures through a micro credit scheme. The country has a relatively low share of expenditures on unemployment benefits (Table 2.11).

Table 2.11. Public Expenditure on ALMPs in Some Transition Countries (percent of GDP)

	Montenegro, 2004*	Czech Republic, 2002	Hungary, 2002	Slovakia, 2002
1. PES and administration	0.29	0.07	0.12	0.15
2. Training	0.08	0.02	0.06	0.04
3. Youth measures	0.07	0.02	-	0.01
Measures for unemployed and disadvantaged youth	-	0.02	-	0.01
Support of apprenticeship and general youth training	0.07	-	-	-
4. Subsidized employment	0.11	0.06	0.34	0.21
Subsidies to regular employment in the private sector	-	0.02	0.08	0.06
Support to unemployed persons starting enterprises	-	-	0.01	0.06
Direct job creation	0.11	0.03	0.26	0.09
5. Measures for the disabled	0.00	0.01	-	0.04
Vocational rehabilitation	0.00	-	-	-
Work for the disabled	0.00	0.01	-	0.03
6. Unemployment compensation	0.09	0.27	0.37	0.48
7. Early retirement for labor market reasons	-	-	-	0.01
TOTAL	0.74*	0.45	0.90	0.94
Active measures (1-5)	0.55	0.17	0.52	0.46
Passive measures (6-7)	0.09	0.27	0.37	0.48

* - Montenegro: January-November 2004 using an estimated GDP for 11 months; additionally, 0.10 percent of GDP was spent by the Employment Bureau on repayment of credits and on investments.

Source: OECD Employment Outlook 2004. Paris; Employment Bureau of Montenegro.

2.42 The micro-credit scheme is the costliest labor market program offered by the Employment Bureau, but its impact on unemployment is yet to be properly assessed. The Bureau provides micro-credit for new business start-ups for those who are unemployed and who may face major difficulties in trying to secure a loan at the market interest rate. Although the efficiency of the program may have improved in recent years, Montenegro's program remains costly – the program spends on average 3,000 euros per job created and embraces only a limited number of participants (around 1,000 jobs are created through the program annually).⁴⁵ International experience suggests that micro-credit programs are successful if supported by technical services such as training, counseling, and assistance in developing and implementing a business plan. The micro-credit program in Montenegro is yet to be properly evaluated in terms of placement rates, career development of participants, and small business survival rates.

2.43 International experience indicates that, even under the best scenarios, payoffs to most ALMPs are modest (Box 2.2). It is difficult to address the problems of large-scale unemployment through these programs. They may work for specific groups in specific circumstances – hence, the need for careful targeting. On the other hand, labor market interventions have a large potential for improving labor market performance. International experience suggests that counseling and job search assistance are more cost-effective in tackling frictional unemployment. In particular, counseling can be crucial in

⁴⁵ Micro credits provided by the Employment Bureau through the commercial banks are for three years with a one year grace period and an interest rate of 3 percent annually while regular commercial credits are at an interest rate up to 20 percent annually. Around 16 percent of the participants have failed to repay the loan.

helping individual workers obtain information about education, training, and alternative job opportunities. The provision of job search assistance or placement services—which provide information on labor markets and job openings, the registration of job seekers, the selection and referral of job applicants, and follow-up with employers after referral—also helps to enhance labor mobility. In any case, the positive impact of labor market policies cannot be taken for granted, which points to the importance of the need for monitoring and evaluating the effectiveness of ALMPs in Montenegro.

Box 2.2. How and Which ALMPs Are Effective?

A recent World Bank review of ALMPs around the world, based on the 152 scientific (i.e., control-group) evaluations, drew the following general conclusions (Betcherman et al. 2004)*:

- *Job search assistance.* These services generally have positive impacts on the post-program employment and earnings of participants. Costs are relatively low (usually assistance is provided by PES staff) so the cost-benefit ratio is often favorable.
- *Training for the unemployed.* Participants often benefit from these programs in terms of higher employment rates but not in terms of higher earnings. The few evaluations in developing countries paint a less favorable picture. Programs seem to work best with on-the-job training and active employer involvement. Results are more positive for women than men.
- *Retraining for workers in mass layoffs.* These programs most often have no positive impacts, although there are exceptions. The few successful cases typically include a comprehensive package of employment services to accompany the retraining. However, these are generally expensive.
- *Training for youth.* These programs are almost always unsuccessful in improving labor market outcomes, at least in developed countries. It makes much more sense to invest earlier in the education system to reduce drop-outs and other schooling problems. While there are few studies in developing countries, evaluations in Latin America do find positive impacts for programs that integrate training with remedial education, job search assistance, and social services.
- *Wage/employment subsidies.* Most often these do not have a positive impact and have substantial deadweight and substitution costs. Targeting and monitoring may help but at the cost of reducing take-up rates.
- *Public works.* This can be an effective short-term safety net but public works do not improve future labor market prospects for participants.
- *Micro-enterprise development/self-employment assistance.* There is some evidence of positive impacts for older and better-educated workers. However, take-up is very low.

Note: * These reviews were based almost exclusively on the experience of industrialized countries because very few evaluations existed anywhere else.

2.44 **Montenegro has not yet established a Labor Fund, despite the need for such a fund to facilitate restructuring and labor redeployment.** The Law on Terms and Conditions of Employment anticipates the establishment of a Labor Fund to provide transitional income support, including severance payments and other social contributions, for employers who are unable to secure assets for payments. The Fund is supposed to be established by the Government, the association of employers, and the authorized trade unions. However, the Fund has not become active despite the need for such a fund. It is expected that the reduction in the number of employees in the formal sector of the economy will continue: in accordance with the Economic Reform Agenda, the reduction is estimated at 5,000 persons in 2005. The launching of the Labor Fund would be instrumental in supporting the displaced workers in their search for alternative employment and in preventing these workers and their families from slipping into poverty.

E. CONCLUSIONS AND POLICY RECOMMENDATIONS

2.45 In view of the high unemployment rate in Montenegro, improving labor market performance is critical for the political sustainability of market-oriented reforms, growth, and competitiveness. The

following measures can improve the institutional framework for labor relations and employment creation in Montenegro:

- *Relax some aspects of the labor regulations.* While the new Labor Law, adopted in 2003, has improved the flexibility of the labor market, considerably it has not yet assured full flexibility (Government of Montenegro, 2005). It is still focused on the protection of existing work places in the Government and in the recently privatized companies rather than on opening new work places in the private sector. The reforms in labor relations should focus especially on the following: (i) relaxing the contracting rules for employing “non-standard” workers, including employees on fixed-term and part-time contracts; (ii) reducing the costs for employers to terminate regular (i.e., permanent) employees for economic reasons; (iii) permitting more flexible arrangements in working hours; and (iv) limiting non-wage costs to employers.
- *Reduce the high rates of labor taxation and strengthen the enforcement of labor taxes to encourage formal employment.* Recent reforms have helped reduce the payroll tax and contributions burden, yet the labor taxes (or payroll taxes) are still too high and among the highest in the region. Montenegro’s tax wedge, one of the most important indicators of tax burden, stood at about 52 percent of the labor costs in 2004, while the comparative burden for the regional non-European member countries was 37.3 percent of total labor costs. A further phased and well-planned reduction in payroll taxes—compensated by equivalent increases in other taxes, and with adjustments to compensate the resulting lost income of the social funds—is desirable. The identification of alternative sources of revenue, such as the VAT or other indirect taxes, to make up for reduction in payroll taxes is critical to maintain the overall fiscal balance as well as the fiscal position of the health and pensions funds. Such reduction in payroll taxes should also be accompanied by improved enforcement of taxes, including through more aggressive use of bankruptcy as a means to deal with delinquent tax payers, as well as regular payments of contributions for health insurance by all users of health care. The reductions should be done in a way that does not hamper the financial sustainability of the both the health and pensions funds. In addition, further reforms of the health and pension systems (early retirement, disability, maternity leave and sickness benefit) may need to be pursued in parallel to tighten eligibility criteria and eliminate abuses in the systems. The legal frameworks have already been laid for pension and health sector reforms, but further reforms are necessary both to improve financial sustainability and service delivery to the people.
- *Rein in the rapid wage growth witnessed in recent years.* This can be undertaken by: (i) establishing a more balanced collective bargaining and wage setting process whereby the voices of employers (including Government) are strengthened; (ii) promoting greater decentralization of bargaining to the firm level; and (iii) undertaking a more vigorous implementation of public administration reforms and the reduction in public sector staffs (many of whom earn wages well in excess of the average for the economy).
- *Introduce or expand, through the Employment Bureau, some other active labor market programs which have proven to be cost effective in other countries in the region.* Those would include: (i) *employer contact services*, which match applicants’ skills and refer the best qualified applicants to employers; (ii) *vacancy and job fairs* designed to assist local employment agencies in matching labor supply and demand; (iii) *job clubs* for those with low self-confidence who have been unemployed for extended periods of time; and (iv) *virtual enterprises (or a practice firm)* to develop teaching and training skills for operating a real enterprise. In addition, an assessment of the net impact of ALMPs needs to be undertaken.

- *Improve labor market data and information.* Available data do not allow a detailed analysis of the labor market in Montenegro. Special and more detailed regular labor force data may be needed to monitor the following: employment, underemployment and unemployment; seasonal, occasional and informal employment; earnings and incomes generated; working time involved, by occupational and professional groups and regions, on alternatives to formal sector employment; and work in the informal sector and in households. The absence of regular and reliable information on the labor market limits adjustments in labor market interventions.