EXECUTIVE SUMMARY

1. **Since the late 1990s, Montenegro has undertaken a series of reforms designed to move its economy from a socialist to a modern market-based economy**. Started in the late 1990s, Montenegro's economic reform program has gathered momentum since the early 2000s. Its reform program rested on two broad pillars: macroeconomic stabilization, and market-oriented structural reforms. With the implementation of currency and fiscal policy reforms, it has succeeded to rein in inflation and bring about macroeconomic stability. In parallel to the stabilization policies, it also implemented a number of structural reforms, including price and trade liberalization, privatization, public administration reform, financial sector reform, and labor market and business environment reforms. The government has recently updated its Economic Reform Program for 2005-2007 to guide the implementation of the remaining economic reforms.

2. **The macroeconomic and structural reforms have yielded modest economic recovery and transition.** Over the last four years, Montenegro achieved modest macroeconomic gains: real GDP grew by an average of about 2 percent per year over 2000-2004; inflation dropped from 24.8 percent at the end of 2000 to 4.3 percent at the end of 2004; Montenegro's consolidated budget deficit was reduced from about 8 percent of republican GDP in 2000 to about 3 percent in 2004; its current account deficit, although still high, is improving; and, its principal human welfare indicators such as poverty, life expectancy, and adult literacy have remained moderate and stable.

3. **Yet, significant challenges remain**. Three key challenges confront policy makers in Montenegro. First, past economic growth has been inadequate. With an average annual population growth rate of about 0.5 percent per year, the per capita income grew by only 1.3 percent per year over 2000-2004. How to move Montenegro to a higher growth path in order to achieve a higher standard of living for its citizens is the first challenge. Second, the limited growth recovery has not been accompanied by employment growth: registered employment *declined* by about 7 percent in 2004 relative to 1998, while unemployment remains high at about 23 percent. With the growth in joblessness, about 12 percent of the citizens of Montenegro have fallen below the consumption poverty line as of 2003. Therefore, reducing unemployment and enhancing job creation is another challenge. Third, despite reforms, Montenegro has become less competitive over the last four years. Its real exchange rate, based on movements in unit labor costs, has risen much faster than that of the EU zone and the United States. The much more rapid increase in labor compensation than in labor productivity (by 12.3 percent in 2004) has reduced the economy's competitiveness. Increasing competitiveness, especially in view of the country's strategic goal of EU accession and its small size, is the third challenge facing policy makers.

4. **This Memorandum, the first of its kind for Montenegro, sheds light on these key challenges**. The considerable data problems in Montenegro limit the ability to make evidence-based analysis and to draw conclusions. On the basis of the best evidence and information available, this report considers the various factors that may have constrained employment creation, growth and competitiveness in Montenegro. The report takes an in-depth look at Montenegro's labor market and at the extent to which, and areas in which the labor law and the collective agreements continue to be limiting. It examines the extent to which administrative and institutional capacity, property rights, contract enforcement, the high cost of capital, and low financial intermediation constrain growth and competitiveness in the private sector, and it takes a close look at fiscal policy, in particular at whether the current level and composition of public expenditure adequately supports growth. It also closely examines the challenges in tourism development, the main growth potential for Montenegro. Based on this analysis, the report provides a comprehensive, prioritized medium term policy reform agenda. This is presented in the table at the end of this section. The report delineates five themes as key priorities for Montenegrin policy makers to address in order to enhance employment generation, growth and competitiveness.

5. **First, key labor market reforms need to be undertaken to increase employment, growth and competitiveness**. Despite high unemployment, Montenegro's average net earnings more than doubled between 2000 and 2004. In contrast, the Montenegrin economy experienced a cumulative labor productivity growth of only 18 percent (2000-2004). Even this low productivity growth derived mainly from a reduction in over-employment within Montenegro's formal sector, associated with enterprise restructuring and privatization. The wage dynamics most likely indicate the strong voice of Montenegrin unions in putting pressure on wage levels. In contrast, employers are not well represented in collective bargaining and wage negotiations. The result has been rapid wage increases in the public sector and a new 2003 General Collective Agreement, which imposed even greater non-wage (cash and in-kind) and non-taxable costs on employers. Compared to the previous 1995 Collective Agreement, the 2003 Agreement expanded the list of supplementary benefits, with significant costs for all employers. Among other benefits, housing allowances and collective insurance for employees were added to the already extensive list of additional benefits to workers. It is estimated that the wage coefficients introduced in the 2003 General Collective Agreement were on average increased by 19 percent (Government of Montenegro, 2005), in part reflecting the strength of trade unions. In addition, Montenegro's labor regulations, although significantly improved in 2003, still hinder labor market flexibility. The relatively high labor taxation, coupled with poor tax administration, encourages informal sector employment. In order to facilitate job creation, growth and competitiveness, Government policies should help improve wage competitiveness and labor market flexibility. Specific measures include the following:

- *Control the rapid wage growth witnessed in recent years through*: (i) implementing more vigorously public administration reforms and the planned reduction in public sector staffs, many of whom earn wages well in excess of the average for the economy; (ii) nurturing the emergence of genuine private sector employers' organizations that would play a moderating role in the collective bargaining and wage setting process; (iii) in the meantime, playing an active role in the General Collective Agreement (GCA) process with a view to keeping nominal wage settlements in line with developments abroad and possibly re-opening negotiations on the recent GCA to that effect.

- *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. The specific reforms should focus on: (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 in a fiscally responsible way 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. In addition, 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.

6. **Second, enterprise privatization and restructuring is well underway but would need to be completed to increase growth and competitiveness.** The private sector's contributions to GDP and employment remain modest. The emerging private sector has not yet developed the critical mass to generate enough jobs to offset job losses in the public sector. Facilitating the privatization and restructuring of enterprises, and promoting the entry of new firms, is necessary to achieve that goal. Many companies that were privatized through the mass voucher privatization (MVP) program still lack strategic investors to re-equip them with new technology and improve their profitability and competitiveness. They also continue to be saddled by the high costs of excess labor and employment. There is thus an urgent need to:

- *Speed up the restructuring of the mass-voucher- privatized companies* by: (i) making budgetary allocations toward covering the social costs of restructuring—including severance payments for shedding off excess labor– for those companies in respect of which the Government agreed to fund such costs; (ii) strictly enforcing the new bankruptcy law for medium and large enterprises privatized through vouchers, that have continued to accumulate losses; and, (iii) strengthening the capacity of courts to deal with such bankruptcy cases.

- *Speed up the consolidation into majority shares of the companies' shares being traded on stock exchanges*. With diffused ownership and lack of majority ownership, the MVP has been fairly ineffective in inducing changes in management and corporate governance. Even where the MVP has led to management changes, the new management has continued to lack expertise in restructuring and developing viable business plans. Currently, shares of companies and investment units privatized through the MVP are slowly being consolidated through trades in stock exchanges. However, the speeding up of the consolidation of shares into majority ownership is needed to bring about management changes, good corporate governance, completion of the restructuring plans, and the introduction of new capital and technology to generate better profitability and shareholders' value, and employment.

7. **Third, key constraints facing Montenegro's emerging private sector, including businesses in the informal sector, must be removed**. The most highly visible feature of Montenegro's economy is the large and persistent informal sector, contributing perhaps about 30 percent of GDP and employing about 27 percent of the workforce (ISSP, 2004). The presence of a large informal sector is a symptom of a high regulatory burden, including the high labor taxation and the unreasonably onerous General Collective Agreements, and a poor public administration and institutional capacity for enforcing rules. In addition to the measures discussed above, the following specific measures are needed:

- *Remove specific governance and regulatory bottlenecks*: (i) speed up the issuance of business licenses and inspections; (ii) ensure greater transparency, and a more consistent application of rules, including an improved tax administration capacity to support rule-based tax collection; and, (iii) speed up the implementation of recently enacted business laws and regulations. The implementation of legislation aimed at improving the business environment--contract enforcement, access to finance, corporate governance, and business exit—has not yet begun in most cases. Speeding up the implementation of these laws will be critical to private sector investment and growth.

- *Reduce the backlog of commercial court cases and speed up contract enforcement:* Investors see the poor functioning of the court system as a major impediment to doing business (FIAS, 2004). The courts are too slow: it can take a year from the submission of a claim to the handing down of a judgment. Overall, according to court statistics, about 40 percent of the commercial court cases are resolved within less than three months, 33 percent take up to six months, and about 28 percent take longer than six months. Speeding up the resolution of cases that take longer than six months—which in many cases also include bankruptcy and liquidation cases—is urgent. Specific steps may include (i) easing the resources and personnel constraints in the Montenegrin judiciary; (ii) ensuring that qualified and better trained judges are put in place, with better compensation; (iii) training court personnel; and (iv) upgrading the court system's infrastructure, which should include including the development and computerization of the case management system/process.

- *Improve land title transparency and property rights*. Until recently, Montenegro's lack of functional restitution law gave rise to uncertainty about the handling of existing and future restitution claims; it caused potential investors to postpone investments; and it drove interest rates up to compensate for security risks. However, the Restitution Law, under development for some time, entered into force on April 8, 2004; accompanying implemented regulations were passed, municipal commissions were formed, as well as the Fund for Indemnity and procedures of restitution for taken away properties. Indemnities based on the said Law have started but would need to be strengthened and sped up. In addition, the Government needs to vigorously enforce land property rights and control illegal construction. With regard to land title, registration is computerized and is not overly time-consuming or costly, the Cadastral Office does not have adequate, reliable land information. The lack of transparency and discretionary public access to land information makes land title transfers risky for investors and complicates the planning and approval activities of municipalities.

8. **Fourth, the cost of capital needs to be reduced and financial intermediation improved.** Total credits from banks to the private sector amount to only 11 percent of GDP in Montenegro. This is quite low compared to the regional countries (42.3 percent in Bosnia and Herzegovina, 26.6 percent in Bulgaria, 57.3 percent in Croatia, and 42.7 percent in Hungary), though credits to the private sector began to rise from fairly low levels in 2004**.** Interest rates as well as spreads remain high: the real interest rate has ranged between 11 percent and 20 percent in recent years. The aggregate interest spread was about 7.6 percent in 2004 (down from 9.6 percent in 2003). Most investors in Montenegro would be hard pressed to find a project whose real rate of return would exceed 11-20 percent. The high cost of capital and the wide variability of interest rates are related to the weak framework for creditor protection and contract enforcement, the high country risk, and the low competition in the banking sector. Specific measures that the Government can take to reduce the cost of borrowing and improve financial intermediation are as follows:

- *Reduce the need for treasury bill financing through tight fiscal policy*. This would help reduce the budgetary burden of interest payments on treasury bills and would help create the conditions for the lower cost of capital in the economy by reducing the crowding-out of Government.

- *Establish an effective, broad-based institution, with full credit information on all borrowers*, to address the problem of asymmetric information in credit markets. At present, Montenegro has neither a Credit Registry nor a Credit Bureau.

- *Introduce more competition into the banking sector* through the completion of the privatization of Government-owned banks (in particular Podgoricka Banka), and by promoting leasing operations in view of the small size of the Montenegrin market.

9. **Fifth, the Government can help to increase employment creation, growth, and competitiveness by undertaking fiscal reforms.** Montenegro's general government services (public

administration, public order and safety, and defense) and social protection each consume about a third (33 percent) of total general government expenditure. Education and health combined account for another 25 percent of total spending. Compared with other countries in the region, Montenegro spends substantially more on almost all of these functions--general public services, defense and public safety, education, and health in that order. Despite the fact that Montenegro started its public sector reforms a couple of years ago, the reforms have not yet resulted in a reduction of public administration costs. Over the last three years public expenditure on general government services has grown instead of declining. To ensure fiscal sustainability, create a budgetary space for capital investment, and improve delivery of social services the following steps are necessary:

- *Control the wage bill, and develop a well-targeted public investment program.* The high wage growth has crowded out spending on public investment and on operations and maintenance—expenditures that are essential for growth. The wage growth thus needs to be controlled through (i) public administration reforms that would eliminate employment redundancies; (ii) other measures outlined under labor market above. Controlling wage growth is essential both for fiscal sustainability and to create a budgetary space for public investment. At 2 percent of GDP, Montenegro's domestically financed capital expenditure is much below the level for other countries in the region. While the low numbers may indicate the need for more capital investment, in particular infrastructure investment, such a decision is best guided by two prior conditions: (i) that there is a trade-off between a public infrastructure investment program and macro stability/fiscal sustainability, and whatever investment in public infrastructure needs to be made within the broader macroeconomic and fiscal constraints; (ii) that a rigorous public investment project appraisal and screening system is put in place to rank public investment projects, and fund only those which are strongly growth-oriented and whose economic and social returns are high enough. In Montenegro, there is a need to do both a strategic assessment of what infrastructure investment may be needed, and which of the many potential infrastructure projects warrant investment based on their economic and social returns.

- *Improve the budget processes and develop a comprehensive plan to eliminate arrears.* This can be done through: (i) undertaking a better and more realistic revenue projection as well as speedy expenditure decisions to be implemented by budget users in the event of revenue shortfalls; (ii) strengthening the commitment control system of spending agencies through better staffing, the upgrading of accounting standards, and transparency; and (iii) developing a time-bound plan for clearing arrears, identifying the most costly ones and retiring those first.

- *Strengthen the link between policy priorities and the budget, especially with respect to tourism development and implementation of the Poverty Reduction Strategy Paper (PRSP).* In the medium to long term, there is a need to develop a comprehensive medium–term expenditure framework as a basis for public expenditure planning, comprising the central government, the social funds, and local governments, and reflecting fully the policy commitments of the Government. The PRSP should also be allocated a budget, with concrete monitoring and an evaluation framework. Montenegro's main potential source of growth, tourism, should be supported through multi-year budgeting and the Government's Tourism Master Plan (TMP) needs to be provided with concrete budgets and interim implementation targets.

10. **Finally, tourism holds considerable promise for Montenegro's export-oriented growth and employment creation**. In the past the manufacturing sector and the metal industry, in particular the most important aluminum company, KAP, played a dominant role in the Montenegrin economy. To date, KAP is the single most important exporter, accounting for more than 40 percent of total merchandise exports; it contributes significantly to value-added and employment in the economy. However, that may be changing. Tourism in Montenegro has recently shown strong growth in absolute terms and relative to the

economy as a whole. According to the World Tourism and Travel Council, the contribution of the travel and tourism industry (TTI) to Montenegro's economy is estimated at 8.5 percent of total GDP and 9.1 percent of total employment in 2005. The same study suggests an even more rapid growth in the future: with a projected average rate of increase of over 10 percent per year over the next decade. By 2015 the tourism industry would account for about 13.6 percent of GDP and 14.5 percent of employment, and the broader tourism economy should account for about 21.1 percent of GDP and 22.5 percent of employment. Even though these projections could be overly optimistic, they are suggestive of Montenegro's considerable potential in tourism development.

11. However, turning this promise into reality requires substantial and well-targeted investments as well as the implementation of most of the policy recommendations outlined above. In many ways the tourism sector illustrates the challenges of competitiveness and growth faced by Montenegro. To realize its tourism potential, Montenegro needs to overcome stiff competition from neighboring countries and other destinations worldwide, many of which currently offer a more competitive combination of quality and price to the same target markets. Several specific measures are needed in that regard:

- *Facilitate the conditions for private investment in tourism by:* (i) Focusing the effort to attract private investment to the coast on international flagship operators; (ii) strengthening land use planning, and property rights and controlling illegal construction at tourist sites; (iii) putting in place supportive, not oppressive, legislation and regulations, and sorting out a thorough review of the body of tourism regulations required for maintaining basic standards (health, safety, environment, etc.) and protecting consumers' interests, versus those that should be left to market-based mechanisms; and, (iv) reducing the cost of capital and increasing access to credit for (domestic) private investment.

- *Help address the public infrastructure constraints-- in particular in water, roads, and waste management—for coastal tourism development*. The water shortage during the short tourism season needs to be overcome; an adequate solid waste management system, including capital investment in landfills and strict and consistent enforcement of anti-dumping laws, needs to be put in place; and a strategy needs to be developed to use road and other transport infrastructure to steer tourism development to new areas. The Government needs to play a coordinating role in areas where donor infrastructure investments are ongoing, and play a complementary role of filling the investment gap in the context of its comprehensive public investment program (see recommendation on public investment above).

- *Help capture the potential employment benefits of tourism.* The potential employment benefits of tourism are not being captured. Local employment in the tourism sector is relatively low and is projected to grow at only a modest rate of 1.7 percent in 2005. The main reasons seem to be the short tourism season and the high labor taxation (or, conversely, the low non-resident taxes) that favor non-Montenegrin employment, but it would be important to carefully assess the reasons why Montenegro is not capturing the employment benefits, and to decide what adjustment, if any, should be made to labor regulations and collective agreements. Also, help address the shortage of skilled labor and inadequate training facilities for tourism services as better skills at the service level are urgently needed to improve quality and competitiveness in the existing facilities. The first private faculty of tourism, management and trade, established in 2004 by Atlas Mont Bank in Bar, is a promising training facility which must be encouraged.

- *Continue to diversify the tourism product, based on Montenegro's strengths.* Most of the attention for both public and private investment continues to be directed at expanding and upgrading coastal tourism, with relatively little attention given to non-coastal tourism. A diversified approach to tourism which promotes landscape-based tourism in Montenegro's hills and mountains is important. Specific plans, programs and incentives need to be developed and implemented to catalyze non-coastal tourism investment and development with the coastal tourism development.

12. Given the small size of Montenegro's domestic market, its future growth and prosperity will depend to a large extent on how successfully it develops its exports oriented tourism industry in a sustainable and environmentally responsible way.

Montenegro: A Policy Reform Agenda for Employment, Growth, and Competitiveness

Policy Measure	**Timeline for Implementation**
Labor Market Reform	
Rein in the rapid wage growth witnessed in recent years through: (i) establishing a more balanced collective bargaining and wage setting process whereby the voices of employers (including Government) are strengthened; (ii) 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; and, (iii) promoting greater decentralization of bargaining to the firm level.	Short-term
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. The reforms in labor relations should focus on: (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 employees for economic reasons; (iii) permitting more flexible arrangements in working hours; and, (iv) limiting non-wage costs to employers.	Medium term
Reduce the high rates of labor taxation in a fiscally responsible way to encourage formal employment. 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. To decrease such high rates in a fiscally responsible way, reforms of the health and pension systems (early retirement, disability, maternity leave and sickness benefit) need to be pursued in parallel.	Medium term
Introduce or expand, through the Employment Bureau, other active labor market programs including: (i) employer contact services, which 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 to develop teaching and training skills for operating a real enterprise.	Short-term
Improve labor market data and information. Special and more detailed regular labor force data are needed to monitor employment, underemployment and unemployment; seasonal, occasional and informal employment; earnings and incomes; working time, by occupational and professional groups and regions; and work in the informal sector and in households. The absence of regular and reliable information on the labor market limits effective labor market monitoring and interventions.	Long-term
Fiscal Policy Reform	
Reduce/control expenditures on the wage bill, transfers to households, and interest payments, which have risen significantly over the last three years. The high wage growth has crowded out spending on public investment and operations and maintenance—expenditures that are essential for growth. It should be controlled through: (i) public administration reforms that would eliminate employment redundancies; (ii) controlling of wage and salary increases.	Short-Medium term
Increase the allocation toward well-targeted infrastructure investment that will support tourism development and growth. At 2 percent of GDP, Montenegro's domestically financed capital expenditure is much below the level for other countries in the region. Capital investment in infrastructure, at only about 0.4 percent of GDP, is even less. Increasing capital investment, in particular in infrastructure, is necessary. The challenge would be to: (i) do this in a way that would not compromise fiscal and macroeconomic sustainability; (ii) carefully target and fund only those infrastructure investments that are strongly linked to growth and tourism development.	Medium term

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Policy Measure	Timeline for Implementation
Eliminate/reduce subsidies and lending to public enterprises by imposing a complete hard budget constraint. Government subsidies and net lending now account for about 1.6 percent of GDP. State-owned enterprises still lack hard budget constraints and budgetary discipline. This problem could be overcome through (i) increasing the transparency around which state-owned enterprises receive subsidies and transfers from the Government; (ii) completing the privatization of these enterprises where privatization is an option; and (iii) where privatization is not feasible, by improving the management of such enterprises and defining strict financial performance criteria that would phase out subsidies and budget transfers. **Increase the productivity of current expenditures on education and health care services**. In the health sector the management of public health funds should be improved, the reforms of primary health care including prioritization of treatment programs, should be continued, and public procurement procedures should be improved through improved legal framework for procurement. In education the disproportionate staffing cost should be reduced through school consolidation, and vocational training programs should be realigned to those demanded by the labor market. **Improve budget processes and eliminate arrears** by: (i) undertaking a better and more realistic revenue projection as well as making speedy expenditure decisions in the event of revenue shortfalls; (ii) strengthening the commitment control system of spending agencies through better staffing, the upgrading of accounting standards, and transparency; and (iii) developing a time-bound plan for clearing the current stock of arrears, identifying the most costly ones, and retiring those first. **Strengthen the link between policy priorities and the budget, especially with respect to tourism development and implementation of the Poverty Reduction Strategy Paper (PRSP).** The Government budget generally, and public investment particularly, should be geared toward supporting the realization of the growth potential of tourism. The Ministry of Tourism should move toward a multi-year budgeting and program implementation. In the medium to long term, there is a need to develop a comprehensive medium–term expenditure framework as a basis for public expenditure planning, comprising the central government, the social funds, and local governments, and reflecting fully the policy commitments of the Government. The PRSP should also be allocated a budget, with concrete monitoring and an evaluation framework.	Short-term Long-term Short-term Medium-Long term
Private and Financial Sector Reforms	
Simplify and speed up the issuance of business licenses and inspections. Business operating licenses take a long time to be issued, and licensing and inspection activities are not conducted in a fair and transparent way (FIAS, 2004). A draft Law on Licensing, prescribing a faster and more efficient registration and listing of business activities, should be implemented as quickly as possible. **Improve governance and regulation through**: (i) greater transparency, and a more consistent application of rules, including an improved tax administration capacity to support rule-based tax collection; (ii) speeding up the implementation of recently enacted business laws and regulations. The implementation of legislation aimed at improving the business environment--contract enforcement, access to finance, corporate governance, and business exit—has not yet begun in most cases. Speeding up the implementation of these laws will be critical to private sector investment and growth.	Short-term Short-term

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Policy Measure	**Timeline for Implementation**
Speed up the restructuring of companies privatized through the MVP by: (i) faster consolidation of the shares of these companies being traded on stock exchanges into majority shares; (ii) making budgetary allocations toward covering the social costs of restructuring—including the shielding of excess labor and severance payments – for those companies for which the Government agreed to fund such costs; (ii) strictly enforcing the new Bankruptcy Law for medium and large enterprises privatized through vouchers that have continued to accumulate losses; and (iii) strengthening the capacity of the courts to deal with such bankruptcy cases (see below, on courts).	Short-term
Reduce the backlog of commercial court cases and speed up contract enforcement through: (i) easing the resources and personnel constraints in the Montenegrin judiciary; (ii) ensuring that qualified judges are put in place; (iii) training court personnel; and (iv) upgrading the court system's infrastructure, including the computerization of case management.	Medium-term
Improve land title transparency and control illegal construction. Lack of transparency on land titles and registration represents one of the greatest threats to the future prospects of Montenegro's tourism industry, particularly in the few remaining high-potential tourism sites (e.g., Ulcinj, and inland areas close to national parks and other natural attractions). The Government needs to vigorously enforce land property rights and control illegal construction.	Medium-term
Reduce the cost of capital and improve financial intermediation through: (i) reducing the need for Treasury bill financing through a tight fiscal policy. This would help reduce the budgetary burden of interest payments on Treasury bills and would create the conditions for the lower cost of capital in the economy by reducing the crowding-out of Government; (ii)establishing an effective, broad-based institution, with full credit information on all borrowers, to address the problem of asymmetric information in credit markets. At the moment Montenegro has neither a Credit Registry nor a Credit Bureau; (iii) introducing more competition into the banking sector through the completion of the privatization of government-owned banks (in particular Podgoricka Banka), and by promoting leasing operations in view of the small size of the Montenegrin market.	Short-term
Tourism Development	
Diversify the tourism product, based on Montenegro's strengths. Most of the attention for both public and private investment continues to be directed at expanding and upgrading coastal tourism, with relatively little attention given to non-coastal tourism. A diversified approach to tourism which promotes landscape-based tourism in Montenegro's hills and mountainous areas is important. Specific plans, programs and incentives need to be developed and implemented to catalyze non-coastal tourism investment and development.	Medium-Long term
Focus the effort to attract private investment on flagship operators. Because Montenegro is currently relatively unknown in many prospective tourism markets, high priority should be given to attracting a few high quality "flagship" operators whose presence could help provide the reassurance that many travelers need in order to try out a new destination.	Short-term
Facilitate the conditions for private sector investment in tourism by: (i) strengthening land use planning, and property rights and controlling illegal construction at tourist sites; (ii) putting in place supportive, not oppressive, legislation and regulations and carrying out a thorough review of the body of regulations required for maintaining basic standards (health, safety, environment, etc.) and protecting consumers' interests versus those that should be left to market-based mechanisms; (iii) reducing the cost of capital and increasing access to credit for (domestic) private investment in tourism.	Short-Medium term

Montenegro: A Policy Reform Agenda for Employment, Growth, and Competitiveness

Policy Measure	Timeline for Implementation
Help address the public infrastructure constraints-- in particular in water, roads, and waste management—for coastal tourism development. The water shortage during the short tourism season must be overcome; a strategy needs to be developed to use road and other transport infrastructure to steer tourism development to new areas; and an adequate solid waste management system, including capital investment in landfills and strict and consistent enforcement of anti-dumping laws, should be put in place. **Help capture the potential employment benefits of tourism.** The potential employment benefits of tourism are not being captured. Local employment in the tourism sector is relatively low and is projected to grow at only a modest rate of 1.7 percent in 2005. The main reasons seem to be the short tourism season and the high labor taxation that makes employers favor non-resident employment, but it would be important to carefully assess the reasons why Montenegro is not capturing the employment benefits, and to decide what adjustment, if any, should be made to labor regulations and collective agreements.	Medium term Short term
Help address the shortage of skilled labor and inadequate training facilities for tourism services. Better skills at the service level are urgently needed to improve quality and competitiveness in the existing facilities. A higher level of professional training in a wide range of skills, with an emphasis on modern information technology, management, and flexibility and "multi-tasking" is needed. Such training facility can be private sector-led. The Ministry of Education has recently introduced "tourism and catering" as a vocational stream, but this would need to be strengthened. The first private faculty of tourism, management and trade, established in 2004 by Atlas Mont Bank in Bar, is a promising initiative which must be encouraged.	Medium term