

Montenegro Growth and Jobs

Report I

September 2018

Montenegro: Growth and Jobs

*The Government of Montenegro has identified a need to exert strenuous to reduce unemployment and bring more Montenegrins into the labor market. It recognizes the complexity of this task, which requires a holistic approach, a long-term development vision and careful identification of priorities and sequencing of policy actions and support programs. The Government has requested World Bank support in outlining the **Growth and Jobs Agenda**.*

*This report, first in the series of few, takes stock of the factors at play in the **Growth and Jobs Agenda** for the country, identifies challenges and opportunities to address this agenda going forward, and sets the framework of analyzing the growth and jobs issues in Montenegro. This stocktaking can help inform policy options, institutional reforms, and support programs that may be needed to respond to the challenges of the **Growth and Jobs Agenda** in a holistic manner.*

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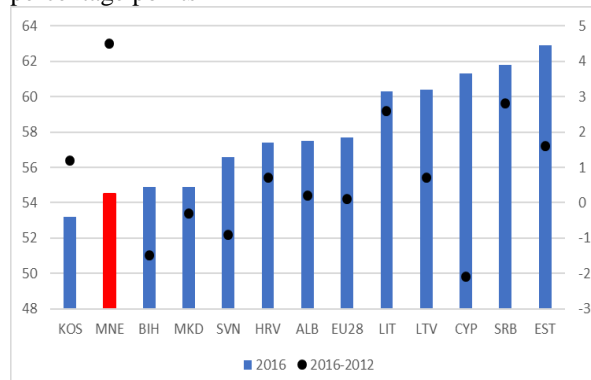
Executive Summary: The Jobs Challenge in Montenegro

Low Labor Force Participation and Employment Rate

1. **Montenegro needs more jobs and more people on the labor market.** Despite years of economic growth, many Montenegrins of working age do not participate in the labor market. The participation rate of 57 percent for those aged 15 and over is among the lowest in Europe (Figure 1). This means that almost every second working age person is out of the labor market. Inactivity rates are especially high among women and in rural areas.

Figure 1. Activity rate is low, more so for female (at 47.6 percent)

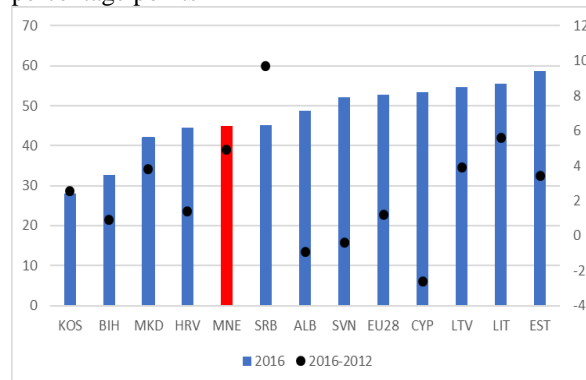
Activity rate (15+) and its change since 2012, percentage points



Source: MONSTAT and Eurostat.

Figure 2. Employment rate is increasing, but remains low compared to EU peers

Employment rate (15+) and its change since 2012, percentage points



2. **Despite recent increases, employment rate is low, especially for women and youth.** At 46 percent, the employment rate of Montenegrins (Figure 2) means that every second person of working age (over 15 years of age) has no job. Moreover, one in three of the jobs available are informal. The employment rate for those aged 15–64 in Montenegro is 54 percent, compared to 65 percent in the EU and the Europe 2020 target of 75 percent. To reach the EU average, Montenegro would need to create another 40,000 jobs (close to the current number of unemployed); but since 2011, less than 6,000 new jobs have been created annually.

Large Underutilized Labor Reserve

3. **The gender gap in employment, although lower than in many other Western Balkan countries (WB6), is still a significant 12 percentage points.** The female employment rate is lower than 40 percent (Figure 3). Almost half of prime-age women cite care responsibilities as the main reason for inactivity, as do 23 percent of older women. This suggests that establishing child-care and long-term care institutions could bring more women into the labor force. Such a development would have a double effect: both freeing women to work and creating new jobs.¹

4. **A large number of youth are not in employment, education, or training (NEET).** Over 18 percent of those aged 15–24 are not active in the labor market or getting more education (Figure 4), meaning that one out of six young people is idle—6 percentage points higher than the EU average of 12 percent. It appears that youth idleness is a greater problem in Montenegro than in most EU countries. Interestingly, the NEET rates for men and women are virtually the same.

¹ World Bank (2016) Montenegro Systematic Country Diagnostics.

Figure 3. Female employment is low and is the untapped potential

Employment Rate, Women, 2016 Percent of Population 15+

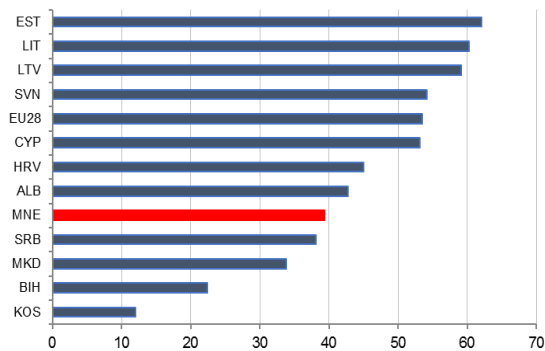
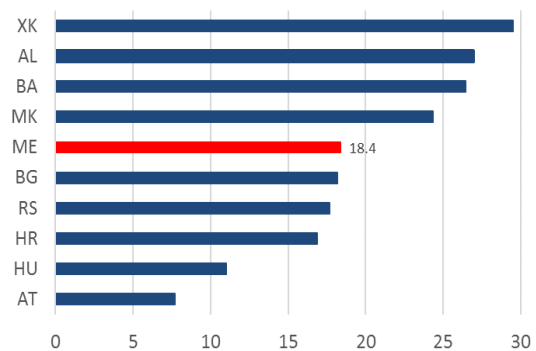


Figure 4. Youth not in employment, education or training is still high

NEET Rate for Youth. 15–24, 2016, Percent



Source: Eurostat, SEE Jobs Gateway Database; NEET- not in employment, education or training.

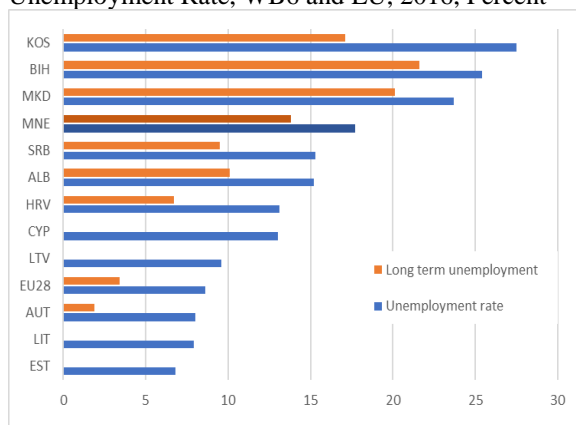
High Long-Term Unemployment Leads to Discouragement

5. **Yet, once in the labor market, many have to deal with long-term unemployment.** At 16 percent, unemployment is high for both men and women—and double the historical low of August 2009). Moreover, for over 80 percent of the unemployed it takes more than a year to find a job (Figure 5). The duration is even longer for new entrants (40 percent of all unemployed), women and those with low education (Figure 6). However, the increasing number of jobs in tourism and construction are being filled by foreign workers, which suggests either preference to migrant workers or high wage reservation of local labor—high informal incomes, remittances, or accumulated social transfers being behind it.

6. **Discouragement is a pre-eminent reason for inactivity among prime-age workers.** People withdraw from the labor force because their job search proved futile. They no longer believe that jobs are available. As many as 14 percent of prime-age men and 10 percent of women are economically inactive because they are discouraged by the lack of job opportunities.² An increase in job offers, but also employability of such workers, are thus a necessary condition for higher labor force participation. According to sector of occupation in the last job, more than half of the unemployed or marginally attached (not looking for a job but would like to work) were previously in the military or in sales.

Figure 5. Unemployment rate is still high compared to regional and EU peers

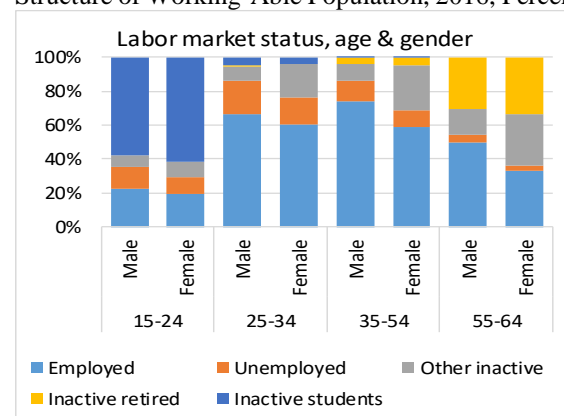
Unemployment Rate, WB6 and EU, 2016, Percent



Source: MONSTAT and Eurostat.

Figure 6. Youth, women, and those with low education levels are less likely to be employed

Structure of Working-Able Population, 2016, Percent



² World Bank (2016) Montenegro Systematic Country Diagnostics.

Low Productive Private-Sector Jobs

7. **Montenegro needs more productive jobs in the private sector.** While the contribution of labor to growth is low, that of total factor productivity has actually been negative since 2008 crisis outbreak. To boost growth, productivity must be increased to boost future growth (Figure 7). However, the private sector is very small. It employs 60 percent of workers (Figure 8), but over 20 percent of the jobs are short-term because the country relies heavily on seasonal tourism and agriculture for job creation. Moreover, rather than accepting private sector jobs, Montenegrins prefer to queue for public sector vacancies. While there is no evidence of a public-sector wage premium, except for some positions in state-owned companies and lower qualified jobs, public jobs are considered more secure and prestigious.

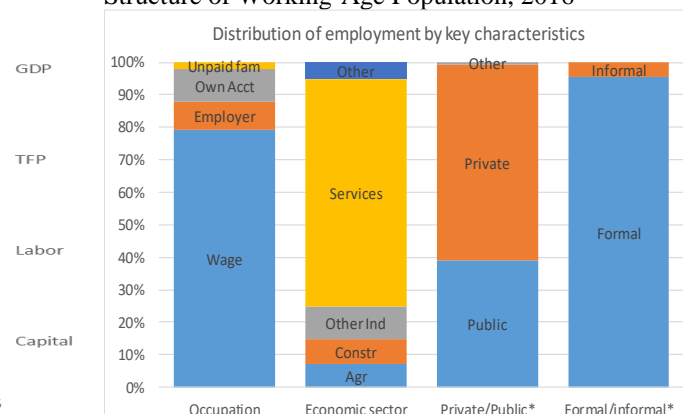
Figure 7. Productivity contribution to growth was negative post-crisis

Contributions to Growth, Percentage Points



Figure 8. Public sector still accounts for 40 percent of all employment

Structure of Working-Age Population, 2016



Note: *The labor force survey underreports the informality, and in addition does not distinguish underreported incomes.

Source: MONSTAT and staff calculations.

8. **The relatively high wages are clearly not aligned with low productivity.** Although total productivity is still about the same as in 2000, real wages have almost doubled since then (Figure 9). In purchasing power parity (PPP) terms, at an average monthly gross wage of €1,500,³ Montenegrin wages are comparable to Croatian and above Hungary or neighboring countries (Figure 10)⁴. That is why Montenegro is attracting foreign labor for highly seasonal jobs in nontradable sectors and domestic workers to apply for public sector jobs. However, the Montenegrin tradable sector is not very competitive, and its exports are still highly concentrated on only few commodities (aluminum and steel constitute a third of exports). Trade, which is vital for jobs and growth in small economies, is far below that of peers: exports of goods and services is at 41 percent of GDP with one of the lowest in the world goods exports—of less than 10 percent.

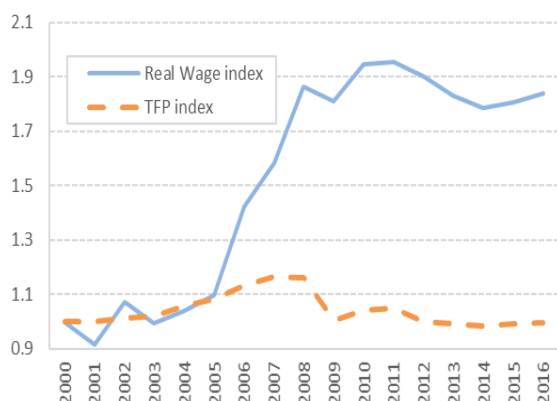
9. **Private sector wages are largely determined by how national wages are set rather than being based on productivity.** The national collective agreement sets the national basic wage and the minimum national wage scale. More flexibility in wage negotiations and delinking the public-sector wage-setting mechanism from the private sector should allow real wages to adjust in line with productivity.

³ World Bank and wiiw (2018). Western Balkans Labor Market Trends.

⁴ Except that the share of low-wage earners in Montenegro is particularly high (around 27 percent) and particularly among youth (over 40 percent), as per the Structure of Earnings Survey.

Figure 9. Wage rates are out of sync with productivity

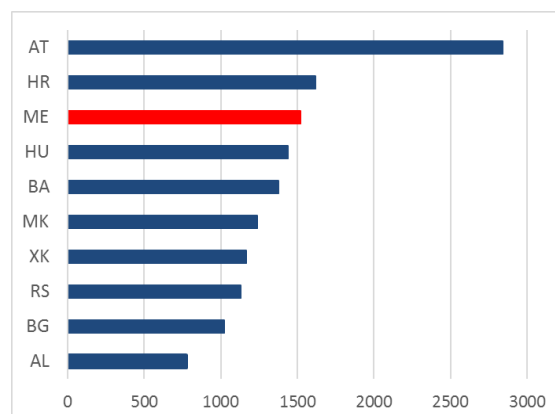
Montenegro Real Net Wage and Total Factor Productivity, 2000=1



Source: MONSTAT and staff calculations and SEE Jobs Gateway Database.

Figure 10. Real wages are relatively high compared to the region

Average Monthly Gross Wages, EUR (PPP), 2016



Low Skills, Aging and Emigration Worsen Labor Supply

10. **A shortage of skills is a problem for growing businesses.** According to the enterprise survey, innovative and high growth firms (*gazelles*) have difficulties finding appropriate labor; soft skills are particularly scarce (Figure 11). The education and training system is weakly linked to private sector needs. Early child education still faces low enrollment rates, while PISA performance is well behind the EU peers (Figure 12) and behind the needs of the constantly changing business environment.

Figure 11. Skills are a particular problem for innovative and young firms

Firms Reporting Problems in Filling Vacancies

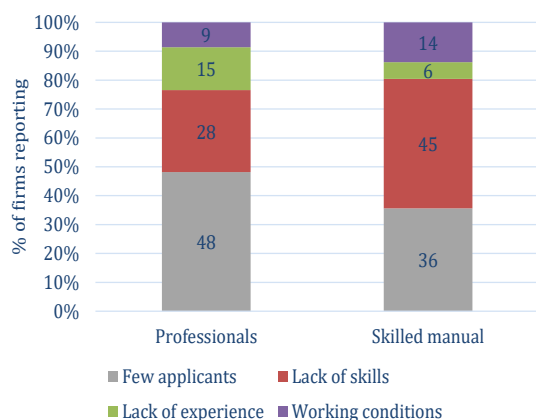
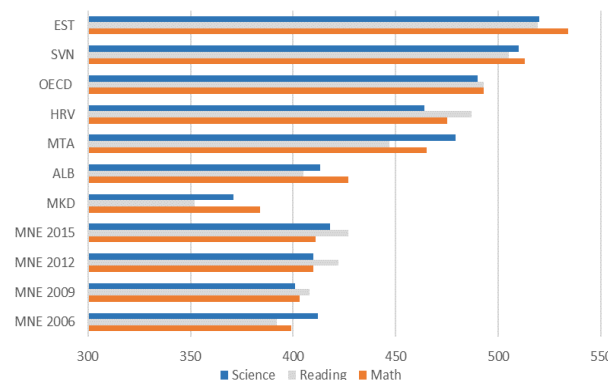


Figure 12. Quality of education not on par with needs

Performance in Program for International Student Assessment

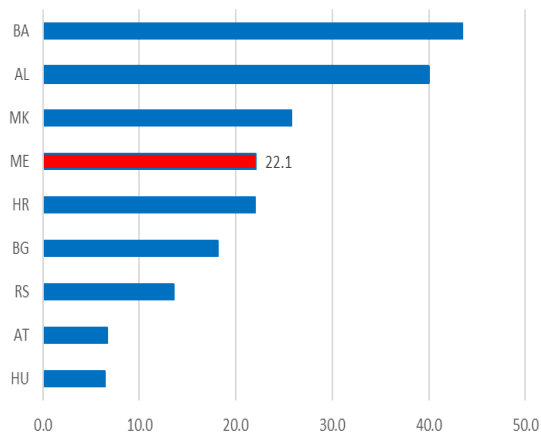


Source: Enterprise Survey 2014, and OECD.

11. **Finally, Montenegro is aging fast and emigration has recently increased,** especially among youth. The estimates suggest that close to 25 percent of Montenegrins live abroad (Figure 13). Recent emigration, which reflects poor job opportunities at home, exacerbates the country's skills shortages. So does the aging of the population as a whole. By 2050, the UN estimates that there will be 150,000 fewer Montenegrins of working-age (Figure 14). Too many are taking early retirement as well, which heightens labor market inactivity rates. In 2015 over 50 percent of those aged 55–59 were out of the labor force, with the large majority being retired. As a result, Montenegro is not using its workforce to full capacity, which it needs to do given the size of the country and the demographic transition that will further shrink the working-age population. An aging population calls for mobilizing the entire potential labor force and

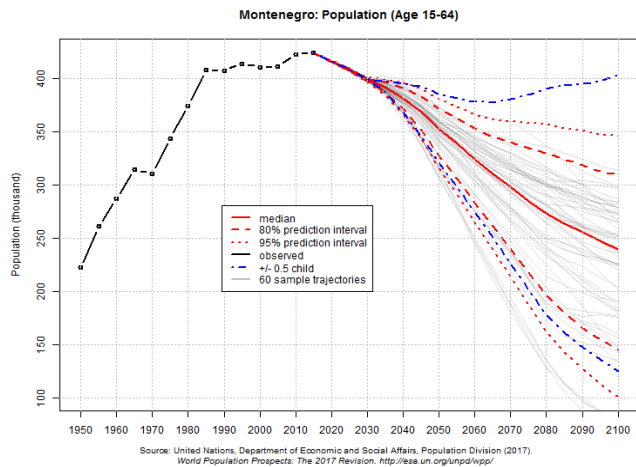
moving people from inactivity to employment by addressing incentives for work, labor demand, and employability.

Figure 13. Diaspora
Percent of Domestic Population



Source: Enterprise Survey, 2014 and OECD.

Figure 14. Working age population is declining
Population of 15-64 Age, 1950-2100



Source: United Nations, Department of Economic and Social Affairs, Population Division (2017).
World Population Prospects: The 2017 Revision. <http://essa.un.org/unpd/wpp/>

12. **Montenegro being a small economy, faces constraints with implications for both market opportunities and supply of skills.** For example, entrepreneurs or high skill workers might choose to emigrate to places with more dynamic business ecosystems. Such further erosion of available skills would further adversely affect productivity, growth and job creation. The successful small states of the EU (e.g. Baltics or Slovenia) offer good development paths that prevented skill and labor erosion by addressing market economy institutions and policies early on.

Emerging Questions

13. **Several questions thus emerge:**

- What can Montenegro do to create more jobs and bring more people to enter the labor market? How can early retirement be discouraged? What can be done to increase female employment rates and better integrate youth into the workforce?
- Why is the labor market failing disadvantaged groups and how can social assistance, job seeker centers, and active labor market policies (ALMPs) be structured to best help them find jobs?
- How can productivity and private sector employment be raised, and what prevents private sector from being the main generator of growth and employment? Does the country have potential to attract higher-value-added investments that would justify high wages?
- How can the skills mismatch be addressed, and what skills will the labor market need in future? How can the skills and resources of the large Montenegrin diaspora be better leveraged?

14. **Based on current and previous World Bank analysis, the *Growth and Jobs Agenda* can be discussed in terms of two broad pillars (Figure 15):**

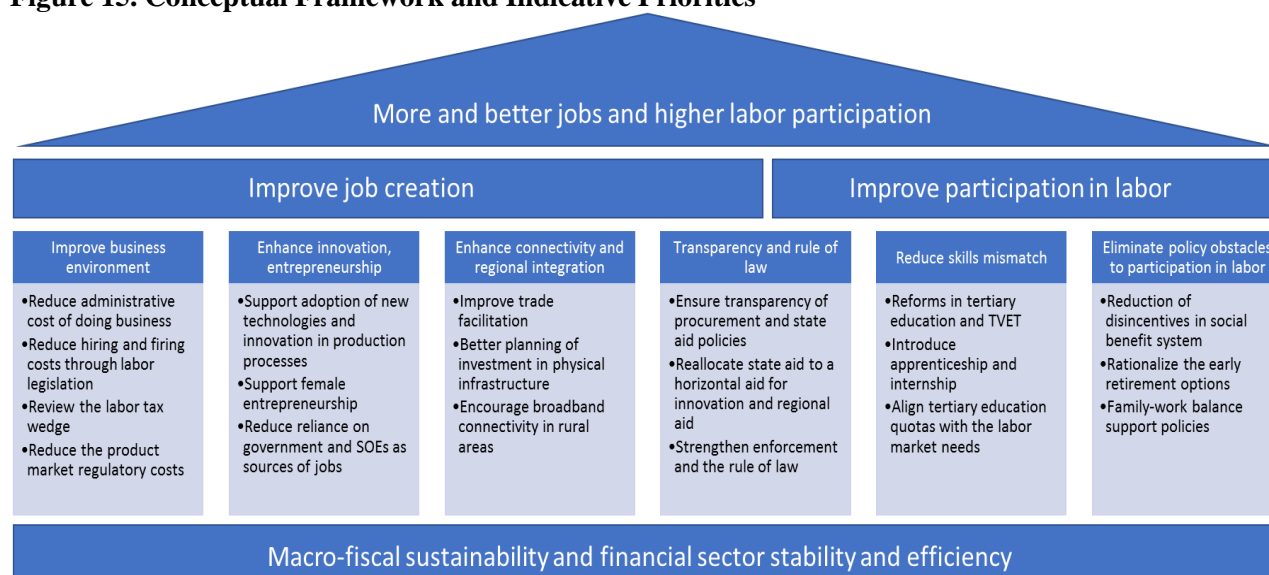
- Creating more and better jobs** – unlocking demand for labor by increasing productivity and competitiveness; and
- Increasing participation in the labor market** – ensuring that jobs are taken and the quality of labor meets the market needs.

Under Pillar I there are four building blocks relevant for labor demand. These are reforms that focus on (i) improving business environment; (ii) enhancing innovation and entrepreneurship; (iii) enhancing connectivity and regional integration; and (iv) improving transparency and the rule of law.

Under Pillar II there are two building blocks relevant for increasing and improving labor supply. These are reforms that focus on (i) reducing skills mismatches, and (ii) elimination of disincentives for labor force participation.

15. **Underpinning the two pillars above, macro and fiscal prudence will remain a precondition for stability and growth**, while growth is directly related to job creation. There are direct and indirect impacts from macro-fiscal stability on the jobs agenda. A direct one is the sovereign risk premium that is currently some 300 basis points above Montenegrin peers and that directly impact the cost of financing for both public and private sector. Indirectly, the high level of debt requires comparatively higher tax burden to finance it in the future; thus directly reducing competitiveness of an economy.

Figure 15. Conceptual Framework and Indicative Priorities



16. **The issues of jobs and growth in Montenegro are intertwined and complex.** They require analysis under each of the five building blocks followed by the formulation of a comprehensive policy agenda. This report focuses on a sub-set of the above policy areas which are all horizontal issues with large impact on growth and jobs; sector specific policy is complimentary, and we illustrate this in three key sectors. These reform policy areas focus on the following:

- a) Creating jobs in the private sector, with an in-depth focus on sectoral reforms in agriculture, tourism and information-communication technology
- b) Supporting social and labor market institutions in incentivizing activity and skills matching
- c) Support for education to give priority to skills needed for future jobs.

17. **Which constraints are genuinely binding?** While the labor supply interventions to increase participation and thus contribute to more jobs would take time to deliver skills and change incentives of people to engage on the labor market, firms should also be strengthening their own managerial skills and skills of their labor, technology adoption capacity, and the ability to access new markets. Labor demand interventions are likely to be a priority for the short term, while labor supply interventions, while required to be acted upon now, will only

deliver over the medium term. The list of the proposed priority areas in Table 1 is further elaborated in the chapters below.

Table 1. Emerging reform priority areas

| Proposed Priority Area | Rationale |
|------------------------------------|---|
| Private Sector Job Creation | <p>There is a critical need to boost job creation through supporting environment for private enterprises and enhancing competitiveness, while maintaining overall favorable macroeconomic conditions. Emerging priority areas:</p> <ul style="list-style-type: none"> • Collect and analyze data on firm and productivity dynamics • Diversify the economy and exports • Streamline the business environment • Expand access to finance • Undertake sectoral policies for agriculture, tourism, and ICT |
| Social and Labor Policy | <p>Work disincentives are highest for low-income earners or those in part-time work (more likely to be women) and are very high for those receiving social assistance. Early retirement options aggravate the labor shortage. Employment intermediation and labor activation schemes need to connect people to jobs and help avoid further degradation of skills that puts them into a vicious cycle of dependence on the state.</p> <ul style="list-style-type: none"> • Incentivize longer working lives • Redesign current benefits to give more incentive for working • Remove disincentives and barriers embedded in labor taxation and regulation • Reinforce employment services and active labor market policies • Support family-work balance by providing access to child and elder care |
| Skills | <p>There is a skill mismatch that disproportionately affects innovative firms: both hiring professionals and skilled workers is difficult. Young workers lack soft employability skills, such as language, leadership and initiative, critical thinking, as well as advanced hard skills like technical knowledge.</p> <ul style="list-style-type: none"> • Strengthen the education sector efficiency • Foster more robust development of foundational skills • Ensure a smooth school-to-work transition • Reskill workers |

A. How Is Montenegro's Labor Market Performing?

18. **Although compared with its Western Balkans peers the performance of the labor market in Montenegro is moderate, it lags behind those of EU comparators and other middle-income countries.** Activity and employment rates are low (Figure 16), and although unemployment is declining, long-term unemployment is high. Some features of Montenegro's labor market suggest that it is more flexible than those of other Western Balkans countries, such as use of temporary contracts, but not flexible enough to engage in the labor market the large groups of youth and women looking for a job for the first time.

19. **Economic growth has stimulated some job creation in recent years:** since 2013, registered employment increased by 2.1 percent a year.⁵ However, job creation by the private sector has not been sufficiently dynamic. The private sector is still relatively small, employing just over half of workers, and those often in less secure short-term jobs. State-owned enterprises (SOEs) still employ a large share of workers but new hires are rare.

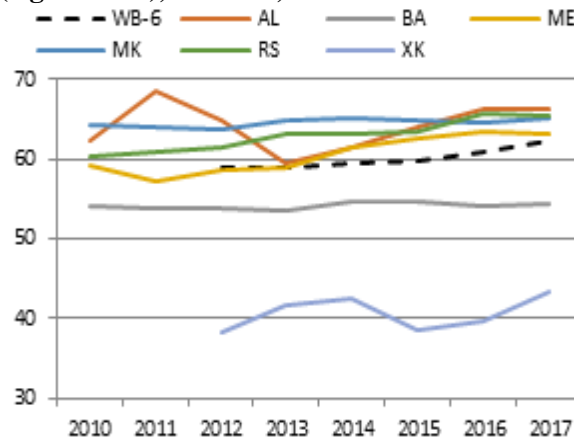
20. **Despite recent improvements, economic growth in Montenegro is not creating enough jobs:** the country faces low labor force participation, high unemployment, and high informality. The employment rate of 46 percent among populations aged 15 or older is one of the lowest in Europe. New labor market entrants have many challenges, and many of the unemployed have been looking for a job for a very long time.

21. **Lower employment is equivalent to untapped potential productivity, which holds back growth and prosperity prospects.** A weak labor market also often implies a greater burden on people who do work, and on the government, through lower tax revenues and higher social spending, to support those unengaged.

22. **The slow increase in labor force participation has not yet brought Montenegro up to the regional average.** Though the participation rate of those aged 15-64 did rise steadily from about 57 percent in 2011 to 65 percent in 2017—a trend similar to the one observed for most of the Western Balkan (WB6) countries—it has still not caught up with the EU28 average of 73 percent.

23. **Unemployment declined in Montenegro from about 20 percent up to 2013 down to 16 percent in 2017.** Though that is very similar to the WB6 average, the EU average is just 7 percent EU (Figure 17). Long term unemployment (those who have been searching for a job for more than 12 months) represents 80 percent of total unemployment and it is harming youth and women particularly. However, long-term unemployment has decreased more rapidly for younger age groups than for the overall population. The unemployed are more likely to be poor, they come from the northern area, and they have lower education.⁶

Figure 16. Labor Force Participation Rates (Ages 15–64), 2010–17, Percent

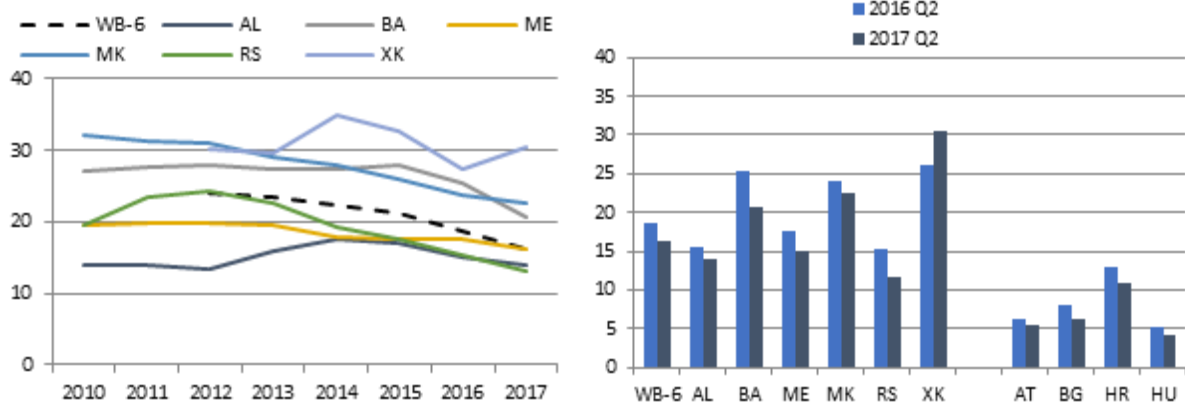


Source: SEE Jobs Gateway, World Bank.

⁵ World Bank (2018), Regular Economic Report No. 13.

⁶ World Bank (2016) Montenegro Systematic Country Diagnostic.

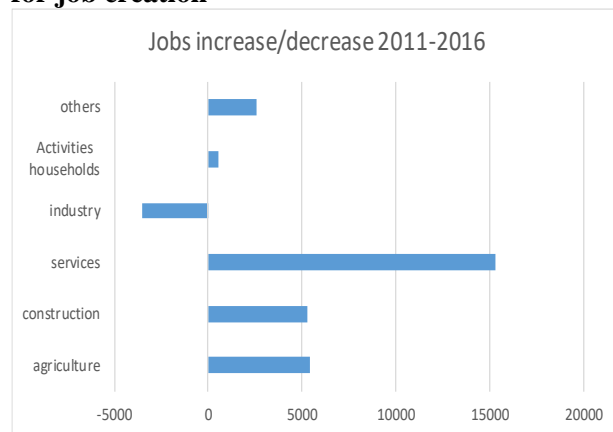
Figure 17. Unemployment Rates, Percent



Source: SEE Jobs Gateway Database, based on data by national statistical offices and Eurostat.

24. **Jobs in Montenegro tend to be wage jobs, in the services sector.** Four in five employed persons are wage employees; self-employment is quite limited, especially in comparison with neighboring countries. Services account for 70 percent of all jobs and contributed most of the new jobs of the past six years (Figure 18). Although private sector jobs have grown much faster than public, the public sector still accounts for 40 percent of all employment. One-third of wage employees have tertiary education (compared to one in five in the entire working-age population). Women are less likely than men to be self-employed or work in industry.

Figure 18. Service is the most important sector for job creation



Source: Estimates based on Montenegro LFS 2016

25. **One in three jobs is informal,⁷ and seasonal jobs are largely filled by migrants from abroad.** Because employers are able to hire people informally, in particular for seasonal jobs in, for example tourism, they prefer to rely on workers from other countries since for these they pay no taxes or social contributions, and sometimes do not adhere to labor standards. In effect this is a disincentive to employing the local labor force; it also has adverse implications for budget and pension fund revenues, in addition to putting informal workers in a vulnerable position.

26. **Self-employment has increased in Montenegro, from about 15 percent between 2010 and 2013 to 18.2 percent in 2017,** but that is still lower than the rates observed in neighboring countries (Figure 19). As in the rest of the region, most self-employed have completed lower or upper secondary school (Figure 20).

⁷ UNDP (2016) National Human Development Report 2016 - Montenegro: Informal Work, May 2016.

Figure 19. Self-employment, share of total employment (15–64 years), percent

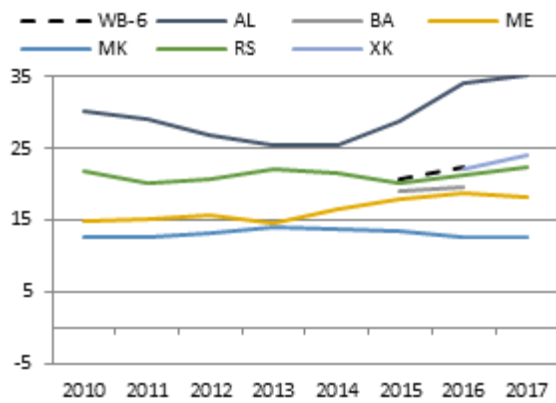


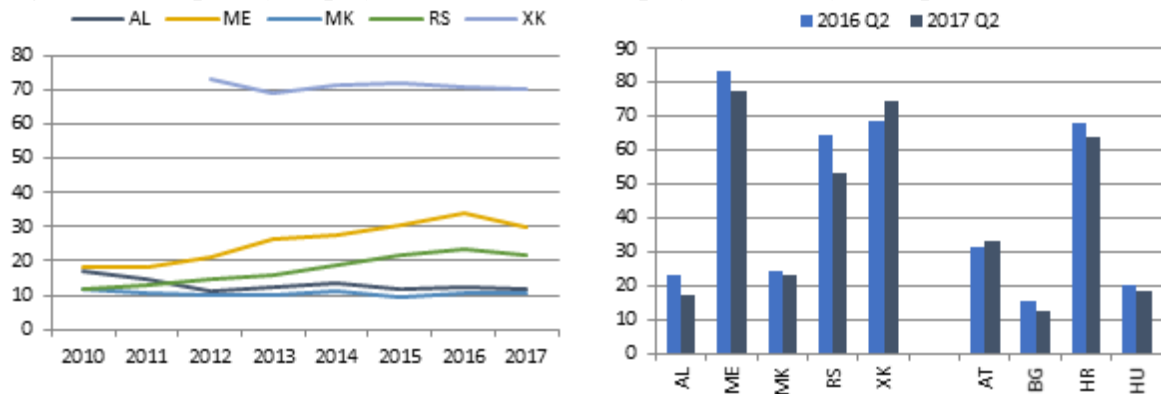
Figure 20. Self-employed by educational attainment, percent, 2016

| | Low | Medium | High |
|-------------------------------|------|--------|------|
| Western Balkan-6 | 37.7 | 51.4 | 10.9 |
| Albania | 56.0 | 37.8 | 6.2 |
| Bosnia and Herzegovina | 31.1 | 62.4 | 6.4 |
| Montenegro | 17.2 | 56.9 | 25.9 |
| FYR Macedonia | 47.9 | 45.2 | 6.8 |
| Serbia | 27.6 | 57.2 | 15.3 |
| Kosovo | 29.7 | 60.8 | 9.5 |
| Austria | 8.7 | 46.5 | 44.8 |
| Bulgaria | 15.7 | 52.3 | 32.0 |
| Croatia | 17.4 | 59.4 | 23.2 |
| Hungary | 4.2 | 63.3 | 32.5 |

Note: Data for Figure 20 are based on the International Standard Classification of Education (ISCED): 2011: level 0-2: early childhood and primary education; level 3-4: lower and upper secondary and post-secondary non-tertiary education; level 5-8: short-cycle tertiary education; bachelor's, master's, or doctoral degree, or equivalent
 Source: SEE Jobs Gateway Database, based on data from national statistical offices and Eurostat.

27. **Montenegro has the second highest rate of temporary employment in the WB6 countries, and the highest among young people (Figure 21).** Between 2011 and 2017, temporary work rose from 18 to 30 percent. Temporary contracts for young workers were primarily associated with occasional work, the probationary period, internships, and seasonal work.⁸

Figure 21. Temporary employees, share of total employees (15–64 years), percent

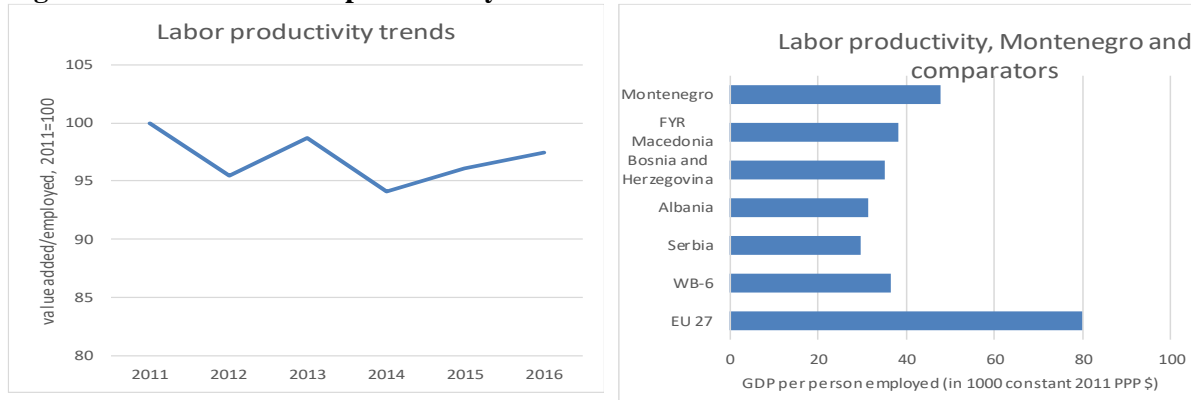


Source: SEE Jobs Gateway Database, based on data from national statistical offices and Eurostat.

⁸ Djuric D. (2016). Labour market transitions of young women and men in Montenegro, Work4Youth Publication Series No. 34 (Geneva, ILO).

28. **Labor productivity has stagnated since 2008 and remains far below that of Montenegro’s EU comparators.** The contribution of total factor productivity (TFP) to economic growth has been negligible (in 2000–13 period) or negative (in 2008–13), meaning that growth in output has been primarily driven by factor accumulation. Although when it comes to productivity, Montenegro compares well to its Western Balkan neighbors, again compared to most EU countries, there is a considerable gap and the overall productivity trend is dismal (Figure 22).

Figure 22. Trends in labor productivity



Source: Estimates based on Montenegro LFS 2011-16, and World Development Indicators.

29. **Unequal job opportunities weaken labor market outcomes.** There are notable differences in job outcomes by age, gender, and ethnicity. High inactivity among older workers may partially reflect early retirement incentives and discouragement after extended periods of job search. For young workers, unemployment rates are more than twice the average (Figure 23). In 2016 the rate of idle youth–NEET (young people aged 15-24 neither in employment nor in education and training) reached 18.4 percent (Figure 24) and for those aged 15–29 it was 22.3 percent. This means that about 13,800 Montenegrins aged 25 through 29 years are neither studying nor working.

Figure 23. Youth unemployment, percent of labor force, 15-24 years of age, 2015

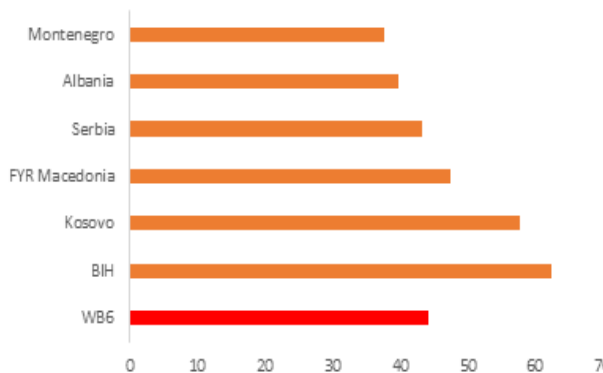
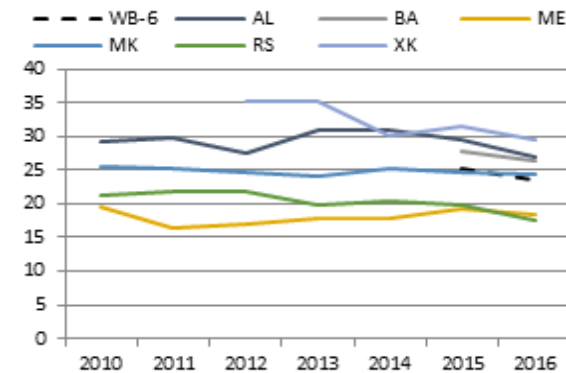


Figure 24. NEET rates, percent of population ages 15-24, 2016

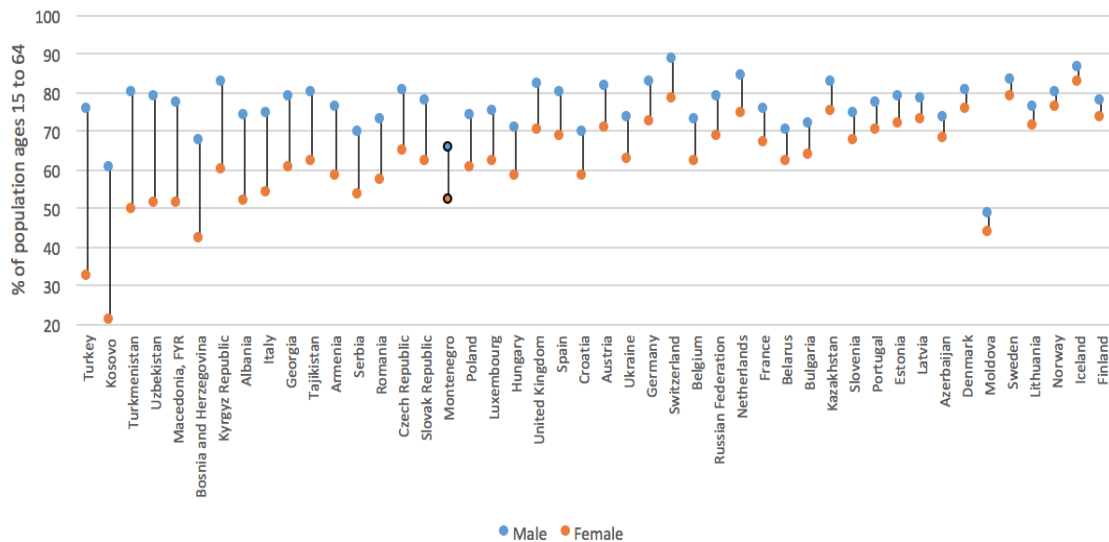


Source: For all countries but Kosovo: Youth unemployment from ILO Key Indicators of the Labour Market database (modeled ILO estimates). Youth labor force numbers estimated from World Development Indicators for participation rates and population structures from *Population Pyramids of the World 1950-2100*. For Kosovo: Youth unemployment and labor force figures for Kosovo from “Results of the Kosovo 2014 Labour Force Survey,” June 2015, Kosovo Agency of Statistics, Social Statistics Department.

30. **In recent years labor market outcomes for women have slightly improved, but gender gaps have widened.** Of women 15–64 years old, only half are employed. The gender gap in employment, although lower than in other WB6 countries, is still a significant 12.1 percentage points. Between 2014 and 2017 the employment and activity rates among women

(15-64 years) slowly increased by 1.1 and 1.5 percentage points, respectively. The improvement has been more pronounced for women 24 and younger). Worryingly, however, the gender gap in employment went from 10.2 to 12.6 pp, and the activity gap showed a similar increase (Figure 25); unemployment is also now higher among women (17.2 percent) than men (15.7 percent). This is to some extent attributable to the introduction of a lifetime mother benefit program which encouraged women of three or more children not to work. Even among youth, in 2017 employment and activity rates declined for young women in 2017, and the gender gap widened.

Figure 25. Gender gap in activity rates, population ages 15-64



Source: WDI 2016.

31. **Women face persistent barriers and disincentives to work**, among them (a) access to assets (property and finance)—only 26 percent of registered properties are owned by women); (b) labor taxation and social benefits that discourage formal low-skill, low-wage, and part-time earners, among whom women are over-represented; and (c) limited flexwork and access to child and elder care. Closing gender gaps in access to labor markets would considerably heighten Montenegro’s economic growth prospects.

32. **Finding jobs is even harder for the Roma population**, who are much less likely to be employed (14 percent) than their non-Roma neighbors (37 percent). In 2017, of economically active Roma aged 15–64, 23 percent were unemployed, the lowest rate in the Western Balkans. Among neighboring non-Roma, the rate was a significantly lower 8 percent.

B. How Can Montenegro Encourage Employers to Create New Jobs?

The government needs to ensure a level-playing field and friendly business environment, as well as a stable macro-fiscal framework. Proactive government support policies are needed to help firms grow, upgrade, and develop new products and services for export. This includes facilitating productivity upgrading and technology adoption, improving innovation support mechanisms, promoting entrepreneurship, improving investment and export promotion policies and services, and facilitating access to finance.

33. **To heighten public welfare, economic policy must make it a priority to stimulate job creation in the private sector.** Only about 60 percent of current jobs are in the formal private sector—the state still has a large footprint. The fact that wages are higher in the public than in the private sector encourages queuing for public jobs.

34. **If its private sector is to grow, Montenegro must become more competitive so that it can become more active in the global market for goods and services.** No country with fewer than 10 million people can achieve high-income status until its exports constitute more than 50 percent of GDP. Yet goods exports contribute only 9 percent and with services total exports only reach 41 percent of GDP (Figure 26). Merchandise exports are highly concentrated in metal products with little technological content, and only 7 percent of domestic firms export goods, compared with 18 percent in the WB6 and 29 percent in Estonia, a similar-sized EU member (Figure 27). Moreover, only one out of three new export firms survive past the first year. These statistics may reflect the fact that less than 5 percent of gross value added in the economy comes from manufacturing. At 32 percent of GDP, Montenegro exports more services than goods, but still less than EU countries. Service exports are concentrated in travel and transport.

Figure 26. Goods and Services Exports, Percent of GDP, 2016

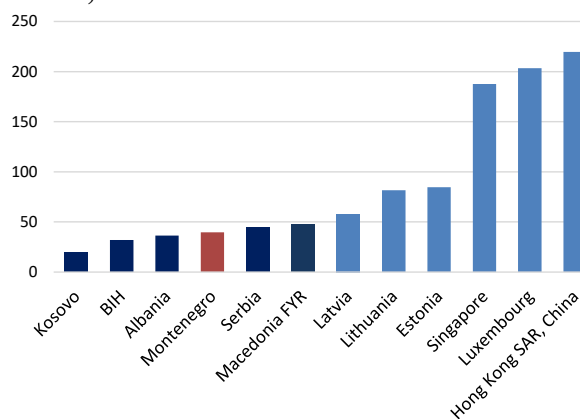
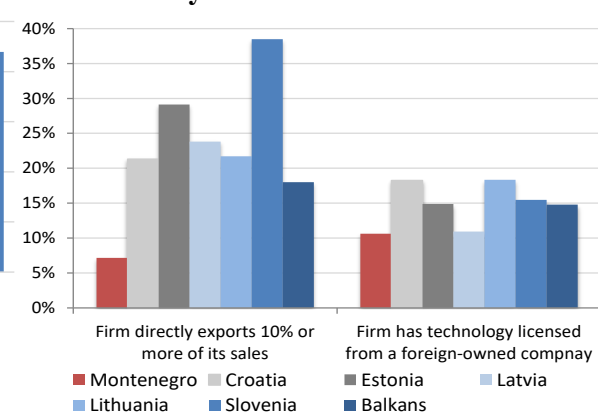


Figure 27. Very Few Montenegrin Firms Trade Internationally



Source: National statistical offices, WDI, World Bank staff calculations. Source: BEEPS 2013.

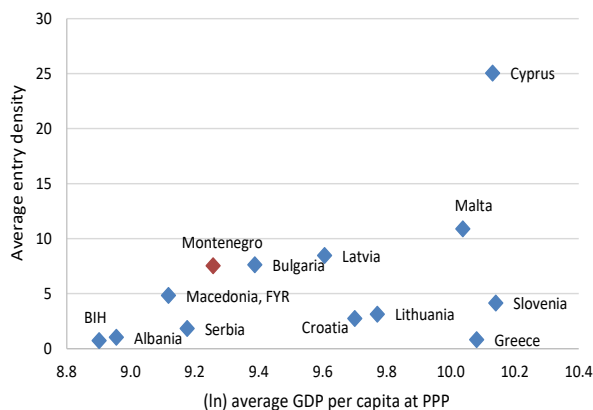
35. **Exports is increasingly concentrated by geographic destination:** goods trade with Serbia, Croatia, and Slovenia has doubled since 2006, while trade with the EU contracted from two-thirds of the total in 2006/07 to slightly over one-quarter. Russia alone accounts for 27 percent of services exports. Further analysis of the reasons for these trends could help identify what types of products could be exported to which potential destinations.

36. **Minimal competitiveness and low productivity are linked.** Productivity in Montenegro has been stagnating for a decade. Yet between 2008 and 2016, real wages went up by 18 percent, so that higher unit labor costs further eroded Montenegro’s ability to compete.

37. **Other factors undermining competitiveness are a lack of private sector innovation and low business use of ICT.** Investment in research and development (R&D) amounts to only 0.45 percent of GDP—significantly below the EU average of 2 percent—and most is generated by the government. At just over 0.1 percent of GDP, business R&D compares poorly with Montenegro’s neighbors: in Serbia it is about 0.3 percent, in Croatia about 0.4 percent, in Hungary 1 percent, and in Slovenia 1.7 percent. Sources of funding are few, and there is not enough cooperation between the business sector and research institutions. Innovative firms are also disproportionately affected by a shortage of relevant skills: 28 percent of the most innovative firms reported difficulties in finding qualified professionals, and 45 percent found it difficult to find skilled workers

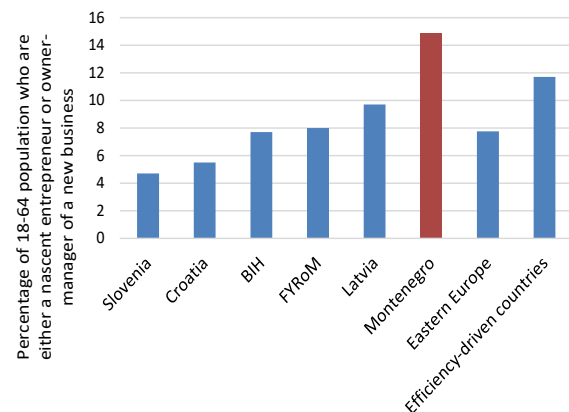
38. **Entrepreneurship shows potential for dynamism, but there is a dearth of opportunities for private companies to grow.** In terms of firm entry, Montenegro is substantially above what its income level would predict (Figure 28). There is also evidence that the proportion of small and micro-sized firms is high relative to other WB6 and Baltic countries. In 2010, nearly 15 percent of Montenegrins were early-stage entrepreneurs (Figure 29); among them, about 10.5 percent were women, which is above the Eastern European average. This suggests that the problem is not with a shortage of firms entering but with entrepreneurs being able to succeed enough to become medium or large firms.

Figure 28. Entry Density and GDP per Capita, 2008-12



Source: World Bank Group Entrepreneurship Snapshots.

Figure 29. Total Early-Stage Entrepreneurial Activity, 2010



Source: Global Entrepreneurship Monitor, 2010.

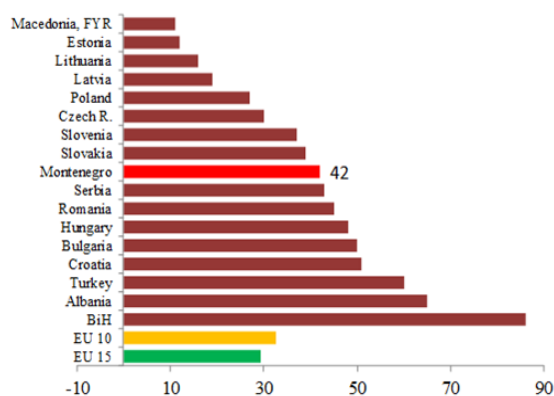
39. **Indeed, Montenegro lacks large and competitive firms.** Unlike in other countries, large companies account for about the same share of employment and revenues as smaller firms. In general, large companies account for an outsized share of revenues because they tend to be more productive and efficient, but that is not true of Montenegro, presumably because of a few large, inefficient SOEs and too few large and competitive private companies. Firms with over 250 employees contribute only 29 percent of the gross value added of the enterprise sector in Montenegro; in, e.g., Slovenia, Slovakia, and Croatia large firms contribute 36 to 47 percent. Yet large firms can have a decisive influence on a country’s competitiveness and export performance. A study of 40 developing countries found that, on average, over five-year period the top five exporters in each country accounted for one-third of exports, over half of export growth, and almost all export diversification.⁹ Given how poorly its largest firms perform, it is not surprising that Montenegro’s exports are disappointing. The 40-country study also found that foreign investors support most top five exporters.

⁹ Freund, C. and M.D. Pierola (2016). “The Origins and Dynamics of Export Superstars”. Peterson Institute for International Economics, Working Paper 16-11.

40. **Montenegro stands out for the high amount of FDI it receives relative to its size; yet greenfield investments in productive capacity are meager.** Montenegro saw its FDI inflows reach 37 percent of GDP in 2009, before halving to 18 percent in 2010 and slipping further to 11 percent by 2017, when inward FDI stock equated to 124 percent of GDP. Inflows are mainly concentrated in non-tradable sectors: For the past several years real estate investments alone have made up about one-third of the inflows.¹⁰ It appears from the analysis of Montenegro’s current FDI portfolio that most foreign investors so far have been related to tourism or market-seeking investments in electricity, telecommunication, financial services, and retail.

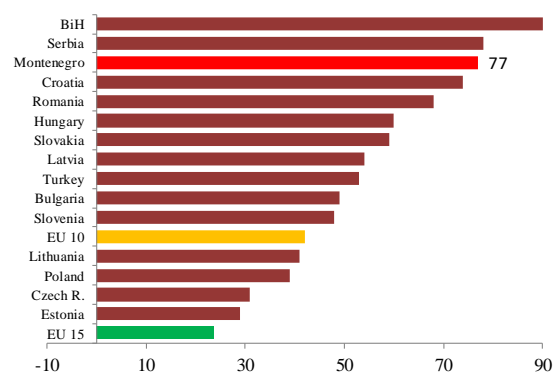
41. **To push up exports and further integrate the country into global and regional value chains, Montenegro must now attract more export-oriented, efficiency-seeking FDI.** Only 2 percent of greenfield investments have been efficiency-seeking investment projects—a very low share considering that the efficiency-seeking share of FDI in global peers Slovenia and Slovakia is 40–50 percent, and even in the region, Albania, FYR Macedonia, and Serbia show significantly higher shares. Efficiency-seeking is highly mobile; these investments seek to compete in international markets and global value chains by benefiting from factors that make a country a competitive investment location. Although more difficult to attract, efficiency-seeking FDI can become a source not only of capital but also of technology and knowledge transfer that can promote export diversification, increase global competitiveness, and create higher-quality jobs for the citizens of Montenegro.

Figure 30. Doing Business Ranking, 2018



Source: World Bank.

Figure 31. Global Competitiveness Index, 2017-18



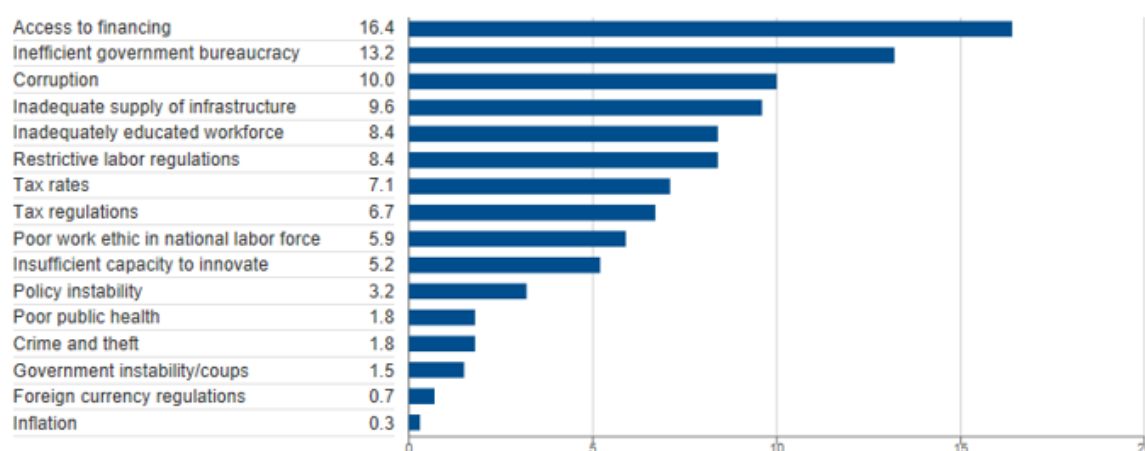
Source: World Economic Forum.

42. **While several improvements have been made in recent years, more can be done to make the business environment more attractive.** Despite a relatively good Doing Business ranking (Figure 30), Montenegro has a low rating on the Global Competitiveness Index, which looks not only at specific administrative procedures but also incorporates macro, social, infrastructure, and other development indicators (Figure 31). While the size of the market will be a continuing disadvantage, the rating was downgraded because of questions related to macro stability, governance, and the rule of law. The top six most problematic factors for companies doing business in Montenegro in 2017 were poor access to finance, inefficient government bureaucracy, corruption, inadequate infrastructure, inadequately educated workforce, and restrictive labor regulations (Figure 32). On average, 12 percent of management time is spent

¹⁰ Most real estate projects involve Russian investors entering the economy either directly or via Cyprus and other tax havens.

dealing with regulators; firms perceive corruption in the granting of licenses and permits and expect to make unofficial payments when dealing with customs, taxes, and regulations.

Figure 32. Most problematic factors for doing business, percent of firms reported



Source: WEF, Global Competitiveness Index 2017-18.

43. **Montenegro's product market regulation also trails the OECD and small EU states for both network and professional services.** Among problems identified are state control, barriers to investment, and lack of harmonization with international standards for restrictions on business entry and conduct restrictions. There is widespread public ownership and little access to information for foreign investors. Procedures need to be more transparent, and the gap between laws passed and administrative practice reduced. The private sector has also objected to the high number of parafiscal charges, particularly at the local government level.

44. **SOEs are over-represented in the economy, and some are a burden on public finances and a barrier to productivity.** SOEs account for about 25 percent of formal jobs (about 20 percent of total jobs counting the informal sector). This is very high, even for the WB6, where SOEs have a relatively large presence. For example, SOEs in Serbia account for about 11 percent of formal employment and in Bosnia and Herzegovina (BiH) 13 percent. The significant role of SOEs has serious negative effects on the business environment, such as distortions and misallocation of production factors; they also deter private sector investments. Because jobs in SOEs are more secure and prestigious, they cause queuing and reduce incentives to take private jobs. Montenegro Airlines, Plantaže winery, and other loss-making SOEs have also accumulated significant tax arrears. Privatization has stalled (e.g., the Port of Bar tender was cancelled again).

45. **The prevalence of informality is having negative effects on the economy.** Employers can easily hire people informally or underreport their wages, in particular for seasonal jobs like many in tourism. They often rely on migrant workers from other countries. On the other hand, many inactive and unemployed Montenegrin workers have low levels of education and skills, yet low-wage jobs are highly taxed. This not only creates a disincentive to employ local labor, it also has adverse implications for budget and pension fund revenues and puts informal workers in a vulnerable position.

46. **Informal enterprises seem to be a major barrier to the development of legitimate businesses.** The Employment Agency of Montenegro (EAM) has been implementing active labor market measures (ALMPs) to stimulate self-employment, entrepreneurship, and formalization of informal businesses; it also offers small loans of €5,000 to €15,000. An Agency analysis found that 90 percent of the loans were used for specific projects, but many

of the start-up businesses supported have failed, reportedly due to informal competition and inadequate attention by policymakers to the informal economy. Similarly, according to the 2013 World Bank and EBRD Business Environment and Enterprise Performance Survey (BEEPS), entrepreneurs identified the practices of the informal sector as the second biggest constraint, after tax rates.

47. **Access to finance is another constraint on Montenegrin firm growth and employment creation.** There is a strong positive relationship in developing countries between access to finance for micro, small, and medium enterprises (MSMEs) and employment growth in developing countries.¹¹ Since the 2008 financial crisis, it has been increasingly difficult for Montenegrin MSMEs to find funding. According to the WEF Global Competitiveness Survey (2017), Montenegro underperforms all other Western Balkan countries except Albania on ease of access to loans, and firms identify access to finance as one of the biggest obstacles to doing business. Collateral requirements are extremely high, and many firms do not find interest rates favorable enough to apply for a loan.¹² As a result, most MSMEs in Montenegro finance their needs from internal resources; 2017 SME Finance Forum data suggest an estimated financing gap of US\$632 million. Although credit growth is recovering, and nonperforming loans are on decline, lending to business is still subdued. Since 2008 the total volume of corporate loans has dropped by 40 percent, mostly due to deleveraging by foreign-owned banks and credit risk aversion, as evidenced by the high share of rejected loan applications. Credit to the private sector of 49 percent of GDP is relatively low for Montenegro’s income level, signaling room for financial sector deepening.

Table 2. Emerging reform priority areas – private sector development

| Proposed Priority Area | Activities |
|---|--|
| Collect and analyze data on firm and productivity dynamics | <ul style="list-style-type: none"> • Additional data collection and analysis is needed to analyze (1) sector and firm level productivity; (2) trends in competitiveness, such as granular export developments and evolution of unit labor costs; and (3) detailed analysis of firm demographics, such as firm creation and evolution, and growth patterns in different sectors. These would depend on access to data in the business registry, since published MONSTAT data do not allow for granularity. • Analyze cost/price competitiveness and the role of the national bargaining system: Centralized or sectoral bargaining systems tend to be more detrimental to smaller firms as negotiations are generally lead by public sector and larger firms (and therefore less likely to align to small firm actual productivity level). |
| Diversify the economy and exports | <ul style="list-style-type: none"> • Conduct a diagnostic of the SME and innovation ecosystem to better understand market failures, binding constraints, and the effectiveness of current support instruments. The potential for leveraging business support ecosystems in neighboring countries could also be explored. • Facilitate productivity upgrading and technology adoption. Given their distance from the technology frontier, Montenegrin firms are likely to benefit greatly from adopting and adapting technology and good management practices. SMEs find it particularly difficult to acquire technology and management know-how and experiment with new practices. Support to consider for EU grant financing could include |

¹¹ Ayyagari et al. (2016). “Access to Finance and Job Growth: Firm-Level Evidence across Developing Countries”. World Bank Policy Research Working Paper 7604.

<http://documents.worldbank.org/curated/en/804781467990954208/pdf/WPS7604.pdf>

¹² Moder, I. and N. Bonifai, (2017). “Access to Finance in the Western Balkans”. ECB Occasional Paper No. 197. <https://ssrn.com/abstract=3047896>

| | |
|--|--|
| | <ul style="list-style-type: none"> ○ A technology extension program, to help firms acquire technological and managerial knowledge and improve their ability to absorb technology to enhance productive processes and products, increase quality, and jump-start new product development. Such upgrading could allow firms to diversify their product offerings and enter new markets. ○ Matching grants for technology adoption could be explored after reviewing current initiatives like the Programme for Supporting Modernization of the Manufacturing Industry. Such support could align with Montenegro’s draft Smart Specialization Strategy. ● Expand innovation support mechanisms: Current instruments¹³ only cover part of what is needed for innovative firms to grow and succeed. To expand these: <ul style="list-style-type: none"> ○ Conduct a public expenditure review to assess how innovation support instruments are functioning and identify gaps. Based on the review and previous analyses and strategic documents¹⁴ identify institutional changes needed and propose new policies and programs. ○ Consider assigning programs targeting business innovation to an agency. This would allow the Ministries of Science and of Economy to give priority to policies, strategic planning, and evaluations rather than administering grant programs.¹⁵ A variety of incentives and EU matching-grant programs could be considered, such as (1) start-up grants; (2) grants supporting product and process innovations; (3) collaborative R&D grants between Montenegrin businesses and academic researchers; and (4) grants to promote business innovation through collaboration with the diaspora for, e.g., mentoring. ○ Introduce incentives for universities to commercialize innovation and study the feasibility of creating a technology transfer office to help commercialize what Montenegrin scientists learn. ● Promote entrepreneurship. Support mechanisms could help build soft skills like leadership, risk-taking, creativity, and networking, and hard skills like drafting business and financial plans. They could leverage such initiatives as FabLab, a 3-D design laboratory funded under HERIC within the PRODE project¹⁶; ongoing initiatives led by Tehnopolis; the global entrepreneurial program¹⁷ led by the UK Department of International Trade; the Digital Cities¹⁸ and 21st Century Schools¹⁹ programs led by the British Council, and others. |
|--|--|

¹³ Supported by the Higher Education and Research for Innovation and Competitiveness (HERIC) project, a \$12 million World Bank-funded loan.

¹⁴ Such as Strategy of Innovation Activity (2016–2020); Economic Reform Program 2017-2019; Smart Specialization Strategy (forthcoming); UNIDO’s 2017 report on strengthening innovation capacity in Montenegro; and others.

¹⁵ Examples of such agencies include Croatia’s HAMAG BICRO, Serbian Innovation Fund, Macedonian Innovation fund, TEKES in Finland, and Georgia’s Innovation and Technology Agency. Alternatively, Montenegro could consider **partnering with an established agency** in the region to help administer support instruments.

¹⁶ The PRODE project found that students are very interested in new technologies and solutions and they quickly build innovative capacities.

¹⁷ The program aims at scaling up promising businesses across the Western Balkans and connecting to investors and global networks.

¹⁸ The Digital Cities program involves: 1) training on project pitching; 2) mobility grant with the UK; and 3) collaboration grants for joint projects developed with a UK partner (grants up to GBP 50k).

¹⁹ The 21st Century Schools program was piloted in 10 primary schools in Montenegro. It provides teacher training and coding classes and promotes interest in STEM disciplines/creative industries.

| | |
|---|--|
| | <ul style="list-style-type: none"> • Improve investment policy and promotion services. To attract more export-oriented, efficiency-seeking FDI, with all its benefits, investment policy and promotion could be organized as follows: <ul style="list-style-type: none"> ○ Put in place an FDI strategy for attracting high-value-added, export-oriented investments. ○ Launch reforms to create a competitive investment climate for efficiency-seeking investments in targeted sectors. • Identify an export promotion strategy and draft an action plan. |
| <p>Streamline the business environment</p> | <ul style="list-style-type: none"> • Conduct sector-specific diagnostics to target business environment issues that affect strategic sectors of the economy. For instance, licensing, labor regulation, and inspection practices and regulator discretion could be a particular burden for tourism, encouraging informality. • Review market regulation of network and professional services. • Revitalize privatization and resolution of nonviable SOEs, as well as improve management of SOEs. This would free up public resources for more productive uses and help level the playing field for private companies. |
| <p>Expand access to finance</p> | <ul style="list-style-type: none"> • Strengthen financial support for MSMEs through the Development Fund, establish a Guarantee Fund (with careful consideration of fiscal liabilities), and analyze the effectiveness and fiscal impact of current programs. • Consider policies to diversify the financial sector through support for non-bank financial institutions and developing the capital market. |

C. How Can Social and Labor Market Institutions Support Jobs?

Labor market institutions are crucial for translating labor demand and supply into effective labor market outcomes. Excessive regulation can deter the creation of formal jobs by encouraging creation of low-quality informal jobs. Preschool care and flexible work arrangements can support the participation of women in the labor market. And used effectively, job search agencies and other active labor market policies can connect workers with employment opportunities.

48. Strengthening labor market policies and institutions can help address bottlenecks on both the demand and the supply sides of labor and more efficiently match employers and workers. Montenegro ranks 74th of 137 countries in the World Economic Forum labor market efficiency index, which combines labor flexibility with efficient talent utilization (WEF 2017-18).

49. **In Montenegro there are numerous disincentives to formal work**, particularly for those qualified only for low-wage jobs. Certain elements of the labor tax and social protection system discourage formal jobs in the private sector.²⁰ Many employers, the self-employed, and workers opt not to register part or all of their activities because the regulations are perceived as too stringent or operating in the formal economy as administratively too burdensome. When formal income may also mean loss of social benefits like social assistance or certain unemployment benefits, people might prefer informal or no work. When regulations and tax collection rules are not enforced, there may be little risk in working informally.

50. **High labor taxes may hinder job creation and work incentives by making vacancy creation and acceptance of jobs in the formal sector less appealing.**²¹ Social security contributions and other labor taxes contribute to the wedge between the cost of hiring a worker and the wage the worker receives. While mandatory contributions can be used to finance such labor assistance as unemployment and pension benefits, if workers and employers do not believe they will benefit much, the tax wedge can influence both demand for and supply of labor. Large tax wedges that significantly reduce net wages discourage participation in the regulated labor market and encourage unregistered, informal work. Informal employment in Montenegro is an estimated 25–33 percent.²²

51. **The tax wedge in Montenegro is quite high.** Labor taxes and contributions constitute 43.2 percent of labor costs (Table 3)—higher than the Europe and Central Asia average of 37 percent,²³ or neighboring Serbia's 42.2 percent. In FYR Macedonia the estimated wedge is 41.4 percent, Bosnia and Herzegovina 34.9 percent, and Albania 33.4 percent. In the region the main component of the wedge is social security contributions, though some countries are beginning to reduce them. The base Montenegro rate on personal income is 9 percent, one of the lowest in the region. On gross monthly personal earnings exceeding €720 the rate on the additional earnings is 11 percent. Although the rates seem comparatively low, because Montenegro does

²⁰ Remittances and preference for public sector jobs can also affect willingness to work because they affect the reservation wage, the lowest amount for which people are willing to work.

²¹ WDR 2013 cites empirical studies of how social insurance contributions can reduce employment.

²² UNDP 2017 and World Bank (2017)

²³ Arias and Sanchez-Paramo 2014.

not have a nontaxable personal allowance, as do most EU and neighboring countries, the effective rate of 9.3 percent in 2017 is similar to countries with higher statutory rates.²⁴

Table 3. Montenegro: wedge between labor costs and net wage (take-home pay)

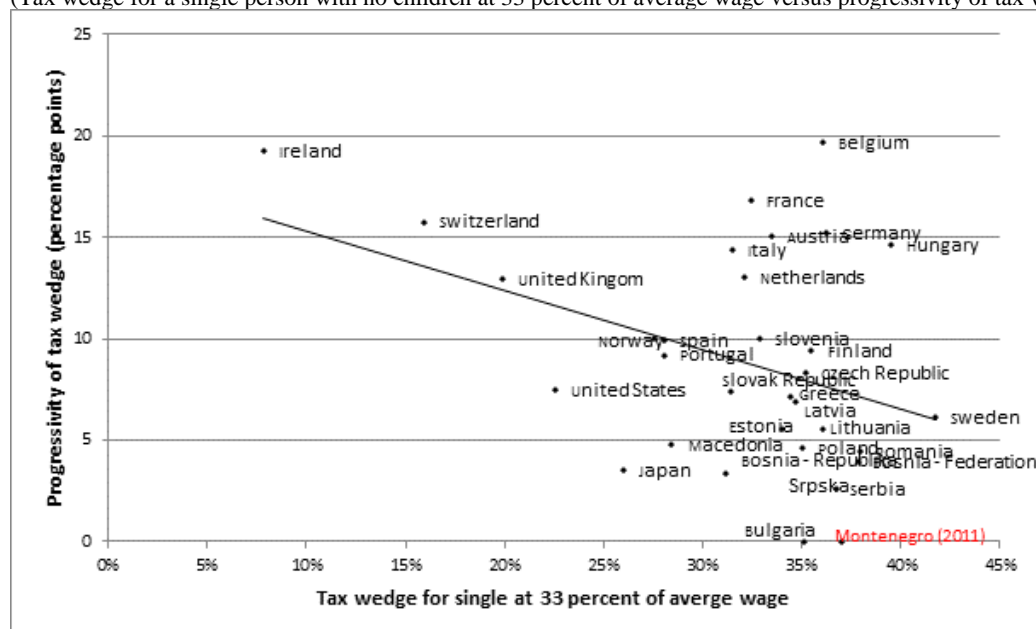
| 2017 | Workers' gross wage=100 |
|---|-------------------------|
| Employer pays | 110.3 |
| <i>Of which:</i> health insurance | 4.3 |
| pension and disability insurance | 5.5 |
| unemployment insurance | 0.5 |
| Worker's gross wage | 100.0 |
| <i>Of which:</i> health insurance | 8.5 |
| pension and disability insurance | 15 |
| unemployment insurance | 0.5 |
| personal income tax (effective) | 9.3 |
| Total social contributions | 34.3 |
| Employee's contributions | 24.0 |
| Worker's net wage as percent of workers' gross wage | 66.7 |
| Net wage as a percent of employer's costs | 60.4 |
| Employer's costs as a percent of net wage | 165.5 |

Source: MOF and Official Gazette.

52. **The progressivity of labor taxes is minimal, which discourages people at the bottom of the earnings distribution from seeking formal employment.** The labor tax wedge is especially high for low-wage and part-time earners (Figure 33). This means that women, low-skilled workers, and youth, all of whom tend to be more represented in low-wage and part-time employment, have a disproportionate disadvantage. Because of higher nonwage labor costs, more unskilled workers move to either unemployment or informality as they wait for better formal-sector opportunities.

Figure 33. Tax wedge for low-wage earners is high and not progressive

(Tax wedge for a single person with no children at 33 percent of average wage versus progressivity of tax wedge, 2008)



Source: Koettl J. "Work Disincentives in Montenegro," World Bank based on OECD tax and benefit models.

²⁴ Until 2018, Croatia's effective rate was 9 percent, while its personal income tax system featured three rates—12, 25, and 40 percent, but part of personal income is not taxable.

Note: The tax wedge is measured as personal income tax and social security contributions paid by both workers and employers as a share of total labor costs. The y axis shows the progressivity of labor taxation for single persons with no children, comparing an average employee earning 100 percent of the average wage and a low-wage employee earning 33 percent. Progressivity refers to percentage point increases of the tax wedge. The x axis shows the tax wedge for low-wage earners.

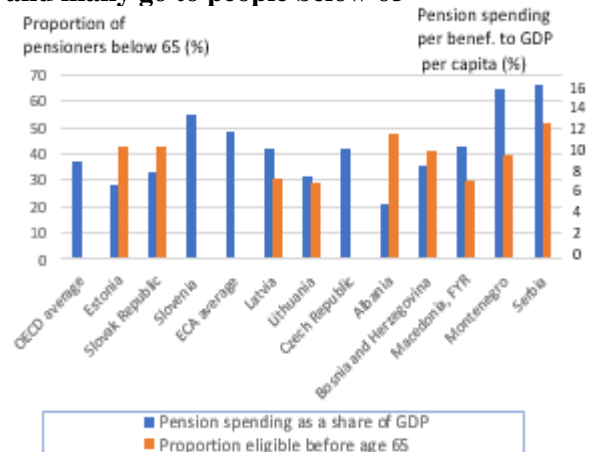
53. **Aside from the formal labor tax, taking up formal employment might mean losing social assistance or unemployment benefits.** While social assistance overall and last-resort social assistance (FMS/MOP) have a respectable targeting with at least half of the spending reaching the poorest quintile, low coverage limits their impact on poverty. The design of Montenegro’s current unemployment, social assistance, and family benefits does not encourage work. For every euro recipients earn in formal work, they lose a euro (or even more) in benefits. For potential low-wage and part-time earners, the cost of shifting from inactivity or informal work to formal jobs could be counter-productive. Social assistance programs thus create disincentives to take up part-time, temporary, and seasonal employment because for earnings below social assistance levels, the marginal effective tax rate is high.²⁵ Work disincentives are highest for low-income earners or those working part-time (who are more likely to be women), and are very high for those receiving social assistance (especially single parents or single-earner couples with children who receive social assistance and family benefits): for them, a part-time low-paying job would actually decrease net income, and a full-time job at minimum wage would bring in no more than social assistance and family benefits with no job. And because this group is not investing in upgrading skills, they are in a vicious cycle of dependence on the state.

54. **Changes to the social assistance system in Montenegro in the past two years had an impact on women’s employment.** First, introduction in 2015 of a lifetime benefit for mothers of three or more children of up to 70 percent of the average net wage, and in 2017 its withdrawal with compensation, led about 3,000 women to drop out of the labor market. The compensation, equal to previous wages, for up to next five years certainly discourages them from returning immediately to the labor market. If they find jobs, they lose the compensation.

55. **Although its total population has gone up slightly in recent years, Montenegro is seeing significant population aging.**²⁶ Between 2010 and 2016 the 45–49 age group declined by 8.1 percent even as the 55–59 group increased by 4.1 percent. Far more alarming is the change in the 60–64 group, which shot up by 31.8 percent.²⁷

56. **Pensions can also lower employment, because they have high coverage and are often more generous than unemployment benefits and social assistance.** The average pension benefit in Montenegro amounts to 56 percent of the average wage and 65 percent of GDP per capita (Figure 34). Early retirement is still common, particularly for certain

Figure 34. Pensions are comparatively generous and many go to people below 65



Source: Revving Up report, World Bank (2017)

²⁵ The effective tax rate is measured as the share of gross income of the formal job—including in-work benefits—that is taxed away through personal income tax, social security contributions, and lost benefits (social assistance, family, and housing benefits).

²⁶ European Training Foundation (2016): Skills Needs Identification and Skills Matching in Eastern Europe

²⁷ European Training Foundation (2017): Montenegro: Executive Summary, Torino Process 2016-2017.

occupations—about 40 percent of pensioners are not yet 65. Pensions combined with benefits and remittances are higher than in most other European transition economies. This is a strong disincentive for older people to work. The government is considering reforms in this area.

57. **Increasing job opportunities for women should be central to the jobs agenda for Montenegro.** With less than half of women aged 15–64 employed, bringing more women into the labor market can make a major contribution to economic growth and higher living standards. Gender gaps in employment (over 9 pp among Montenegrins aged 15–64) are driven by gaps in labor force participation. The participation of women in Montenegro is 8 pp lower than the EU average. Entrepreneurship also has gaps: only 19.3 percent of firms have a woman as manager; and just 10.5 percent have a woman as owner;²⁸ these figures are similar to the regional averages. Among the employed, although slightly more women than men have tertiary education, men on average earn about 6 percent more; the gap remains even after accounting for such characteristics as education and experience. The differences between men and women in labor market activity amount to potential economic losses in gross income per capita of about 13.5 percent for Montenegro.²⁹

58. **Gender gaps in the labor market reflect not only differences in access to income-enhancing assets like education but also differences in the returns on those assets, barriers to transition into the work force, and cultural norms.** Closing gender gaps in access to economic opportunities requires removing barriers and disincentives to work by, e.g., (a) opening up access to assets and productive inputs, (b) providing access to child and elder care, (c) removing the disincentives and barriers embedded in labor taxation and regulation, and (d) heightening the employability of women through effective ALMPs and adequate skills and training. Also important are cross-cutting policies related to social norms and discrimination, access to information, and monitoring and evaluation systems.

59. **Labor regulations and interventions affect incentives to work and to hire women.** Women are more likely to be overrepresented among part-time and low-wage earners, whose tax wedges are higher than the average. Regulation of flexible work arrangements and family leave provisions can disproportionately affect women. In Montenegro, only about 6 percent of workers are employed part-time—drastically lower than the EU average of 20 percent. From a policy perspective, further analysis of factors behind lower female labor force participation (level of education and other individual characteristics, or the second earner income tax) would be warranted.

60. **Montenegro provides for a long maternity and parental leave.** The leave is 365 days (like Albania and BiH, but higher than other ECA averages), part of which can be taken by the father, with the full wage paid by the government to the insured mother or father. While the parental leave policy does keep workers attached to the labor market around child birth and could keep women participating, the prolonged leave is costly for employers and may reduce women’s employment prospects (evidence from the Albania STEP survey). In 2017 Montenegro increased the birth grants by a 20 percent and provided the compensation for giving birth also when one parent is either registered as unemployed or is a full-time student.

61. **Social norms about women’s duties of care can limit the time they have for participating in the economy.** About 21 percent of Montenegrin women and 7 percent of men not participating cite “other personal and family reasons” as the primary reason.³⁰ Utilization of formal childcare services is low, and though net enrollment in kindergarten (children aged

²⁸ Business Enterprise and Economic Performance Survey (BEEPS), 2013.

²⁹ World Bank 2017 “Montenegro: Promoting Women’s Access to Economic Opportunities Policy Note”

³⁰ The category includes “looking after children or incapacitated adults.”

0–6) has been increasing, there are persistent inequalities between southern and northern regions. At 52 percent preschool enrollment of children aged 3–6 in preschool is very low, beneath the ECA regional average.³¹ Evidence from a recent World Bank assessment of supply of and demand for formal childcare and eldercare in countries in South East Europe suggests there are (a) not enough affordable and quality child care services and (b) a lack of day-based services and few and expensive residential care centers for senior citizens. The Law on Gender Equality in Montenegro and adoption of a new National Gender Action Plan through 2021 can help prepare institutions for expanding such public services and releasing women to enter the labor market.

62. **Efficient and effective public services aimed at fostering successful job matching can make a significant difference in labor markets**³². Analysis of how well local branch offices of the EAM helped those unemployed find formal jobs in 2014–16 had important findings. The analysis compared how efficiently different branch offices used their resources to produce different services and the impact of their activities on the number of unemployed who found formal jobs. The methodology provided each branch office with an analysis of its weaknesses and strengths, organized in terms of the relationship between inputs, outputs, and outcomes: (a) Inputs are the resources offices use, such as spending on staff and in other areas; (b) Outputs are the activities these resources produce, such as number of contacts with unemployed Montenegrins and employers, number of vacancies registered in the office, and number of participants in different activities; (c) Outcomes are the number of registered unemployed moving to formal jobs. Clearly, the jobs outcome is affected by more than the efforts of branch offices; control variables were factors reflecting the environment in which branch offices operate, such as number of formal jobs in the office catchment area, number of unemployed, average income, and number of beneficiaries of social assistance. The analysis focused on the efficiency, impact, and effectiveness of the branch (the relationships between resources, activities, and outcomes) but also looked at the efficiency of *scale*—whether their size (measured by inputs, such as staff and expenditures, or outputs, such as activities) is optimal for maximum productivity.

63. **Different offices face significantly different challenges.** The number of unemployed per counselor (case-load) is ten times higher in some offices than others. There are also tenfold differences in the number of formal jobs (an indicator of local labor demand and formal sector size) and the number of unemployed. Except for the capital, Podgorica, labor market conditions are considerably more favorable in coastal regions, reflecting the influence of tourism on labor markets, and caseloads there are also lower on average than in other regions.

64. **Spending on ALMPs has gone up but job placements have not followed suit.** Between 2014 and 2015, the number of staff increased marginally but total spending, especially on ALMPs, increased dramatically, reflecting an increase in more elaborate programs. Yet there was no significant increase in average job placements. There was an increase in the nominal job placements. Poor-performing branches also caught up with the technology of better-performing offices—but the productivity of the best units actually fell.

65. **In Montenegro, average office effectiveness (measuring distance to the best offices) is very low, which has significant opportunity costs.** These low levels reflect both large variations in branch outcomes and the strong performance of one office, the Tivat branch, which defines the best-practice frontier in Montenegro. Tivat and three other very efficient

³¹ UNICEF (2014) and World Development Indicators.

³² World Bank (2018). Efficiency of the Public Employment Agency of Montenegro.

offices are on the coast. If the inefficiencies of other branches were addressed and all branch offices became fully effective, jobs placements could increase by one-third.

66. Based on these findings, it is possible to make some observations about how underperforming offices can become more efficient:

- Merging or splitting offices is not recommended: offices are more likely to become more productive by adapting the mix and quality of activities to the local context and learning from others. Although not all offices may be of optimal size—a few may be too large—geographical reorganization is unlikely to be cost-effective. Instead, offices can look at how to improve their processes and programs.
- A few measures seem to be particularly effective. Reducing caseloads by hiring more staff has a strong effect on job placements. So does contacting employers and increasing the number of participants in ALMPs. Additional expenditure efforts should be put on expanding programs instead of implementing more and new expensive programs.
- It may be helpful to take a closer look at the business methods of more successful branches—their structure, staffing, and mix and quality of activities. Such offices could serve as benchmarks for each individual office.

Table 4. Emerging reform priority areas – social and labor policy

| Proposed Priority Area | Activities |
|--|--|
| Incentivize longer working lives | Promote longer work life by limiting incentives for early retirement and providing pension bonuses per year of service beyond statutory retirement age. |
| Redesign current benefits to give more incentive for working | Consider a phased withdrawal of social benefits, so that beneficiaries can actually increase their income from work if benefits are withdrawn only gradually: for every euro earned, the beneficiary loses only, say, 80 cents of benefits. |
| Remove disincentives and barriers embedded in labor taxation and regulation | <ul style="list-style-type: none"> • Analyze the impact of the reducing tax and contributions for certain groups like seasonal part-time and low-wage workers (<i>examples</i>: UK, Austria, France), taking into account high reservation wage and fiscal impact. • Consider introducing an in-work benefit that promotes work by paying benefits conditional on having a job, subsidizing low-paying formal jobs. This could be implemented, for example, through the Earned Income Tax Credit where beneficiaries receive a tax return in the form of a cash benefit only if they have a formal (low-paying) job. Alternatively, consider introducing nontaxable formal income. • Introduce flexwork (telework and part-time). |
| Reinforce employment services and active labor market policies | <ul style="list-style-type: none"> • Build up the efficiency of employment agency branches. • Strengthen the employment services brand and make the service proactive for vulnerable groups. • Profile the long-term unemployed and improve labor market matching. • Introduce regular, rigorous impact evaluations for programs; use a standardized profiling approach to identify candidates for ALMP. • Pilot small programs to start addressing low labor force participation and high unemployment in subgroups, e.g., facilitating Internet-based part-time employment among women, which could make work and family life more compatible. |
| Support family-work balance by providing access to child and elder care | <ul style="list-style-type: none"> • Expand access to subsidized quality child and eldercare: expand childcare centers; offer public subsidies for private childcare. • Create education and accreditation programs to prepare caregivers and care entrepreneurs. |

| | |
|--|--|
| | <ul style="list-style-type: none">• Formulate a plan to increase the quality of services, particularly eldercare, with attention to costs.• Promote day-based services and ensure the availability of affordable residential care for senior citizens.• Promote paternity leave as part of the current parental leave entitlement. |
|--|--|

D. How Can Montenegro Equip Its Citizens with the Right Skills?

Montenegro needs to deliver skills relevant to both current and, more importantly, future private sector needs and ensure that the current supply of skills is activated and utilized. There is a need for strategic and operational alignment between vocational education and training and higher education.

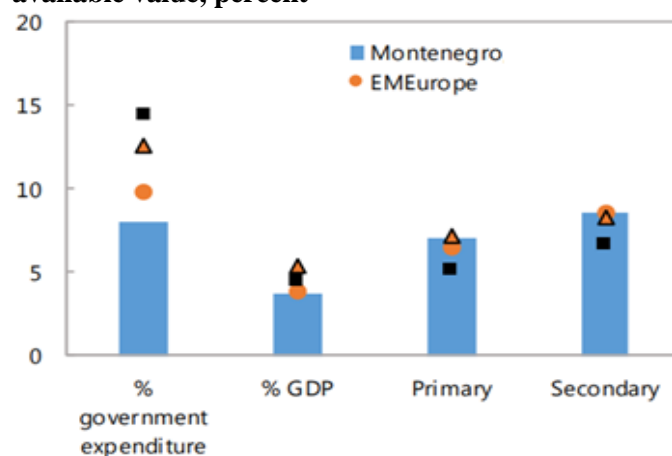
67. **For many years education in Montenegro has been driven forward by major reforms.** These have been extensive legislative changes, including laws on general, preschool, primary, secondary, vocational, tertiary, and adult education. Today, the country's focus has shifted from enacting policy reforms to the implementation. Montenegro has an ambitious roadmap for aligning its education system with EU best practices and breakthroughs.

68. **While access to primary through tertiary education has improved, there is a troubling disconnect between investments in education and the outcomes in terms of student performance and employment.** Montenegro spends about 4.5 percent of GDP on education, near the 5 percent of GDP that the OECD recommends (Figure 35); however, its education outcomes are far behind those of EU and OECD members.

69. **Although their test scores in the OECD Programme for International Student Assessment (PISA) improved between 2006**

and 2015, Montenegrin students still underperform in science, mathematics, and reading relative to 15-year-olds in other countries. The difference in average performance compared with the OECD average is equivalent to more than 2.5 years of schooling in science, about 2.5 years in mathematics, and over 2 years in reading. In PISA 2015, about 50 percent of the Montenegrin students tested lacked basic proficiency in mathematics and science, and 40 percent lacked basic reading competences (Figure 36). Equity challenges persist: the test scores imply that students from the top income quintile have the equivalent of an extra two years of schooling (Figure 37).

Figure 35. Government education expenditure, latest available value, percent



Source: IMF FAD Expenditure Assessment Tool (EAT); MONSTAT

Figure 36. Student PISA Performance, 2006 and 2015

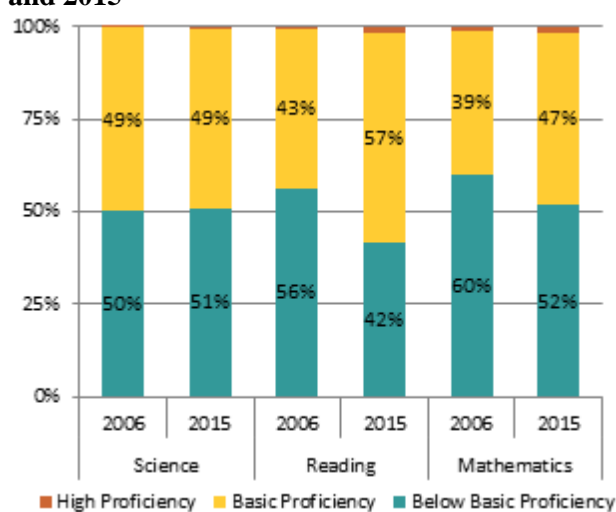
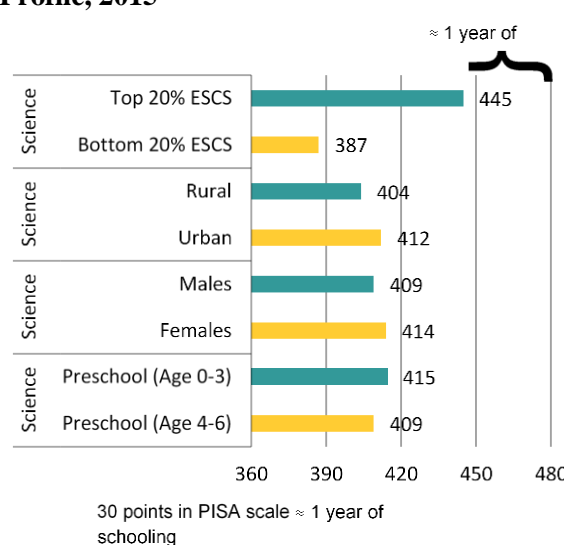


Figure 37. Student Performance, Equity Profile, 2015



Source: OECD and World Bank staff calculations.

70. **Improving the relevance of education to the job market and improving its outcomes will be difficult**, particularly in ensuring that tertiary and vocational education students transition smoothly from school to work. Education must also adapt to support the long-term unemployed by providing opportunities for retraining and re-entry into the labor market. Moreover, there is a skill mismatch that disproportionately affects innovative firms: 28 percent of the most innovative firms reported that the main problem in hiring professionals was the lack of appropriate skills, and 45 percent had similar difficulties in hiring skilled workers. Young workers lack soft skills, like language, leadership, initiative, and critical thinking, as well as advanced hard skills like technical knowledge.

71. **Investing early in families and their children reaps many benefits.** Evidence from Europe and around the world shows that quality early childhood education and care (ECEC) interventions yield benefits in both the short and the long term, and also lay a foundation for lifelong learning. ECEC investments can bring significant, long-lasting benefits to Montenegro by enhancing school readiness; improving cognitive and socioemotional skills; improving physical and mental health; lowering repetition and drop-out rates in early grades; improving educational outcomes generally; and increasing productivity in adulthood. Research-based evidence points not only to a high return on investment from high-quality ECEC interventions but also to a higher rate of return than interventions directed at older children and adults³³.

72. **There is a significant performance gap between students who attend ECEC programs and those who do not.** Among Montenegrin students, the difference in PISA (2012) mathematics scores for students who had attended ECEC programs and those who had not was 51 points—the equivalent of more than 1.5 years of formal schooling (PISA 2013). Moreover, a PIRLS study found that across the EU28, reading skills at age 10 were correlated with the number of years a child had attended preprimary school: children who had attended preschool for three or more years had higher scores than children who had attended for 1–3 years, who

³³ Carneiro & Heckman (2003): Human Capital Policy, IZA Discussions, Paper No. 821

in turn outperformed children who been in preprimary school for less than a year or not at all.³⁴ Academic capabilities clearly benefit from early access to some education.

73. **For children of preschool age (at least 3 years old), studies from a variety of perspectives across a range of EU countries have found significant and lasting effects of preschool on later educational attainment and labor wages³⁵.** A study from Norway underlines this positive effect of ECEC on economic outcomes: it found that a large-scale expansion of government-subsidized ECEC resulted in increased educational attainment and labor market participation and a concurrent reduction in welfare dependency. Children whose parents had less education benefited most. Moreover, in addition to benefiting the children, high-quality ECEC benefits the labor market by providing reliable childcare for women who otherwise could not previously take jobs. In a country with a shrinking population, engaging more of the nonworking adult population will be vital to economic growth. If better ECEC options were available, working mothers could make up an increasing proportion of the labor market.

74. **Currently there are deep inefficiencies in Montenegro's spending on upper secondary technical and vocational education and training (TVET).** Given both high youth unemployment (about 37 percent)³⁶ and the high enrollment of TVET graduates in tertiary education, it is imperative to better understand the ecosystem that has promoted this apparent skills mismatch. TVET schools currently enroll two-thirds of secondary students. The remaining one-third attend the more academically rigorous secondary schools (*Gymnasiums*). In some years, the proportions skew even more heavily toward TVET, reaching more than 70 percent. Based on historic norms, the articulation between secondary and tertiary education was intended to promote transition to university only from Gymnasium schools.

75. **Unfortunately, high unemployment—38 percent for those who graduate from all types of secondary schools and 19 percent for secondary TVET graduates—and the low skills of TVET graduates have led to** (a) high enrollments of under-prepared TVET students in tertiary education—raising quality assurance questions and financing burdens for the universities affected—and (b) relatively high un- or underemployment of tertiary graduates, compared to EU and other WB6 tertiary graduates.

76. **To better link the labor market with higher education, many countries use ALMPs.** These programs combine policy tools to both support and incentivize job-seekers, in terms of both searching for and finding a job. ALMPs also promote productive participation in society and becoming self-sufficient and less dependent on public income-support mechanisms. Previously, on average countries in the region spent 0.5 percent of GDP on these programs. ALMPs in Montenegro, however, require more resources to adequately link the labor market and higher education, given the economic and demographic pressures on the country's long-term potential for growth.

77. **Particularly in Montenegro, ALMPs can help address the skills gaps of graduates and adults excluded from or struggling to find employment.** It takes young people an average of almost two years to find their first stable/satisfactory job. The longer individuals are unemployed, the more hurdles that confront them in entering, or re-entering, the labor market.

³⁴ Mullis et al. (2012): PIRLS 2011 International Results in Reading, Boston College; Van Belle (2016): Early Childhood Education and Care and its long-term effects on education and labor market outcomes, Cambridge, UK

³⁵ Havnes & Mogstad 2011; Bauchmüller et al. 2014; Bauer & Riphahn 2009; Dumas & Arnaud 2010; van Belle 2016.

³⁶ About 40 percent of individuals aged 15–24 are unemployed, compared to 20 percent of those aged 25–49 and 12 percent of those aged 50–64 (World Bank, Systematic Country Diagnostic, 2016),

Meanwhile they must deal with both a deterioration of skills and social stigma. Thus, complementary programs of apprenticeships and reskilling are policy options for addressing high youth unemployment.

Box 1. Active Labor Market Programs

ALMPs are often tailored to certain population segments, such as youth or the long-term unemployed. Well-designed ALMPs can have a positive impact on employment outcomes. ALMP success stories come from a variety of countries: In the UK's New Deal program, a work requirement in tandem with subsidies for private sector employment had positive outcomes on youth incomes. What worked in Romania were effective public employment and relocation services. Positive outcomes were also found for married women, who are required to search for a job, as in Hungary, or who receive childcare support, as in the Conditional-Cash Transfers in Chile Solidario. Similarly, long-term unemployed beneficiaries of social assistance can become active with mandatory intensive counseling (Denmark and Norway) or temporary sanctions (the Netherlands).

However, many programs fail for such reasons as low take-up rates, claimants' failure to comply with program requirements, poor program design, bad matching of programs and beneficiaries, and others. While ALMPs around the world have been associated with many benefits, the evidence base needs to be strengthened.

Sources: Arias et al 2014. "Back to Work: Growing with Jobs in Europe and Central Asia." Washington, DC: World Bank.

78. **An EU-led approach to using apprenticeships more effectively was launched in 2013.** The European Alliance for Apprenticeships convenes policymakers, leaders of industry, businesses, and providers of education and training, among others, to promote apprenticeship programs across Europe. It remains to be determined how useful a broader apprenticeship system would be for Montenegro but given the focus on jobs and skills across the region—particularly to reduce youth unemployment—the utility of apprenticeships deserves closer consideration. As a member of the Alliance, Montenegro has outlined plans to design a system of quality apprenticeships to provide skills and competences relevant to labor market needs. However, it has not yet signed any pledges to strengthen the supply, quality, or attractiveness of apprenticeships and address mobility.³⁷

79. **Although future demand is likely to focus on higher-order skills, tertiary education is not effectively equipping sufficient numbers of graduates with them.** While job creation has historically focused on low-skilled sectors like construction, mining, retail trade, and tourism, in the last five years most jobs have been created in such high-skill sectors as finance, ICT, and other sophisticated services. Employment growth of more than 40 percent among tertiary-educated workers illustrates the premium placed on higher skill development—but most beneficiaries of the expansion in employment were tertiary graduates who had attended gymnasium secondary schools.

80. **It is critical that Montenegro equips its workforce with adequate skills that are relevant to the new economy, including the socioemotional skills for which employers report shortages** (e.g., leadership and initiative, creative and critical thinking, and digital skills). Skills development should be accompanied by efforts to reinforce foundational skills since despite progress, more than half of Montenegro's students do not have basic proficiency in reading, science, and mathematics.

³⁷ European Commission. European Alliance for Apprenticeships, Pledges.

Table 5. Emerging reform priority areas - skills

| Proposed Priority Area | Activities |
|--|---|
| Strengthen the education sector efficiency | <ul style="list-style-type: none"> • Conduct a spending review of the education sector to verify whether efficiency of spending is appropriate given the limited ability of the sector to provide the right skills. |
| Foster more robust development of foundational skills | <ul style="list-style-type: none"> • Expand early childhood education and care and support access for disadvantaged groups. • Reform the secondary TVET/Gymnasium education system by supporting the clarification and delivery of expected skill outcomes from each type of education, supporting efficiencies in both the distribution of students across TVET/Gymnasium institutions and programs and in spending on the entire sector. |
| Ensure a smooth school-to-work transition | <ul style="list-style-type: none"> • Give TVET more national strategic planning and policy support. • Strengthen the links between occupational and educational standards and foster academic/industry collaboration. • Promote collaborations of schools with private sector employers. • Raise the quality of the input, process, and outcome elements of VET provision. • Diversify the VET offer (short and long-term programs + optimization of the network of public VET providers + post-secondary VET provision). • Accredite VET providers (public and private – the latter to contract out training the public sector cannot provide). • Scale up successful models of work- based learning, including through on-the-job training of workers in firms. • Use a performance-based funding model for public VET provision. |
| Reskill workers | <ul style="list-style-type: none"> • Invest in opportunities to re- and up-skill workers, to support expanded workforce opportunities. • Establish apprenticeships. |

E. How Can Montenegro Enable Job Creation in High-Potential Sectors?

Although government should not pick winners and instead simply ensure the level playing-field, certain sectors have higher potential for creating jobs, directly and indirectly. They are agriculture, tourism, and ICT. While the reforms proposed are vertical, they complement horizontal policy actions proposed earlier.

Agriculture

81. **As a primary sector, agriculture is critical to the Montenegrin economy and is an important formal (full and part-time) employer in rural areas.** Agriculture and food production contribute about 10 percent to GDP, of which the primary sector contributes 7.5 percent and agro-food processing and fisheries the rest. Close to 50,000 families (about 25 percent of the country's population), with an average holding of 4.5 hectares, derive their income partly or entirely from agriculture.

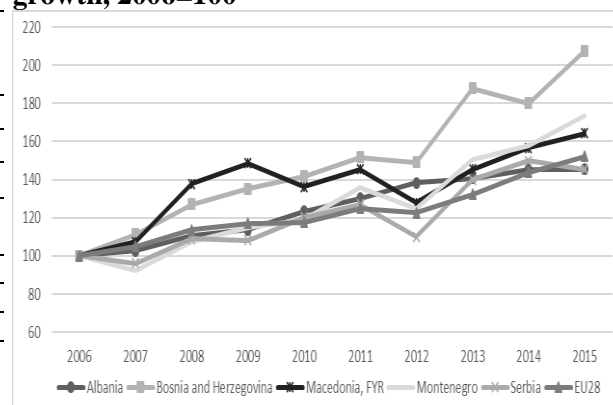
82. **Agricultural absorption of labor is broader than measured in the formal labor market—the sector is significantly informal.** According to MONSTAT, in 2010 2,347 people were formally employed in agriculture. Yet, according to the 2010 Agricultural Census, the equivalent of 46,473 Annual Work Units were employed in agriculture, suggesting that only about 5 percent of agricultural employment is formal.

83. **Migration from rural areas has contributed to a decline in agricultural employment.** Youth and rural residents are among those most affected by the lack of gainful employment opportunities. In the Western Balkans, Montenegro has the smallest share of people living in rural areas (Table 6). This decrease in rural population has partly driven the decline in the share of agriculture in total employment in the region.

Table 6. Agriculture in the Western Balkans, 2015

| Country | Share in GDP, % | Employment, % | Rural Population, % |
|---------------|-----------------|---------------|---------------------|
| Albania | 22.1 | 41.3 | 42.6 |
| BiH | 7.1 | 17.9 | 60.2 |
| Kosovo | 13.7 | 2.2 | 60.0 |
| FYR Macedonia | 11.2 | 17.9 | 42.9 |
| Montenegro | 10.2 | 7.7 | 36.0 |
| Serbia | 9.5 | 19.4 | 44.5 |
| EU28 | 1.6 | 4.2 | 25.2 |

Figure 38. Agricultural labor productivity growth, 2006=100



Source: WDI, The World Bank (2016), Eurostat (2016), Kosovo Green Report.

84. **Agricultural labor has become more productive, mainly out of necessity because many rural workers have left.** Over the past decade, agricultural labor productivity (agricultural value-added per farm worker³⁸) has significantly increased in the Western Balkans; more so than in the EU28. Agriculture labor productivity increased by 73 percent in Montenegro since 2006. (Figure 38). Since 2006 the labor productivity of Montenegrin agricultural has gone up by 73 percent.

³⁸ Agriculture value-added per worker is a measure of productivity. Value added measures the output of the agricultural sector (ISIC divisions 1-5) less the value of intermediate inputs. Agriculture comprises value added from forestry, hunting, and fishing as well as crop and livestock production. Data are in constant 2010 U.S. dollars.

85. **The historic perspective on small-scale farming has serious implications for labor allocation and productivity growth.** The average Montenegrin farm is smaller than 5 ha. Although land consolidation can bring economies of scale in production and contribute to growth, the rest of the economy would have to enable job creation and absorption—not easy given high unemployment. With credit and land markets weak, consolidation will take time; , in the short run, small land units may be the only asset many agricultural producers, formal and informal, can rely on.

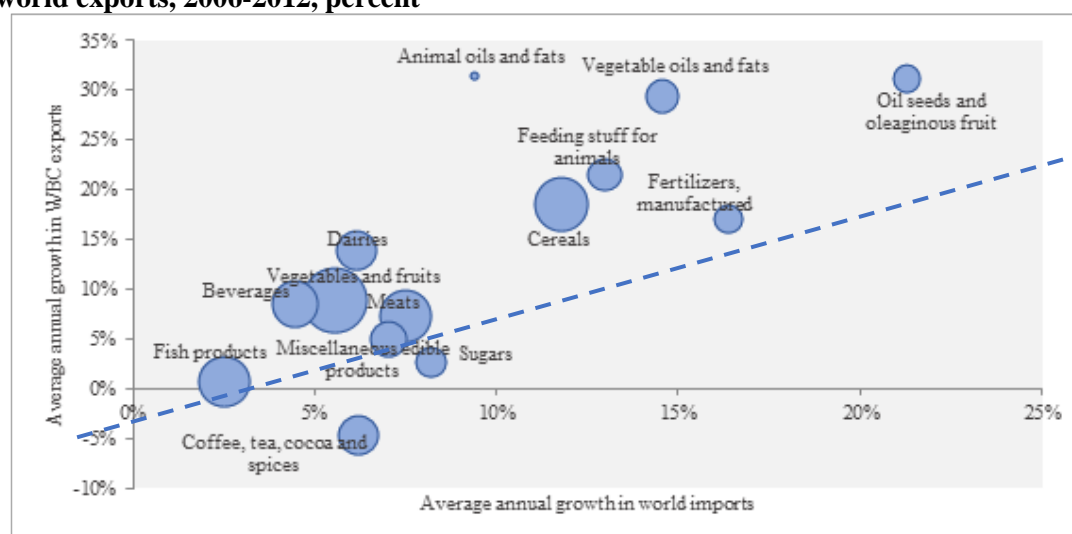
86. **Much of primary agriculture is not part of the commercial agri-food chain.** Semi-subsistence is widespread—around 35 percent of farmers. The agricultural decisions of small producers are driven by their own consumption needs, with excess production sold in local markets. The presence of many small-scale farmers with market surpluses of variable volume and quality limits their power to negotiate with retailers and processors. This affects both the rural economy (fragmented value chains) and the labor market (informality).

87. **Limited education and the age composition of those in primary production make it harder to modernize agriculture.** In Montenegro, a third of agricultural workers are over 65. Many have not completed primary or secondary school, and some have no formal education at all. The agricultural labor force is thus diluted by aging, migration, and lack of opportunities to educate and train new entrants.

88. **Agriculture continues to be a major safety net.** Rural households consider farming to be a source of both food and income security; older people use farming to complement small or even nonexistent pensions. Montenegrin social security policy is directed mainly to the rural elderly: Old Age Allowance Program provides social transfers to rural farmers in the form of de-facto pensions. The goal is to secure an adequate standard of living for beneficiaries in rural areas. One elderly member of each household is eligible. This policy, however, takes up about 20 percent of Montenegro’s agriculture budget.

89. **Montenegro can transform its agri-food industries into an engine of growth, which is important to job creation and absorption of the unemployed.** Consumers in high-value export markets are shifting their food and beverage spending to safe, healthy, convenient, and sustainably grown products. The modern retail sector is increasingly differentiating products in response to shifting consumer demand and stricter regulations. The country’s agri-food industry has grown in recent years thanks in part to gradual integration into regional markets. Exports of food and beverages from the region have also grown faster than total world exports for such subsectors as beverages, fruit, vegetables, dairy, and edible oils, which have all increased their market shares (Figure 39). Agri-food businesses can help stimulate competitiveness in the rural economy and support modernization. In new EU member states that had once been in situations similar to the Western Balkans, foreign investment in the agri-food industry was the most prominent contribution to productivity growth, quality improvements, and enhanced agricultural competitiveness.

Figure 39. Exports of food and beverages from Western Balkans have grown faster than total world exports, 2006-2012, percent



Note: The size of the bubbles represents the size of the sectors as measured by total world exports in 2012;
Source: OECD

90. **Convergence to EU standards allows local producers and processors to better supply the local hospitality sector and opens up opportunities for accessing European markets with higher-value niche products.**³⁹ While many farms are not likely to grow significantly and adjust to the competitive EU environment, there is untapped potential for local artisanal products (e.g., cheeses and smoked dried meats) and for supplying fresh produce to the summer tourism industry when production potential is highest. A program to build the capacity of food and beverage suppliers and link them to tourism buyers could be considered. The sector could also benefit from targeted export promotion.

91. **Sustainability standards and certifications could provide economic, social, and environmental benefits for the Montenegrin agri-food industry.** International sustainability standards and certification systems can build up competitiveness by enabling access to productive and resilient supply chains, enhancing business reputations, adding market value, and reducing both operational and compliance costs associated with environmental regulations. In particular, organic certification can be a source for value addition and job creation in the agri-food sector as a whole. The rapid rise in EU consumer demand for organic products far outpaces current supply. Montenegro is well-positioned to help bridge the current supply gaps for organic products. Its most significant organic crops are small fruits (cherries, strawberries, raspberries, blueberries, and blackberries), aromatic and medicinal herbs, and certain cereals. In recent years, Montenegro has been able to adopt a range of support measures designed to strengthen sustainable agriculture, including incentives for organic farming.

92. **Investments in agricultural competitiveness are closely related to employment and can have strong multiplier effects.** A recent analysis of World Bank investments in agricultural competitiveness found a positive correlation with employment. Investments in competitiveness generally focus on enhancing the business environment by stimulating adoption of new and improved inputs and technologies, enhancing the capacity of agricultural institutions, and improving infrastructure, as by upgrading links between agricultural producers and markets, reducing market transaction costs, aligning production decisions with business

³⁹ Among other things, the World Bank Montenegro Institutional Development and Agriculture Strengthening Project (MIDAS) project is supporting convergence with EU standards and accession requirements related to food and agriculture.

and market opportunities, and linking small farms to international market supply chains. Agribusiness has the highest short-term indirect impact on employment growth because of its close link to labor-intensive agriculture. In the long term the effects are lower but still significant: every six jobs in agribusiness create one job in the rest of the economy.

93. To realize the potential, the following structural challenges to the competitive position of the agri-food industry in Montenegro must be addressed:

- Large agri-food trade deficits (imports valued at €503 million, exports at €68 million)⁴⁰ imply continuing major concerns about agri-food competitiveness.
- The limited amount of agri-food FDI confirms this.
- There are numerous nontariff barriers to accessing both EU and regional markets.
- Lack of access to reliable volumes of quality inputs further dilutes the competitiveness of agri-food manufacturers.
- Fragmentation, low capital investment, and little R&D spending inhibit productivity.

94. Public policies and investment can do a great deal to foster sector transformation and smooth its effects. Current Montenegrin agricultural budgetary transfers are dominated by direct producer support, delivered as price supports, area payments, and input subsidies. Although these may be considered necessary in the short and medium term to protect the sector from more competitive producers, they are not sustainable in terms of both their fiscal weight and the economic incentives they promote. Rural development investments that promote farm modernization, food transformation, and development of rural non-farm enterprises where the public and private sectors share the costs and the benefits can boost employment and contribute to economic growth in rural areas.

Table 7. Emerging reform priority areas - agriculture

| Proposed Priority Area | Activities |
|--|--|
| Promote compliance with international quality standards | Promote compliance with public and private food safety and quality standards by supporting the ISO 9001 certification process ⁴¹ . |
| Incentivize agglomeration and cooperation | <ul style="list-style-type: none"> • Make the enforcement of contract law in land leases more efficient and easier. • Encourage efforts of agricultural cooperatives to improve capacity for storage, packaging, marketing, and exporting. |
| Facilitate well-functioning agri-food value chains | Analyze value-chain links and their potential. Well-functioning value chains help the agri-food sector to create, deliver, and capture market value by closely coordinating actions between upstream and downstream agri-food value-chain stakeholders, including tourism. |
| Incentivize innovation and entrepreneurship | Increase public funding (using EU funds) for research and innovation based on well-coordinated innovation policies and systems. This can help bring knowledge to producers and support the process of strengthening extension services and food quality control. It can be the link between producers and consumers in rural and urban areas where roads are not sufficient and production units are geographically dispersed. These new jobs are likely to be |

⁴⁰ FAO Europe and Central Asia Agro-Industry Development Country Briefs 2014

⁴¹ Across the Western Balkans region, the number of ISO 9001 certificates registered per million inhabitants is lower than in the EU. Serbia has the highest rate, while Albania, FYR Macedonia and Montenegro have the lowest. OECD (2016), *Competitiveness in South East Europe: A Policy Outlook, Competitiveness and Private Sector Development*, OECD Publishing, Paris

| | |
|---|--|
| | taken by youth in both rural and urban areas. Experience from the HERIC project could also be leveraged to boost agribusiness growth and productivity. ⁴² |
| Build sector-specific human capital | Closely match education and training programs with agri-food industry needs. |
| Promote foreign direct investments and trade | FDI can be vital for technology transfer and improving the access of agri-food businesses to international markets. Export promotion and trade facilitation can boost agri-food export growth. Digital marketplaces could help food and beverage manufacturers to forge direct links with buyers and consumers. |
| Diversify the rural economy | As the national economy and the agri-food sector modernize, fewer people will work in primary agriculture and more will work in upstream segments of value chains. The agri-food sector is highly cross-cutting, linking with, among other areas, biotechnology, ICT, research and education, transport and logistics, tourism, health and well-being, natural resource management, sustainability innovation, and cultural creative industries. |

Tourism

95. **Travel and tourism is already the largest sector in terms of employment and share of GDP, and international arrivals are expected to continue growing.**⁴³ With the country's rich tourism assets and its active investment promotion strategy, tourism is an increasingly important driver of growth. However, there are related concerns about the supply of domestic skills for this sector, perhaps related to the quality of general schooling, the capacity and quality of vocational training, and the limited interest of youth because tourism labor demand is seasonal. There is general agreement that addressing the seasonality issue is critical: foreign tourist overnight stays are highly concentrated, with 70 to 80 percent occurring in summer months—'sun and sea' tourism. There is also heavy dependence on certain source markets, with Russia accounting for 30 percent of tourist overnight stays and Serbia for 24 percent.⁴⁴ Another concern is the promotion of more domestic entrepreneurship and small business growth around this sector, either as tourism operators or as providers of goods and services.

96. **Much private investment in recent years was for the physical infrastructure of the tourism sector and modernizing tourist services.** One of the main challenges now is to develop more complementary services that put the new infrastructure to work. To capture part of the income generated by the capital investments, Montenegro has to build its capacity to compete with foreign-sourced inputs, the skills of Montenegrin workers, and internal demand for these skills.

97. **Diversifying beyond summer coastal tourism is also very important.** To protect natural resources, Montenegro should adopt safeguards against the environmental risks associated with tourism development, such as waste management, water quality, unmanaged urban growth, and industrial pollution. A first step could be to update and extend the

⁴² The HERIC-funded KATUN project facilitated the design and production of new cheese products, introduced production standards, set up associations of traditional dairy producers, promoted local entrepreneurship and created links with coastal tourism promotion offices. HERIC also supported the BIO-ICT Center of Excellence. BIO-ICT has been working on unlocking the potential of the Montenegrin South Adriatic Sea and inland rural areas, bringing innovative ICT-based solutions in various bio-economy sectors related to food security, blue growth, bio-based innovation for sustainable goods and services, etc. See www.bio-ict.ac.me.

⁴³ According to the World Travel and Tourism Council, in Montenegro the industry accounts for about 13 percent of direct and 21 percent of total employment. International arrivals and tourism receipts are projected to grow by 4.6 percent annually through 2025. According to the UNWTO Compendium of Tourism Statistics, tourism expenditures are 22 percent of GDP.

⁴⁴ MONSTAT, 2014 data.

Montenegro Tourism Development Strategy to 2020, with a focus on quality over quantity (as stated in the 2001 Masterplan), increasing domestic revenue per tourist, and sustainability.

Table 8. Emerging reform priority areas - tourism

| Proposed Priority Area | Activities |
|--|---|
| Promote foreign direct investments | Focus on high-value markets in marketing, branding, and service offerings. |
| Increase tourist spending per day and duration of stay | <ul style="list-style-type: none"> • Develop more complementary services. • Develop MICE offerings. • Increase backward links to local inputs, such as food and beverages from agribusinesses. |
| Build skills in demand in tourism | <ul style="list-style-type: none"> • Understand and reduce disincentives for Montenegrin (vs. migrant) workers. • Strengthen vocational education through dual education curricula. |
| Diversify beyond summer coastal tourism | <ul style="list-style-type: none"> • Take advantage of global trends (including increasing numbers of millennials), such as tourists seeking experiences related to, e.g., adventure, cultural heritage, wellness, and eco-tourism, and create new niches, e.g. health, wine, events (conferences, art, music). • Leverage experience from the HERIC-funded KATUN project in terms of developing adventure, cultural heritage, and eco-tourism in the north of Montenegro,⁴⁵ and from the HERIC-funded SUST-Marina project to support the sustainable development of other coastal areas.⁴⁶ |
| Safeguard against environmental risks associated with tourism development | <ul style="list-style-type: none"> • Manage environmental risks and protect natural resources. • Ensure strict environmental standards. • Invest in waste water, water supply, and waste management infrastructure. |

Digital Agenda for Jobs and Growth

98. **Broadband Internet-enabled information and communication (digital) technologies are becoming prerequisites for growth and job creation in every economy.** They connect people to knowledge, ideas, and services that drive economic growth and provide the skills most occupations today require. Yet their positive impact on employment generation tends to be unevenly distributed across nations, with Montenegro being no exception. According to the *World Development Report 2016* on Digital Dividends, for digital technologies to benefit everyone everywhere requires closing the digital divide, especially in broadband access and ICT adoption.

99. **In terms of digital development Montenegro is one of the most dynamic WB6 countries.** The sector contributed 4.2 percent of GDP in 2016, near the 4.5 percent of the EU28⁴⁷ and the 5.4 percent of OECD members.⁴⁸ The country has a vibrant electronic communications sector, especially the wholesale broadband market segment,⁴⁹ and high

⁴⁵ *Katuns* are temporary settlements in mountainous regions where agricultural households stay with livestock during the summer season; they are a unique socio-cultural resource of Montenegro. The KATUN project aims to create a knowledge base for the use of Montenegrin mountain resources by combining traditional agriculture with boosting tourism activities and protecting the cultural heritage of *katuns*. See <http://katun.me>

⁴⁶ The project promoted sustainable development through international certifications of the AD Marina Bar. The marina was awarded the prestigious Blue Flag eco-label, three gold anchor awards, and certifications in Integrated

⁴⁷ Eurostat, 2017.

⁴⁸ OECD, 2017.

⁴⁹ Networld Consulting for the World Bank, 2018.

broadband market concentration.⁵⁰ In 2017, on the Information and Communication Technologies (ICT) development index measuring Readiness, Capacity, and ICT Use (ITU 2016), Montenegro was ranked 61st of 176 countries. The country is farthest behind developed countries on ICT readiness, which measures access to digital infrastructure and devices, and ICT use, digital adoption. It underperforms on the following indicators (ITU, 2016):

- households with Internet access (61.1 percent for Montenegro vs. 81.3 percent for developed countries)
- individuals using the Internet (64.6 vs. 78.1 percent)
- fixed broadband subscriptions per 100 inhabitants (18.1 vs. 29.4 percent)
- active mobile broadband subscriptions per 100 inhabitants (43.7 vs. 87.1 percent)⁵¹.

100. **The two main barriers to digital development in Montenegro are that** (a) high-speed broadband is not universally available,⁵² and (b) adoption of digital technologies is insufficient, especially in their productive use, e.g. for learning, access to labor and product markets, and services.

101. **High-quality, affordable, and stable broadband Internet connection can be a lifeline for isolated rural inhabitants**, connecting them to knowledge, services, learning, and labor markets within and outside the country. Broadband has become the primary vehicle for exporting homegrown services and products even in the world’s most remote places. In Montenegro, access to broadband is unevenly distributed, with a pronounced digital divide between urban and rural areas, and between the Northern Region vs. the Coastal and Central Regions (Table 9). Cut off from reliable (uninterrupted) and quality (high-speed) broadband access, many businesses and communities struggle to benefit from the digital revolution. The Government of Montenegro has set ambitious goals through 2020 to support this population through policies and programs directed to deployment of next-generation broadband networks and deeper penetration of broadband access.

Table 9. Fixed broadband penetration and broadband technologies in use in Montenegro’s regions

| | Penetration [per inhabitants] | Penetration [per households] | xDSL | Cable modem | FTTx | Fixed wireless | Other |
|-------------------|----------------------------------|---------------------------------|--------------|----------------|--------------|-------------------|-------------|
| Montenegro | 18.5% | 59.7% | 51.0% | 32.0% | 11.3% | 3.2% | 2.5% |
| Northern Region | 8.2% | 26.5% | 59.0% | 31.5% | 2.3% | 1.5% | 5.7% |
| Central Region | 19.0% | 61.3% | 40.8% | 35.9% | 17.1% | 4.8% | 1.4% |
| Coastal Region | 29.7% | 96.0% | 61.3% | 27.3% | 6.9% | 1.8% | 2.7% |

Source: EKIP (2017)⁵³

102. **Low population density is driving up the costs of private broadband network infrastructure, especially in mountainous areas.** The Northern Region, where over 30 percent of the population live but where population density is lowest, accounts for only about 12 percent of total Internet traffic and has the lowest recorded average Internet speed in the country at 4.9 Mbps. Uneven distribution of the population increases the costs of private broadband deployment and discourages broadband investments in less-populated areas.

⁵⁰ The World Bank Broadband Policy Note, 2017.

⁵¹ ITU, 2016.

⁵² High-speed broadband is defined as an Internet access connection of 30 Mbps or more, according to the *Strategy for the Development of Information Society 2016–2020*.

⁵³ Networld Consulting for the World Bank (2018).

103. **Where broadband is available, low speeds are very common, which prevents Montenegrins from fully seizing digital opportunities.** The cost of basic broadband (below 10 Mbps) is currently above the ITU affordability threshold of 5 percent of disposable income, and a 10 Mbps connection on average accounts for ~10 percent of monthly household expenses. This is due to both high broadband prices and relatively low GDP per capita (one-fifth of the EU average). Limited affordability seems to be one of the factors limiting adoption of high-speed broadband, if an average household spends 5.7 percent of its disposable income on communications.⁵⁴

104. **The ICT industry is one of the greatest suppliers of high-paying jobs in Montenegro.** In 2017, the average monthly gross wage paid per employee in the sector (€1,052) was behind only financial and insurance activities (€1,384) and electricity, gas, steam and air conditioning supply (€1,302). The sector has also had stable employment growth since 2010. In 2017, the ICT sector employed 2.4 percent of the total Montenegrin labor force, which is more than, e.g., the two sectors that pay more, but less than other sectors. The EU28 average for total ICT employment is 3.7 percent, although some member states, like Finland, Sweden, and Estonia, outperform on this benchmark.

105. **However, it should be noted that annual ICT employment generation has been rather modest and driven mainly by the telecommunications industry.** In developed countries the ICT sector is usually driven by IT. In contrast to telecommunications, Montenegro's IT industry is characterized by a small domestic market (by one estimate, there are fewer than 300 IT firms, and total turnover is a tiny fraction of that of telecommunications), few exporting businesses, and a small number of employees (by the same estimate, it employs fewer than 700 specialists). Among development constraints are insufficient IT and computer literacy, lack of skills, lack of institutionalized state assistance to the sector, minimal development of e-government services, and little export promotion assistance.⁵⁵

106. **Montenegrin citizens have a lower than desired level of digital adoption—women are particularly disadvantaged.**⁵⁶ Montenegro trails its regional comparators as well as highly developed countries on Internet users per capita. Nor are Montenegrin Internet users benefitting fully from digital technologies; typically, they use online resources mainly for video calling, participation in social networks, or news reading, rather than, for example, education, online work, or accessing specialized business or government services. Significantly more women than men rarely access the Internet, probably because of gender-specific barriers.⁵⁷ As global experience shows, broadband demand-side programs are needed to link Internet users to productivity-enhancing online activities, such as learning, government services, or jobs. On their own, users are unlikely to find the most efficient ways to search for information and resources that are legitimate (secure, safe, and not fraudulent) and impactful.

107. **Demand-side programs typically target vulnerable population groups, whose digital literacy tends to be lower than average.** In Montenegro, broadband demand-side activities are likely to be required to support the 65+ age group, women (especially those inactive in the labor force or un- and underemployed), NEET youth, and minorities (especially Roma). The preconditions for their success are already in place: First, adult literacy is almost universal. Second, the age pyramid still has a relatively high share of youth; the median age is

⁵⁴ <http://www.monstat.org/userfiles/file/apd/2015/saopstenje%202015%20g.pdf>.

⁵⁵ http://www.privrednakomora.me/sites/pkcg.org/files/multimedia/gallery/files/2012/09/brosura_next_ict_sep_2015_2.pdf.

⁵⁶ *Strategy for the Development of the Information Society 2016–2020*.

⁵⁷ <http://www.monstat.org/userfiles/file/ICT/2017/ICT%20USAGE%20IN%20HOUSEHOLDS%20IN%202017.pdf>.

38 (the EU average is 42.6).⁵⁸ Third, the young and highly literate workforce is well educated; a third of Montenegrins aged 25–29 have tertiary education. For these reasons—plus the country’s proximity to Serbia, one of Europe’s top digital freelancing nations—younger Montenegrins are likely to benefit from the digital skills training.

Table 10. Emerging reform priority areas - ICT

| Proposed Priority Area | Activities |
|--|--|
| Formulate strategic policies | Draft action plans to realize the <i>Strategy for Development of the Information Society 2020</i> that incorporate financial and policy incentives for rural broadband. |
| Encourage deployment of joint infrastructure | Introduce a new procedure for joint infrastructure deployment across sectors (a “dig once” policy), streamlining infrastructure deployment and introducing requirements for household deployments. |
| Connect rural businesses and communities to broadband | Consider a public-private partnership (PPP) arrangement to bring private investments into domestic broadband connectivity. Broadband PPP arrangements are quite common in the EU, grounded in the belief that the social returns from increased broadband speeds and penetration in rural areas are significant enough for public co-financing and state aid to encourage. |
| Put in place a digital economy skills development program | <ul style="list-style-type: none"> • Implement employability-enhancing training and other types of demand-side programs to promote and trigger creation of digital economy jobs, especially for un- and underemployed young men and women. • Identify an export- and demand-driven mechanism to accelerate young people into new jobs at businesses and startups operating in the digital economy • Target and focus digital skills development efforts, e.g., digital skills training for local ICT and global online work. • Introduce ICT literacy into the primary education curriculum. |

⁵⁸ Eurostat (data available at: <http://ec.europa.eu/eurostat/web/products-eurostat-news/-/DDN-20170215-1?inheritRedirect=true>).

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