

DRIVING FACTORS OF THE MONTENEGRIN ECONOMY - FDI AND TOURISM

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ABSTRACT

The aim of the paper is to assess the level of competitiveness of Montenegro and the possibilities for future progress based on the analysis of the level of foreign exchange inflows from foreign direct investment and tourism as factors contributing to the development of the Montenegrin economy. The desk research was conducted on the basis of officially available data from the Central Bank of Montenegro and the Statistical Office of Montenegro (Monstat). The period covered by the research is from 2019 to 2022. The research results show that a foreign investor in Montenegro is legally treated in the same way as a domestic investor, that the tax system is very attractive and among the most competitive in the whole of Europe, which provides investors with an attractive business environment, a low tax burden and thus maximizing their profits. Furthermore, one of the main priorities of the Montenegrin economy should be focused on the development of tourism, as tourism in Montenegro is the foundation of the country's prosperity and well-being. In this regard, those responsible for economic policy in Montenegro should continuously evaluate and adapt their strategies to global economic trends in order to create an appropriate business environment and thus the country's prosperity.

Keywords: Foreign Direct Investment, FDI, Tourism, Montenegro, Competitiveness, Business Environment.

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INTRODUCTION

Montenegro is an open economy with great potential for flexible adaptation to global trends in the field of foreign direct investment, which presents the country with a special task when it comes to improving its overall investment environment. Improving the investment environment in order to attract foreign direct investment should be one of the main goals of Montenegro's development policy, as foreign direct investment has a strong impact on economic and employment growth. Creating a healthy and competitive business environment and a flexible labor market are just some of the factors that influence the attraction of foreign direct investment. In the past period, Montenegro has tried to be very attractive for foreign investors with the lowest taxes in the region. With the entry into euroization, the country became even more interesting for foreign investors and further improved the business environment. In addition to foreign direct investment, tourism is a very important economic sector that can contribute significantly to the growth and development of Montenegro, which should consequently have an impact on the country's competitiveness, especially in comparison to countries in the immediate neighborhood.

Over the past ten years, Montenegro's stimulating business environment has undergone certain reforms on the one hand, while on the other it has faced certain challenges in the form of the coronavirus pandemic and political instability. Despite all the challenges Montenegro has faced, the country has developed significantly and increased its GDP by 50% during this period. Attracting foreign direct investment (FDI) is one of Montenegro's main goals, which is also compatible with the goal of improving the business and investment environment, considering the positive impact of these investments on overall economic development, import and implementation of know-how, dynamization of production and creation of new jobs by opening new companies. New measures are constantly being taken and applied to attract foreign direct investment, which has an impact on the constantly changing investment environment. The aim is to create the necessary conditions so that the investor's decision to invest in Montenegro is facilitated as much as possible. The synergy of local and central authorities is crucial for the implementation of the policy of openness and improvement of the investment environment. In order to improve the business environment, create the conditions for greater competitiveness and thus better position itself in international competition, the Government of Montenegro adopted an action plan in June 2019 to improve the business environment, which covers five areas, namely: (a) starting a business, (b) obtaining building permits, (c) obtaining an electricity connection, (e) paying taxes and (f) registering real estate. Only a transparent business environment is acceptable to foreign investors. Therefore, it is necessary to strengthen control in the area of compliance with legal regulations, taking into account the prevailing shadow economy.

Investing in Montenegro can be attractive for several reasons, from its strategic location and natural beauty to its efforts towards economic reform and development. There are several key factors that make Montenegro an attractive investment destination. Montenegro is strategically located on the Adriatic Sea and offers access to major European markets. Its proximity to other Balkan countries and potential integration into the EU increase the country's attractiveness as a regional hub. The government has implemented economic reforms to improve the business environment and attract foreign investment. Ongoing efforts include legal and regulatory reforms, tax incentives and infrastructure development. In addition, various incentives are offered to attract foreign investors, including tax breaks, reduced fees and other favorable conditions for business development. Infrastructure development is very important as ongoing infrastructure projects such as highway construction and energy sector development are aimed at improving connectivity and supporting economic activities.

Montenegro is a candidate country for accession to the European Union, which indicates a commitment to comply with EU standards and regulations, but the accession process itself can also open up additional opportunities for businesses and investors. The country is making efforts to improve its digital infrastructure and promote innovation, which creates opportunities for technology-oriented industries. Montenegro has untapped potential in the field of renewable energy, especially hydropower and wind energy, offering opportunities for investment in a growing green economy. It is important to note that the country is actively adapting to global economic trends, including the practices of sustainable development and technological advancement. An ecosystem for start-ups has emerged in the country, focusing on innovation and entrepreneurship in areas such as technology and tourism.

The goal of the Montenegrin government is to accelerate economic growth, which is driven by the development of tourism as the engine of the Montenegrin economy. In order to ensure an increase in employment, an increase in living standards and a more balanced regional development through tourism development, continuous sustainable development of tourism is necessary, with a focus on efficient use of resources, together with the promotion of Montenegro as a green, sustainable and responsible destination.

LITERATURE REVIEW

Economic variables no longer have the exclusive power to influence FDI given the heightened level of global competition and the advancement of investment theories. These days, a wide range of noneconomic elements, including institutions and policies, are crucial to FDI inflow. Investor interest in the business environment as a composite indicator is rising [1], [2]. In recent years, FDI inflows have been increasingly drawn to emerging and developing nations [3], [4]. When choosing a site for outbound foreign direct investment, businesses should take into account the differences between the business environments in their home and host countries [5]. Every country aspires to attain economic advancement [6]. Business environments' dynamism and competition play a critical role in influencing how well various innovation strategies—both in terms of process and product—deliver company performance [7]. To ascertain the significance of the business environment for technology SMEs, [8] investigated the relationship between the business environment, economic growth, and funding sources of Chinese SMEs.

The state and institutions take great care to create an atmosphere that encourages and supports entrepreneurship [9]. In light of the business environment's significance, a few components of it have been examined by Khan et al. [10] in relation to the business sector. The best resources must be made available for unrestricted growth, internal coherence, organizational cultural stability, and market competitiveness for entrepreneurial organizations to successfully design their business strategies [11]. Due to its emphasis on fresh perspectives on innovation and creativity, entrepreneurship is garnering more and more attention [12], [13]. Different responses from nations have been made to the new circumstances brought about by the COVID-19 viral pandemic, which has helped to adopt the necessary economic measures to contain the problem and lessen its new effects [14]. In the face of the COVID-19 pandemic, numerous businesses have demonstrated incredible fortitude by adjusting to shifting conditions and coming up with innovative ways to cater to their clientele [15].

It is believed that increasing a nation's comparative advantages through foreign direct investment is a successful strategy [16]. Rose-Ackerman & Tobin [17] looked at whether or not bilateral investment treaties encourage foreign direct investment to host nations and whether or not this relationship is dependent on the degree of political risk in a nation. BITs don't appear to have much of a positive impact on foreign investment or how outside investors view the investment climate in low- and middle-income nations. When making foreign investments, investors consider a variety of location-related considerations, including the business environment. Witkowska [18] has concentrated on the connection between the conduct of foreign direct investors and modifications in the business environments in the newly admitted EU member states. Domazet et al. [19], [20] came to the conclusion that rising business sector investment at the current GDP level affects rising innovation. The impact of a nation's business regulatory framework on the volume of foreign direct investment it draws was studied by Corcoran & Gillanders [21]. The authors find little indication that a country's overall level of FDI is impacted by the ease of doing business in neighboring countries. An environment that is conducive to business can be created by effective governance, the rule of law, political stability, lower trade costs, and lower levels of corruption. These factors are essential for drawing in foreign direct investments [22], [23], [24].

Ambrož & Omerzel [25] have attempted to elucidate the function and significance of the business model in the tourism industry and to illustrate the need for business model modifications in order to preserve competitiveness. The creation of methods to evaluate the environment associated to the tourism business has been examined by Nikazachenko et al. [26]. It has been demonstrated that the idea of sustainable tourism development emerged in response to the necessity of growing a lucrative sector given the constraints of scarce visitor resources. The main drivers of competitiveness in developing nations are tourism-specific factors like destination management and tourism infrastructure, whereas in developed nations, destination competitiveness is dependent on both tourism-specific factors like destination management and broader economic conditions like general infrastructure, macroenvironment, and business environment [27], [28]. The relevance of research on innovation in the tourism sector has grown. Martínez-Román et al. [29] propose a two-stage interactive model based on innovative capability, environment, and other contextual factors of firms to explain the impact of these outcomes on SMEs' profitability. The model explains how innovative outcomes in products and processes arise first.

WB nations have used a variety of policy incentives during the past 20 years in an effort to draw in as many foreign investors as they can. Inflows of foreign direct investment increased economic growth by keeping up with the rate of economic reform and transition to a market economy [30]. In the past 10 years, Montenegro has experienced a notable influx of FDI, a crucial driver of economic expansion. The tourism, finance, telecommunication, and energy sectors are the most alluring to international investment [31]. Positive initial consequences of the direct capital inflow include rapid growth, low inflation, higher employment rates, and stability in Montenegro's fiscal balance [32]. Nonetheless, with a substantial development potential and a 22 percent GDP share, tourism is Montenegro's most significant export industry [33]. Given that more tourists are seen in the coastline area, the seaside position is crucial to Montenegrin tourism. The main factor impeding the growth of tourism in Montenegro is the lack of diversity among foreign visitors [34]. Selimi et al. [35] conducted an investigation and came to the conclusion that tourism significantly and favorably influences economic growth in the Western Balkan countries. According to the Hausman Taylor IV model, output will rise by about 0.08% for every 1% increase in visitor arrivals.

RESEARCH METHODOLOGY AND RESULTS

Foreign direct investment is considered a very important factor for the development of a country, especially when it comes to developing and emerging countries. Montenegro, which suffers from a lack of capital, also belongs to this group of countries, and in this situation it is most profitable to fill the gap with foreign direct investment as the best form of utilizing foreign capital. The development of Montenegro, and thus the increase of its competitiveness in relation to other countries, especially those in its immediate vicinity, is strongly influenced by the inflow of foreign direct investment and the development of tourism. Without a well-developed state strategy focused on these two segments, one could not speak of progress in the Montenegrin economy. Since its independence (2006), Montenegro has recorded a relatively high net inflow of foreign direct investment, placing it among the best European economies in transition. The reason for this is that Montenegro has created an attractive legal framework that allows foreign investors national treatment. On the other hand, the tourism sector is becoming more and more important in the overall economic development of Montenegro every year. Tourism represents an extremely important component of the Montenegrin economy, which has the potential to bring economic growth and development to the country. In this regard, objective of this paper is to analyze selected factors that can contribute to the development of Montenegro's economy (foreign direct investment and tourism) and then assess the country's competitiveness and opportunities for further progress. The methodology is based on desk research using secondary data from the Central Bank of Montenegro and the Directorate for Statistics of Montenegro (Monstat). The analysis covers the period from 2019 to 2022.

Net direct investments are 90.7% higher in 2021 compared to 2019, mainly due to an increase in equity investments and a decrease in direct investment outflows, while they are 23.5% higher compared to 2020. A comparison of the net inflows of foreign direct investment in the years under review shows that the highest net inflow of foreign direct investment was recorded in 2022 and amounted to around 782 million euros. In the period under review, Montenegro recorded a growth trend in net inflows of foreign direct investment (Fig. 1). Montenegro's progress in this segment is best illustrated by the percentage increase in net FDI in 2022 compared to 2019, which amounted to 157%.

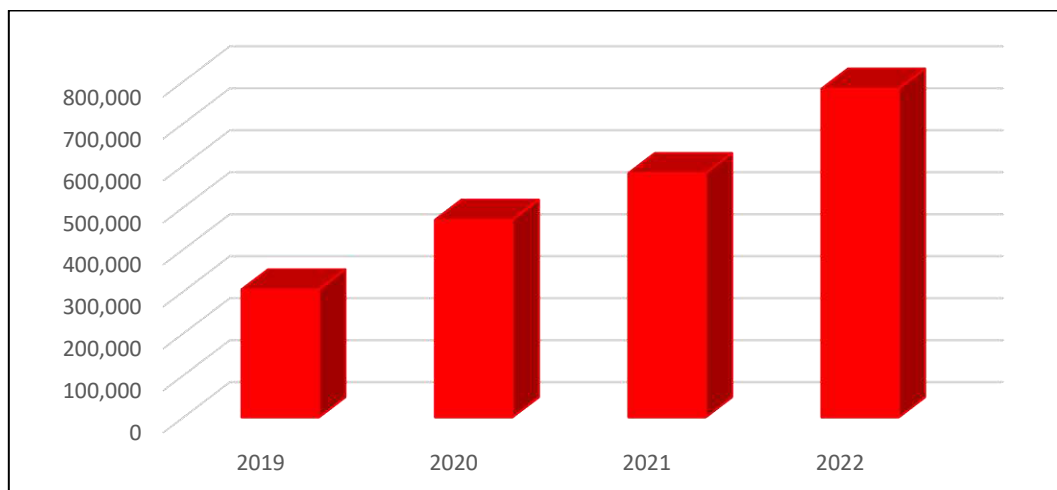


Figure 1. Net inflow of foreign direct investment (EUR 000)

Source: Central Bank of Montenegro, 2024.

One of the basic indicators that should help Montenegro identify the target markets it should focus on and thus improve its position in the world is the net inflow of foreign direct investment. In the period 2019-2022, Montenegro had the largest net inflow of FDI (Fig. 2) from the Russian Federation, followed by Azerbaijan, Switzerland, Serbia, the United Arab Emirates, Germany, Italy, Turkey, the USA, the Netherlands etc.

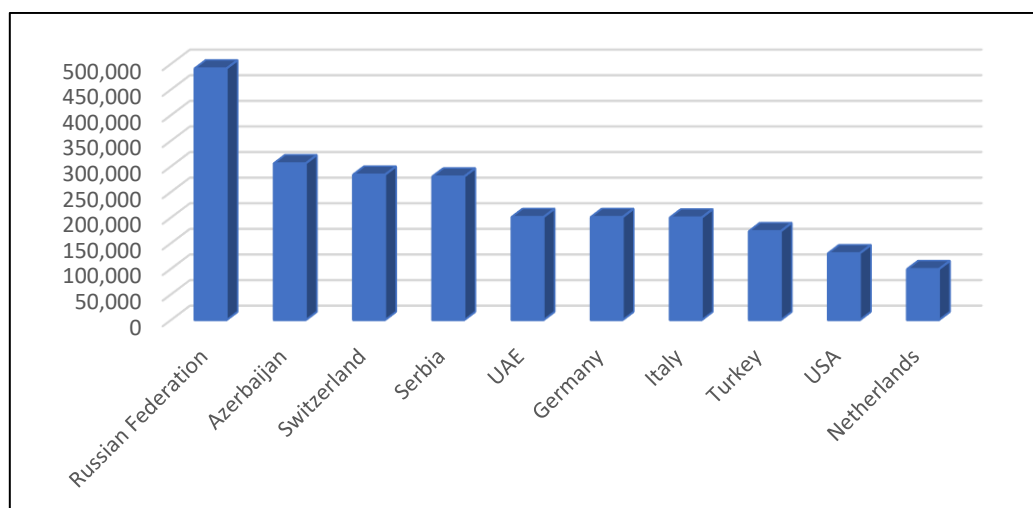


Figure 2. Net foreign exchange inflows from foreign direct investment by country in the period 2019-2022. year (EUR 000)

Source: Central Bank of Montenegro, 2024.

Over the last ten years, Montenegro has experienced a significant inflow of foreign direct investment compared to the size of its GDP, with this ratio approaching the rate of 20%. There are numerous advantages that Montenegro offers to foreign investors. This primarily concerns the legal framework for investment in accordance with European legislation (national treatment of foreign investors), a favorable tax policy, lowering the costs of registering companies and obtaining construction permits, easy conditions for starting a business, encouraging tax, regulatory and financial measures. In addition, Montenegro offers tax incentives for investment in the northern part of the country and tax incentives for investment in newly established business parks. Montenegro also offers foreign investors a liberal foreign trade regime, preferential access to the European Union market, the avoidance of double taxation and the free transfer of reinvested profits and payments abroad. Not to be forgotten is the fact that Montenegro has an extremely favorable geographical location and good climatic conditions, free access to the EU market and relatively low customs duties. The special advantage of Montenegro concerns the payment system, as the national currency is the euro, which makes the work of foreign investors much easier.

The business environment plays one of the most important roles in attracting foreign direct investment to Montenegro. Therefore, it is very important to improve the business environment through appropriate reforms, simplify administrative procedures and create incentives for investors. Monitoring and adapting to global trends and investor preferences are essential to ensure that Montenegro remains an attractive destination for foreign investors. A favorable business environment is often characterized by factors that create a favorable atmosphere for investment, reduce risks and increase the overall competitiveness of the country. Key factors of the business environment that can influence the attractiveness of foreign direct investment in Montenegro:

- Political stability - a stable political environment is attractive to foreign investors as it reduces uncertainty and the risk of political upheaval.
- Efficient administration - transparent and efficient administrative structures contribute to a positive business environment by providing a fair and predictable regulatory framework,
- Investment laws - clear, investor-friendly investment laws that protect property rights and provide a transparent regulatory framework.
- Legal protection - legal protection for foreign investors, including protection against expropriation and dispute resolution mechanisms.
- Transportation and logistics - a well-developed transportation infrastructure, including roads, ports and airports, facilitates the movement of goods and people.
- Energy infrastructure - reliable and efficient energy infrastructure is essential for industrial and business activities.
- Tax incentives - attractive tax policies, including incentives for foreign investors, can significantly improve the attractiveness of the investment environment.
- Stability of the tax system - a stable and predictable tax system reduces uncertainty for investors.
- Skilled labor - availability of skilled and educated labor that meets the requirements of the industries targeted for investment.
- Labor regulations - flexible and business-friendly labor regulations that balance the protection of workers' rights with employer flexibility.
- Market access - proximity to major markets or trade agreements that provide favorable conditions for exports and market access.
- Trade facilitation - policies that facilitate international trade and reduce barriers for foreign companies.
- Stable financial system - a stable banking and financial system that allows companies access to capital.
- Ease of capital flow - policies that facilitate the free flow of capital in and out of the country.
- Quality of life - factors such as overall quality of life, healthcare, education and social stability can influence investors' decision to locate in a country.
- Digital infrastructure - a well-developed digital infrastructure, including high-speed internet and technology deployment that supports modern business operations.
- Sustainable development - an emphasis on environmental responsibility and sustainable development practices can positively influence a country's image and its attractiveness to socially responsible investors.

One of the main characteristics of the business environment in Montenegro is the existence of business barriers that impede regular business and limit the development potential of the private sector. Due to the impact that foreign direct investment has on economic development, Montenegro is not in a position to ignore obstacles, but to remove them as quickly and efficiently as possible. Work to remove barriers is ongoing, as evidenced by international reports on competitiveness and the business environment. Circumstances that prevent a greater inflow of foreign direct investment take the form of administrative obstacles, the implementation of laws and legal frameworks, complicated and lengthy approval procedures, the lack of a suitably qualified workforce, a lack of spatial development plans and inadequate infrastructure. The aforementioned obstacles can significantly impair the investment environment and thus the inflow of foreign direct investment.

There is much scope for improving the business environment, and the prerequisite for this is the suppression of the shadow economy and a predictable and transparent business environment based on the rule of law and respect for legal frameworks and procedures and the equal application of the law for all. A predictable business environment is one of the most important prerequisites for investors. By frequently changing

regulations, procedures, conditions, tax rates and other benefits, decision-makers can negatively impact the business environment and business security. It is also necessary to implement certain legislative reforms. Namely, Montenegro should revise its legislation in order to create clear, predictable and favorable business rules. This may include adopting laws that protect property rights and intellectual property and regulate trade agreements. Work should also be done to strengthen the regulatory and supervisory system to reduce the risk of corruption and unfair practices. For investors, a well-developed infrastructure is often an important factor when choosing a location. In the coming period, Montenegro should invest in the development of the transportation network, energy infrastructure, digital communication and other key infrastructure projects that would improve connectivity and facilitate doing business in the country. In addition to developed infrastructure, a skilled workforce is an extremely important factor for foreign investors when choosing an investment location. Montenegro should invest even more in education, professional development and adaptation to the skills required for modern industries.

Foreign investors who decide to invest in Montenegro invest their capital mainly in tourism, real estate, energy, agriculture and transportation. Therefore, tourism is considered one of the most important drivers of social and economic development in Montenegro. Considering the increasing number of foreign tourists coming to Montenegro, which is reflected in the number of overnight stays and thus in revenues, the share of tourism in total GDP has been steadily increasing in recent years. In 2019, Montenegro generated income from tourism of around 1.1 billion euros. In 2020, this revenue was at a significantly lower level (around 145 million euros) due to the occurrence of the COVID-19 pandemic, which had a significant impact on the tourism sector. In 2021, economic activity in the tourism sector recovered and revenue of 758 million euros was generated. The progress continued in 2022, as tourism revenue reached the amount of around one billion euros, which corresponds to the level before the outbreak of the coronavirus pandemic (Figure 3).

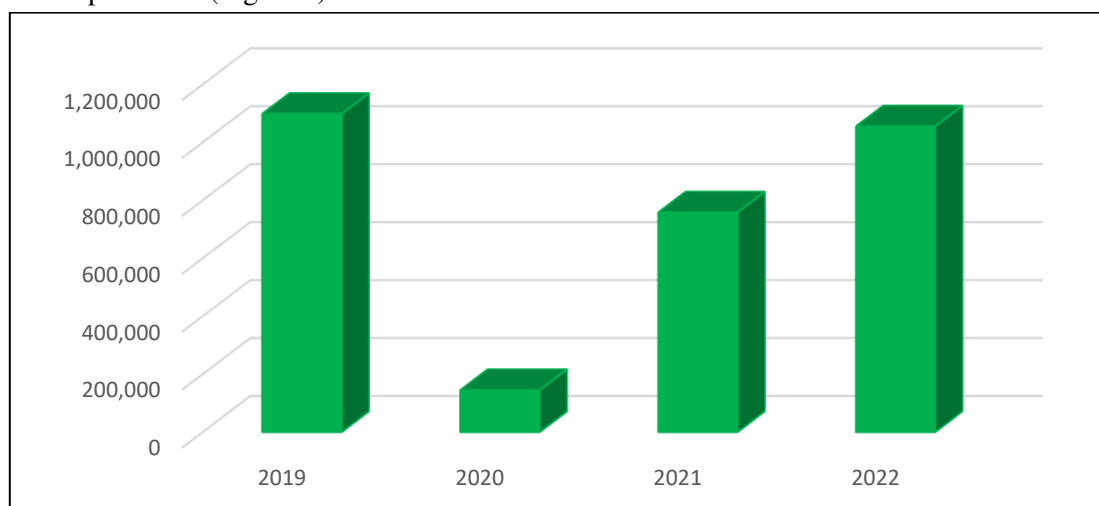


Figure 3. Income from tourism (EUR 000)

Source: Statistical Office of Montenegro, 2024.

In the coming years, foreign exchange inflows from tourism are expected to be around EUR 1.5 billion, taking into account that the tourist season has been extended from 3 to 5 months with the help of major tour operators through which most hotels operate. In the period 2019-2022 year, Montenegro had a foreign exchange inflow from tourism in the amount of over 3 billion euros. According to the structure of inflows by country (Fig. 4), Serbia and the Russian Federation occupy the most important place, followed by Bosnia and Herzegovina, Ukraine, Germany, Kosovo*, Poland, Great Britain, France, Albania, etc.

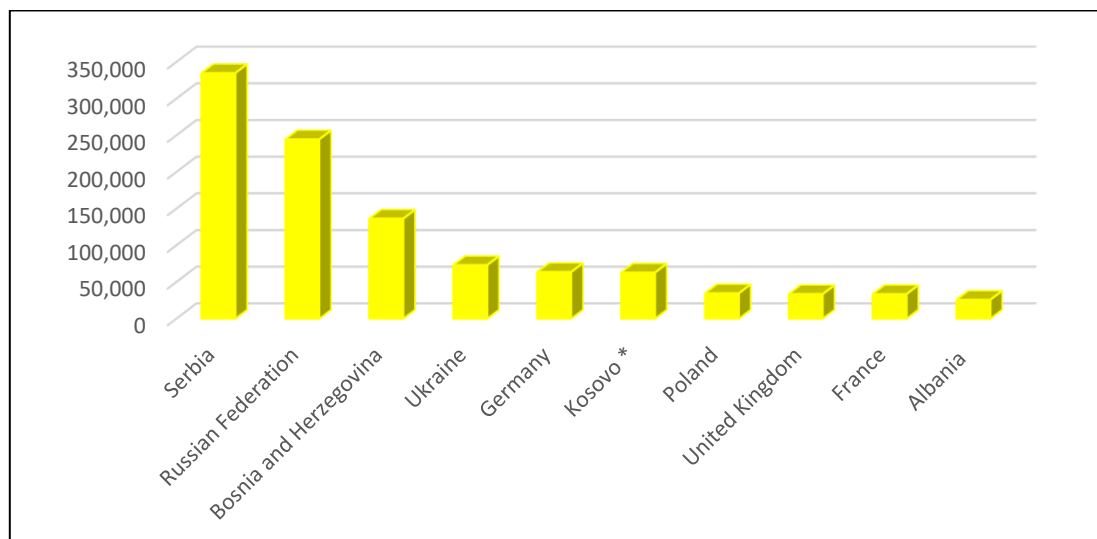


Figure 4. Estimate of foreign exchange inflows from tourism by country in the period 2019-2022, year (EUR 000)

Source: Statistical Office of Montenegro, 2024.

In the course of 2019 year 2,645,217 foreign tourist arrivals and 14,455,920 overnight stays were realized in Montenegro. The global crisis caused by the COVID-19 pandemic also had a negative impact on Montenegro, resulting in a significant decrease in these parameters in 2020 (444,065 foreign tourist arrivals and 2,587,255 overnight stays). The recovery of tourism begins in 2021, where there is a significant increase in both arrivals of foreign tourists and overnight stays, so that in 2022 there are 2,183,975 arrivals, i.e. 12,428,787 overnight stays. It can be stated that there was a clear recovery in the tourism sector in 2022, although it has not yet reached the level of 2019. Based on the quarterly reports of the United Nations World Tourism Organization, Montenegro belongs to the group of countries that have achieved the best results in tourism in the past two years. Montenegro has achieved a significant increase in tourist numbers in 2022 compared to 2020 and 2021, but is also at the top in terms of tourism results achieved compared to numerous other destinations.

After the first year of the outbreak of the coronavirus pandemic (2020) and a sharp decline in tourism revenue, the next two years (2021 and 2022) already saw a recovery in this sector. The rising trend in annual income from tourism indicates that the country's attractiveness as a tourist destination is increasing. However, it is very important to point out two trends - an increase in the total number of foreign tourist arrivals, which is increasing year on year, and a decrease in the total number of domestic tourist arrivals, which has tended to fall annually in the past period.

CONCLUSION

In the coming period, Montenegro should work on improving the business environment and strengthening legal certainty for foreign investors in order to create favorable conditions for investors. This includes reducing bureaucratic procedures, further simplifying the process of company registration, reducing administrative obstacles and improving the efficiency of the judicial system. It is important that Montenegro strengthens its institutional capacity, which is reflected in improving the rule of law, fighting corruption, improving the business environment and creating favorable conditions for investment. Market competition is important as Montenegro needs to continue to develop a competitive environment that supports the private sector and encourages innovation. In this regard, it is necessary to improve the business environment in order to facilitate the establishment and management of businesses, attract investment and promote sustainable growth.

Another possible strategy that would help to attract more foreign investors to Montenegro would be based on stronger tax incentives and concessions. Montenegro could offer more competitive tax incentives and concessions to attract foreign investors. This could include reductions in corporate taxes, incentives for investment in certain sectors and simplification of tax procedures. Among other things, the focus should

be on promoting its investment opportunities internationally. This may include participating in trade fairs, organizing investment conferences and working with investment agencies and diplomatic missions to attract the attention of potential investors. A positive business environment can significantly contribute to making Montenegro an attractive investment destination. If the country actively works on improving all aspects, the result will be an increase in foreign direct investment, which will undoubtedly lead to economic growth, the creation of new jobs and technology transfer.

Tourism is one of the fastest growing economic sectors and the most important sector when it comes to the economic development of Montenegro. It has positive multiplier effects and plays a stabilizing role in the balance of payments, where tourism revenues have successfully contributed to mitigating the negative trade balance with foreign countries for many years. Tourism accounts for 23% of Montenegro's total gross domestic product, making it the most important segment of economic development. Unofficial data show that tourism accounts for up to 40 of GDP, mainly due to undeclared tourists and seasonal workers in the summer months. Accordingly, it is to be expected that in the coming period even more investments will flow into the tourism sector, which will undoubtedly contribute to its development, which will be reflected in an increase in the number of tourist arrivals in Montenegro and thus in the total number of overnight stays by foreign tourists.

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