

July 21, 2020

H.E. Sanja Damjanović  
Minister  
Ministry of Science  
Podgorica, MONTENEGRO

*Montenegro Growth and Jobs  
Comments to Draft Laws on Innovation*

Your Excellency,

I would like to thank you and your colleagues for the productive discussion held on July 9, 2020, to discuss possible World Bank technical assistance regarding the innovation reforms in the country. As part of the discussion, the World Bank team was asked to provide comments on two draft laws currently being finalized, the Draft Law on Innovation Activities and the Draft Law on Incentives for Research and Innovation Development.

We would like to congratulate your team on making progress with these important laws, that will set the foundations for further developing country's innovation system. This builds on some important steps already taken in 2019: Montenegro was the first non-EU member state in the region to adopt a Smart Specialization Strategy (S3); this was followed by establishing the Council for Innovation and Smart Specialization, which was set up in September 2019.

Nevertheless, despite this overall good progress, after reviewing the two draft laws our team would like to flag few important issues that could hinder further successful development of the innovation ecosystem in the country. As the laws will be central in setting the future institutional and regulatory framework in this area, we believe the Ministry should work on addressing a few main issues highlighted in this letter before proceeding with the adoption of the laws:

**Draft Law on Innovation Activities:**

- From the present draft it is not fully clear how will the Council for Innovation and Smart Specialization be coordinated or possibly overlap with other relevant existing councils in particular the Montenegro Scientific Research Council. Proper policy coordination and avoiding overlap of responsibility should be better ensured.

- During earlier discussions with the Ministry of Science the World Bank team indicated that the legal status of the future Innovation Fund of Montenegro should be carefully considered, in particular if public funds from both national and EU sources are going to be received and managed by the Fund as is expected. However, the current version of the draft Law still maintains that the Fund will be incorporated as LLC (not a State Agency), with the only major difference now that the Fund will be owned by the State. That said, the ownership of the Fund will not influence its legal status in terms of type of entity it is. Based on the current draft Law the Fund is expected to receive funding from national budget, EU funds, private sources, donations, shares, profits, etc. However, as the LLC (regardless of its ownership by the MNE Government) the Fund will be considered by the European Commission as a non-public entity, based on "EU Funding & Tenders – Rules on legal entity validation, LEAR appointment and financial capacity assessment" (Version 2.0 from November 6, 2018). This will have direct implications for funding that the future Fund will receive from EU funds. We recommend that these rules should be carefully consulted and considered prior to the final decision of the legal

status of the future Fund. Montenegro is already receiving EU funding and it is expected that in the future EU funding for its innovation activities could significantly increase as the accession process advances. Thus, EU rules should be carefully considered.

- The present draft does not include detailed Governing and Supervision of the future Innovation Fund. Although the governing structure of the Fund will be defined at a later stage, it is strongly advisable that beside the Ministry of Science, the role of the Ministry of Economy and the Ministry of Finance in the supervision of the Fund should be defined in this Law. The involvement of these ministries in the future Fund will also ensure that the appropriate policy mix will be jointly developed, and the entire innovation value chain will be properly covered with the appropriate financial instruments.

#### **Draft Law on Incentives for Research and Innovation Development:**

- Incentives for R&D activities should be part of a well-defined innovation related Policy Mix that should be jointly developed by the Ministry of Science, Ministry of Economy, and the Ministry of Finance. MNE Ministry of Finance should ensure that the proposed Law on Incentives (and the accompanying rule books and by-laws that will follow) are well aligned with the country's main general tax law (in every aspect of the proposed measure) and this should be clearly indicated in the current draft Law. The Ministry of Finance should be fully involved in the design and implementation of the current Law and the accompanying by-laws and it should evaluate possible overall impact, including fiscal, of the proposed interventions. The involvement of the Ministry of Finance should be indicated whenever possible in the draft Law.

- The impact of the proposed R&D incentives as currently outlined in the draft Law could be broad and will be highly sensitive to their design and implementation. As currently defined in the law, the proposed incentives could apply to a very broad range of entities and could include various types of incentives (going beyond taxes only). As such, these could have a significant fiscal impact, yet due to broad range of entities to which they might apply they could have quite limited impact in terms of their main goal of stimulating innovation. In addition to considering narrowing the scope of incentives and defining better eligible costs for the incentives, it is recommended that the MNE Government develops a specific and detailed Rule Book on Tax R&D incentives based on the proposed Law upon its adoption. The Rulebook should outline detailed procedures for application and the principles for its development should be indicated in the draft Law.

- Similarly, it is not clear under which conditions investors in innovation would be eligible for R&D incentives as proposed in the draft. This does not appear to be based on a common international practice. The most common incentives in majority of countries involve incentives on each specific R&D project and directly related issues: machinery and equipment used for R&D; wages, overhead on projects; R&D services, consumables; depreciation, outsourced services; prototypes. In some EU member states the measure applies on buildings.

- The current draft proposes that the Innovation Fund could qualify to receive the tax R&D incentives. It is not clear at all why and how would the Innovation Fund qualify for this measure because it is not Fund's role to perform R&D activity but to provide funding instruments to performers of the R&D and innovation activities. Contrary to this proposed measure, it would be advisable that similar to other countries, the Innovation Fund provides technical support to the Ministry in implementing Tax R&D incentives. The current draft Law proposes that all these activities will be done by the Ministry of Science and as a policy body the Ministry could delegate this technical activity to Fund. Supervision of Fund's work by Ministry of Science, Ministry of Economy and the Ministry of Finance should be ensured.

We would like to note that in addition to these main issues, our team has a number of more specific and technical comments and suggestions. These are provided in the Annexes to this letter.

We hope you find these comments useful as the work on finalizing the draft laws advances. Our team stands ready to continue working with you and your team, both on improving the draft laws, as well as working on subsequent by-laws and other related regulations that will be equally important when it comes to the actual implementation and building of the successful innovation ecosystem in the country. The team also stands at your disposal for any additional information or clarifications.

We would once again like to thank you for the productive and candid dialogue so far and look forward to our continued cooperation on this important agenda.

Sincerely,



Emanuel Salinas  
Country Manager  
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Annex 1: Detailed comments to the Draft Law on Innovation Activities

Annex 2: Detailed comments to the Draft Law on Incentives for Research and Innovation Development

cc.

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