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PUBLIC PROCUREMENT AS DETERMINANT OF COMPETITIVENESS OF THE CONSTRUCTION SECTOR IN MONTENEGRO³

Abstract.

In this paper, the authors analyze the relationship between the public procurement system and the competitiveness of the construction sector. The work is based on the hypothesis that the public procurement system is one of the key determinants of competitiveness of the construction sector in Montenegro, which is reflected in the overall development of the national economy. After analyzing the key features of the current state of the construction sector in Montenegro, the authors identify the particular problems faced by the mentioned sector in the national public procurement procedures, which serves to reduce its competitiveness. The main conclusion reached by writing and researching in this area, is that this issue must be given more detailed attention so the identified problems in the public procurement procedures must be viewed in the broader context of economic and legal consequences which can be caused in this sector.

Keywords: *the construction sector, public procurement, competitiveness, Montenegro...*

1. Introduction

Development of the construction as an industry is a significant part of the economy and the competitiveness of each state and Montenegro as well. Nowadays, it is a very competitive sector in most countries which generates important parts of the GDP and which represents one of capital determinants of foreign direct investments. Although the construction market in Montenegro is quite small compared with other European countries, due to the share of GDP and strategic importance of the development of Montenegro, this market must not be ignored.

The construction sector of a country involves a whole range of economic activities which are compiled and ultimately manifested in the construction of a building. This doesn't refer only to building an object, but also to the production of building material and equipment, so that it can connect more economy sectors through the means of synergetic effect (electro industry, manufacturing the machine parts, chemicals etc). In this way, the construction sector makes a strong influence on the financial sector and mortgage market. Construction is obviously a high

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accumulative industry, not only in the developed countries, but also in the developing ones. Because of all this mentioned above, the development of economic and legal framework is crucial and it corresponds to the development of the construction sector and stimulates it permanently. In that sense, legal regulation that determines this sector has a special significance. Due to multiple specifics, Montenegrin construction sector is quite strictly regulated, making it significantly different from other sectors of the economy. Nevertheless, numerous problems arise in this area in practice. Among a variety of legal acts which regulate this area, the influence of public procurement on the development of the construction sector takes a special place and it is also the subject of this paper. This is particularly so because the construction industry faces various challenges through public procurement and these challenges must be addressed to, because they ultimately effect the level of its development and competitiveness.

Public procurement is the purchase of goods or services by the public sector (Lloyd and McCue, 2004, pp. 2-18). No doubt, in many countries the public sector is the largest buyer of goods and services, and is therefore in a position to influence and develop the field by their behavior in the market. The government can stimulate through public procurement, but also that adversely affects competition to any industry, including the construction sector. The negative effect is manifested through the practice of allowing the creation of public procurement, which limits participation in tender procedures and discriminates against certain bidders. Effective functioning of the public procurement market is considered one of the basic assumptions of improving competitiveness in the European Union (hereinafter: EU), but also at the national level. On the one hand, the regulation of this market is an indicator of the openness of possibility of (in) discrimination. On the other hand, in this way it influences the attraction of investment, reduces corruption and strengthens confidence of the economy in the state administration functioning . All this leads to an increase in the competitiveness of the national economy (Fiorentino, 2006, pp. 848-849.).

Proceeding from the above mentioned, the procurements significantly shape the construction sector and have strong influence on the development and competitiveness of this sector. It is therefore understandable that the construction market is very sensitive to the specificities and possible irregularities in the field of public procurement. Therefore, the authors put forward the hypothesis that the public procurement system is one of the key determinants of competitiveness of the construction sector in Montenegro, which is reflected in the overall development of the national economy. Namely, the tendency to increase the competitiveness of construction has a multiple effect on other industries, increased employment and overall development of the society, which is desirable to make at any time, especially during the turbulent developments and crisis, and what is the actual time in which we live. Therefore, the aim of this paper is to demonstrate how public procurement (de) stimulates the level of development and competitiveness of the Montenegrin construction sector, and what measures should be taken to minimize the more negative impacts of this legislation on the part of the construction sector.

**2. Key characteristics of the construction sector in Montenegro -
Current status and future directions for work**

Construction sector in Montenegro, as one of the vital economic sectors, has reported a significant expansion in the development of several successive years, especially before the onset of the global economic and financial crisis. Economic liberalization and market opening, in terms of creating a favorable investment climate, influenced most strongly to a relatively large inflow of foreign direct investment in this area. In addition, all the more powerful position of Montenegro as an attractive tourist destination, has led to a growing increase in demand for residential and office buildings, primarily by non-residents. This resulted in the emergence of a number of construction companies, but also the need of the state to legally raise this issue to a higher level, to make it more competitive.

The construction sector in Montenegro is characterized by a significant increase in investment in the last decade, mainly in the field of construction and it is dominant in the coastal and central region. This situation is primarily due to the continuous increase in the number of foreign investors, whose number significantly increased in a few successive years (especially in the period between 2005 and 2008), and which applied international trends and standards in Montenegrin construction sector. In addition, the Montenegrin construction industry also features a certain growth of investment in the construction of road networks and other infrastructure, as a result of government strategic investments of capital importance and partnership cooperation with international financial institutions which stimulate this area through a variety of credit and other arrangements.

Along with the rapid development of the construction industry, the process of creating a legal infrastructure in different areas has been intensified, with the aim of encouraging the developing of this sector through the removal of administrative barriers, and also aspirations that this area could be better regulated legally, given that it directly or indirectly touches many other sectors of Montenegrin economy. However, the global financial crisis and a recession across the world resulted in a slowdown of economic growth in Montenegro, and therefore the construction sector. The situation in the construction industry is closely linked with the state of the entire economy. The above mentioned and other reasons have led to the point that the construction sector is facing the problem of lack of liquidity and relative lack of banking support for the implementation of projects that had been initiated, particularly in the housing sector. In addition, there is also the problem of blocked assets in unfinished buildings. All this has affected the complexity of the situation in the area and numerous repercussions that resulted from them. It is obvious that such a relatively small but very open Montenegrin economy cannot avoid the negative effects of the global market, but may seek to minimize their impact as much as possible with appropriate measures of economic and legal policy. In this sense, one of the ways to stimulate the further development of the construction sector is the creation of the public procurement system in a way that encourages them through the development of the overall competitiveness of the national construction sector..

This issue is also treated by the state through the capital document – *The Strategy of the development of construction sector in Montenegro until 2020*, stating that the current state of development, and in particular in the construction sector is characterized by three main phenomena⁴:

- significant increase in the volume of investments in Montenegro until 2008, with a tendency to fall during the global economic crisis;
- modification of the structure of investors, expressed in a dominant share of private foreign investment, as well as investment of realized loans from foreign banks and international financial institutions;
- foreign competition t the domestic market.

According to the above mentioned strategy, the key characteristics of the national construction sector are reflected in the following⁵:

- large number of passive enterprises, much more than those who are constantly active,
- there are no major companies that are sources of development, only a small number of medium-sized companies, and the rest are small businesses,
- uneven regional distribution of construction companies, with the largest number of registered companies in the southern region around the coastal and central region, and with a minimum in the northern region,
- foreign companies are the most represented in this sector, motivated by the market potential with high profit,
- significant share of non-residential construction workers in business construction firms,
- large short-term obligations in the amount of fixed assets, which is likely a guarantee for loans,
- presence of large inventories in business,
- few companies have been certified for quality management systems,
- lack of resources in companies,
- lack of available financial funds,
- unsatisfactory level of mechanical equipment for most companies - outdated equipment and machinery,
- relatively poor and inefficient organization,
- poor and inefficient productivity,
- lack of quality staff - an insufficient number of qualified and highly skilled staff,
- difficulty in obtaining bank guarantees,
- largest number of companies with relatively same kind of offer,
- limited conditions for education through the work of the technical staff,

⁴ *The Strategy of the development of construction sector in Montenegro until 2020*, (2009), The Government of Montenegro, Ministry of Economic Development, Podgorica, p. 54.

⁵ *Ibid*, p. 59-60.

- present insolvency of the contractor's work and clients,
- accumulated losses,
- insufficient development of domestic production of building materials - import dependence of operations.

Previously stated views on the overall state of the economy and the construction sector are confirmed by official statistics, about the structure of the total value of public procurement in the period between 2007 and 2011 and participating of the construction sector in public procurement structure. Namely, between 01.01.-31.12.2011, the commissioners of the Public Procurement Directorate submitted a report to the 5022 procurements whose total value amounts to € 377,260,094.38, or approximately 11.43% of the total gross domestic product⁶. If we observe the share of public procurement in the gross domestic product from 2007 to 2011, we can notice an apparent decrease. In 2007 this percentage was 18.92%, in 2008 it was 16.11%, in 2009 - 14.43% and in 2010 it was 12.14%. In addition, the structure of the total value of public procurement in 2011, supplying goods dominated with 47.65% of all purchases, and then construction works with 32.69%, and services with 19.66%. For the purpose of this presentation, it is necessary to point out the fact that in comparison to 2010, there was a decrease in the share of construction works from 49.74% to 32.69%, and increase in the share of goods from 33.61% to 47.65%. As for services, there was an increase from 16.65% to 19.66%. Without a doubt, the reasons for such data should be sought in current economic crisis, which has a particularly negative impact on the construction sector. It is noticeable that there is a constant decline in the share of construction work in the overall structure since 2007. In fact, in that year the share of construction work in the overall structure was the highest, amounting to 57.99%. Since then, the general trend is to reduce the share of construction work in the overall structure of public procurement (in 2008 it was 56%, in 2009 - 54% and in 2010 - 49.74%).

Taking into account the above mentioned features of the construction sector and the statistical data, we can conclude that not only the crisis is present in construction sector, but according to many it reached its zenith in the last two or three years. After several years of intense growth in this sector, there was an overall decrease in activity, a slowdown or delay of some parts of the announced investments, limited access to credits and increase of the interest rates.

In such conditions of the economic growth and development, it is logical to focus the future investments in the construction industry, in building construction, in the high-class restaurants, refurbishing existing facilities of strategic importance, but also to develop the capacity to carry out manufacture and installation works which are strongly integrated into overall construction activity. On the other hand, constantly insisting on the development of road infrastructure requires strengthening the capacity of civil engineering companies, which is also one of the future activities.

⁶ *Report on public procurement in Montenegro in 2011*, p. 39-51, the Public Procurement Office of Montenegro, available at: www.djn.gov.me

Future development of the construction sector should be based on the desire of the participants in this field to be the carriers or the partners in the realization of the original building solutions, from an idea and design to construction works and finalization of the project. Modern technology, international partners and their experiences, as well as the desire to preserve the environment, possibly due to the devastation of the area affected by the construction, should be the future courses of action in order to strengthen the competitiveness of the national construction sector. In doing so, it is necessary to bear in mind that good results can be expected only in the long term and, with proper support of relevant government and banking institutions, in carrying out various activities in this field.

3. Current problems of public procurement in the construction sector in Montenegro

The legal framework for public procurement in Montenegro is the Law on Public Procurement ("Official Gazette of Montenegro", no. 42/11), which entered into force on January 1st 2012 and the set of regulations. The institutional framework for the implementation of this law comprises of three government bodies - the Ministry of Finance, the Public Procurement Office and the Commission for Public Procurement. The creation of a legal framework for public procurement in Montenegro began in 2001 when it adopted the first Law on Public Procurement. With subsequent adoption of the Law on Public Procurement in 2006, the legal framework has been significantly improved, but it was not in full compliance with the EU law in this area. Also, in practice, many problems arose with the implementation of this legal document. Based on the above mentioned, it can be concluded that the area of public procurement in Montenegro is still in the development stage, and that this issue must be given due attention in the future.

The new law from 2012 has significantly increased the legal framework for the implementation of public procurement procedures. The official report of the European Commission is the confirmation of the preceding paragraph through which the progress of Montenegro to the EU and other relevant international organizations monitoring the area are assessed. For example, the Report on the assessment of the public procurement system by the European Bank for Reconstruction and Development emphasizes the improvement in the public procurement system. According to this report, in terms of quality of legislative public procurement and its compliance with EU standards, Montenegro is ranked first in the region of the Balkan countries and Turkey, and it took the second place in the overall competition (after Hungary). Particularly the results in regard to the indicators of reliability, competitiveness and cost-effectiveness of procedures got very high grades. Regarding the institutional framework, Montenegro also occupies a high position, and showed by far the best results in terms of communication between clients and vendors in the preparation and evaluation of tenders and access to the record bid evaluation (European Bank for Reconstruction and Development, *Public Procurement Assessment - Review of laws and practice in the EBRD region*, available at: <http://www.ujn.gov.me>). In addition to this, other reports of the international institutions speak positively about the public procurement system in Montenegro. So, for example, in a regular Report of the European Commission on the progress of Montenegro towards the

European Union, detailed attention is paid to the issue of public procurement. According to this document, the general principles of public procurement in the domestic market have been incorporated into the Montenegrin legislation (European Commission, *Analytical Report - Commission Opinion on Montenegro's application for membership in the European Union*, Brussels, 2011, page 36., available at: <http://www.mip.gov.me>).

However, despite these positive ratings, experience in the application of this law, especially in the construction sector, points to some weaknesses that must be analyzed and corrected in order to improve this area. For this reason, the paper will show the key gaps in the system of public procurement from the perspective of the construction sector which affect the competitiveness of these areas, but the overall competitiveness of the national economy as well.

First – the work of the institutions that implement public procurement system. Despite efforts to increase efficiency in the work, these bodies - mostly due to lack of administrative and professional capacities, are an obstacle to improving overall public procurement system. The biggest complaint in the areas related to the construction sector, is the lack of adequate communication. This issue is particularly important due to the fact that the nature of specific procedures in the construction industry requires constant communication and availability of information regarding the rules and procedures of public procurement. Unfortunately, the lack of administration also means objective inability to respond to all requests. *Second* -the disregard of basic principles of public procurement by the bidders in practice. Namely, The Law on Public Procurement is based on four basic principles - the principle of cost-effectiveness and efficiency in the use of public funds (Article 5), the principle of ensuring competition (Article 6), the principle of transparency in the public procurement procedure (Article 7) and the principle of equality (Article . 8). For example, the principles of economy and efficiency in the use of public funds, the nature of construction, the total estimated value are often exceeded, and given that purchasers do not adequately specify the required works and services, the offer is cheaper at the time of delivery, and in the end it turns out to be more expensive than others. Violation of the principle of equal treatment of bidders in practice is reflected in the fact that some construction companies have a monopoly on construction sites. Similar to the above, the transparency principle is not respected in practice when, for example, a purchaser, because of the nature of work, foresees the negotiated procedure without prior publication of a contract notice. In the end, the principle of equality can be broken in such a way that potential bidders do not have equal treatment in terms of access to relevant information. *Third* - the use of discretion rights of the ordering party to determine himself the public procurement procedure in accordance with the value rank. In practice, it happens that bidders choose the negotiated procedure without prior publication of a contract notice, which hampers the development of competitiveness. *Fourth* - the issue of proving the fulfillment of the mandatory and optional conditions in public procurement. One of the mandatory conditions for participation in the procurement procedure is the proof of registration with the competent authority for registration (Art. 66, para. 1). In public procurement procedures, the reported bidders are frequently registered in the Central Registry of companies, whose main or prevailing activity is not the construction work. This fact would have no impact

if they do not often rejected offers due to non-compliance with this condition. It happens especially in the practice of public procurement whose subject is construction works - the other controversial mandatory requirements are permits, licenses, approvals, or other documents in accordance with the law. The authority in charge of the construction works is Engineers Chamber of Montenegro, which issues all the necessary licenses for construction works. However, in practice... it "turns a blind eye" with this clause for a number of clients and allows delivery of various licenses issued by other bodies, which violates the principle of equality between the parties in the proceedings. Also, applying the provision of evidence of professional technical and human resources in the public procurement of works causes confusion in practice. *Fifth* - the criteria for selecting the best offer. No doubt, in practice the implementation of public procurement procedures there may be situations that favor certain bidders, or disqualify the others, through (not) meeting the above criteria. *Sixth* - the work of the Commission for opening and evaluation of bids. Often in practice the implementation of public procurement procedures and above mentioned committee members did not have the expertise to effectively carry out inspection, assessment and safety evaluation of tenders. This fact is particularly evident in the actions of the construction work, which are complex in nature. *Seventh* - the lack of knowledge of the law by the bidders and the lack of information about their rights in practice. This fact leads to two situations in practice that are just as bad: 1) sometimes the privileges of the law are not used even if they are violated, 2) when the intended rights are not used, they are carried out without any legal basis, and requests are often denied. Above mentioned is significant because the an appeal process is a cost for bidders, as the review of the process by the Commission for Public Procurement is paid in the amount of 1% of the total value of the public procurement. *Eighth* - the issue of financial security (guarantee) in public procurement procedures. For bidders the guarantee is the cost and it is security for the customer. Given the often high estimated value of construction work, the cost and the amount (of money) that bidders have deposited as collateral with the bank, in a separate account is high, and that cannot be disposed until the end of proceedings. From the perspective of the economic logic of the bidder, this is a barrier that reduces its liquidity and competitiveness. *Ninth* - breaking deadlines and disrespect of other contractual obligations. This issue is particularly important in the construction sector, due to the complexity of the obligations assumed by the construction company. The European Commission, in its report for 2011 specifically stated that monitoring of the signed contracts must be improved (European Commission, *Analytical Report - Commission Opinion on Montenegro's application for membership in the European Union*, Brussels, 2011, page 35., available at: <http://www.mip.gov.me>). *Tenth* - non-performance of work according to the standards in the construction industry. In some cases, providers take advantage of the purchasers' ignorance and frequently do not perform the contracted construction work professionally and efficiently, according to the technical documentation. *Eleventh* - the issue of ensuring the construction work. Contractors are required to ensure that all the work at their own expense against any damage that may occur from start to handover. However, ordering parties have no access to insurance policy in a number of cases. *Twelfth* - there are cases when the offers of certain bidders are accepted, but it is not in accordance with the invitation to public bidding. In the end, we can see that there is still lack of awareness in this area, even among the lawyers themselves. Therefore, in the future we need to work on vocational

training in this area. One potential solution to overcome all these problems is the involvement of experts hired by ordering parties in public procurement procedures.

4. Concluding Remarks

Construction in Montenegro is seen as an economic sector that has great potential. However, one should bear in mind that the future economic growth and development of the construction sector are to a large extent determined by the capabilities of the new investment, which have been significantly reduced under the influence of the current world economic and financial crisis. Potential investors access to this area with much more caution. It is logical to expect that the greatest influence on the development of construction is certainly from investments in tourism, infrastructure, housing and energy. Construction is increasingly attractive area of the economy, not only for domestic but also for foreign investors, it is thus necessary to create favorable conditions for the realization of investments in this area through the creation of an adequate legal framework. One of the prerequisites for long-term development of construction in Montenegro are construction companies (enterprises), which should be properly territorially dispersed, on a high organizational and technical level and with raised educational level of employees. It also means that for the optimal development of Montenegrin construction sector and strengthening its competitiveness – it is necessary to ensure continuous knowledge transfer, permanent education of staff and their maximum contribution.

Total public procurement system in Montenegro has significantly improved with the adoption of the new Law on Public Procurement. However, the problems in the application of this legal act from the perspective of the construction sector which are analyzed in this paper represent a business barrier that affects the competitiveness of the industry. Without a doubt, through the further improvement of the public procurement system, the state can influence the improvement of the competitiveness of the construction sector. In this regard, the positive steps that have been made by adopting the new law should be continued through its enforcement and correction of problems identified in practice. Finally, to improve the system of public procurement in the future will, undoubtedly lead the process of accession of Montenegro to the EU. And not just through the harmonization with the EU, but also through the provision of implementing the law in national practice. In the end, the relevant institutions that follow the process of accession to the European Union will push this issue, and it will lead to improvements in the overall level of competitiveness of the construction sector in Montenegro.

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