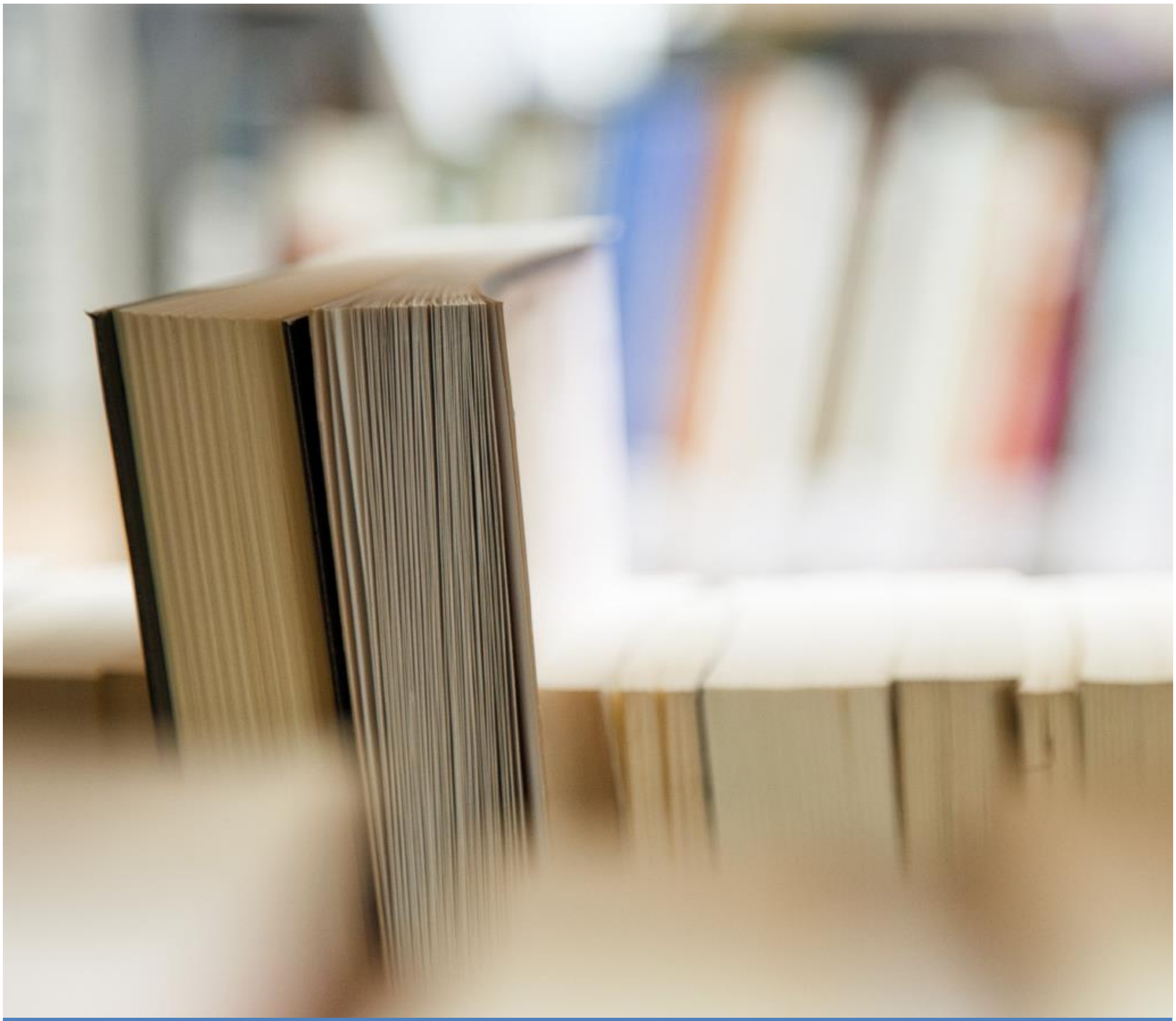

# Country briefing

# Montenegro

CSOs as equal partners in monitoring public finances

April 2016

BALKAN MONITORING PUBLIC FINANCES

www.wings-of-hope.ba

# CREDITS

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This document has been produced as a part of the project "CSOs as equal partners in the monitoring of public finance", which started beginning of 2016 and is implemented by a consortium of 10 organizations from 7 countries and will last for four years.

The aim of the project is to improve the transparency and accountability of policy and decision making in the area of public finances through strengthening the role and voice of NGOs in monitoring the institutions that operate in the area of public finances. In this way, the project will strengthen CSO knowledge of public finance and IFIs and improve CSO capacities for monitoring. Additionally, it will help advocate for transparency, accountability and effectiveness from public institutions in public finance. Moreover, this project will build know-how in advocating for sustainability, transparency and accountability of public finance and IFIs. This project will also increase networking and cooperation of CSOs on monitoring of public finance at regional and EU level. Lastly, it will increase the understanding of the media and wider public of the challenges in public finance and the impacts of IFIs.

Key project activities are research and monitoring, advocacy, capacity building and transfer of knowledge/practices and networking in the field of the 4 specific topics: public debt, public-private partnerships, tax justice and public infrastructure.

More information about the project can be found on [http://wings-of-hope.ba/balkan-monitoring-public-finance/](http://wings-of-hope.ba/balkan-monitoring-public-finance/) and on the Facebook Page Balkan Monitoring Public Finances



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# CONTENT





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# EXECUTIVE SUMMARY

Montenegro as a country significantly burdened by corruption faces significant economic challenges in the upcoming years.

Current and projected GDP growth is not enough to cover significantly increasing public debt, which is currently estimated at 66,5% of the GDP and with further increasing trend, due to expected highway construction. This is the reason why Montenegrin sovereign rating was decreased in 2016, with additional negative outlook in future. Trade balance of Montenegro continues to be negative, with over 480 million of Euros of deficit in 2015.

On the other hand, it is estimated that one third of the working population is fully or partially in gray economy, due to weak rule of law, inadequate regulatory framework, insufficient and ineffective implementation of policies and laws and relatively high business costs, which is causing significant loss of income for the State.

At least 8,6% of the population lives in the extreme poverty, while available data in this field are extremely outdated. In addition, according to the newer data held by the UN, at least 10% of the youngest population lives in poverty. Poverty is a special problem in the northern region of Montenegro, which is economically less developed then the rest of the country, and where poverty rates are significantly higher.



Unemployment rate in Montenegro for 2015 was 17,6%. Unemployment rates in the north are around two times greater than the national average and citizens there have limited access to public services. This reflects an internal problem within the country, namely regional development disparity.

Montenegrin economic development is primarily oriented towards foreign direct investments (FDI) and economy of services, especially tourism. Unfortunately, in recent years, participation of the FDIs in the GDP is decreasing. Until 2010 it was above 20% (with over 30% peek in 2009), while from 2011 it is dropping, and in 2014 it was barely above 10%.

Value Added Tax in Montenegro is 19%, while its reduced rates go to 7% and 0% for some goods and services. Tax rate of 9% and 11% are applied for monthly personal incomes, depending on its value. Corporate Tax in Montenegro is 9% of respective income.

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In 2015, VAT constituted for the highest share of tax revenues, around 20% of the total, at the amount slightly over 437 million euros. Revenues from Personal Income Tax scored above 104 million euros, while Corporate Tax revenues were 42 million euros. Customs Administration contributed to the Montenegrin 2015 budget with over 192 million euros.

Montenegro has reached agreements with 41 countries on elimination of the double taxation.

Key problems in infrastructure in Montenegro are construction of irrationally expensive highway, which is undermining entire fiscal stability of Montenegro, as well as extensive investments in energy sector, which has no adequate economic rationale, including energy objects constructed and owned by private entities close to the leadership of the ruling party.



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# MACROECONOMIC OUTLOOK

## Gross Domestic Product

Montenegrin GDP growth rate is quite controversial issues, since official data differ from one available at our international counterparts. Therefore, according to MONSTAT, GDP growth in 2015 was 3,4%[i] while according to the World Bank it was 3,2%[ii].

During previous five years, in three Montenegro had GDP growth above 3%, once it was below 2% and in 2012 it was negative, at the rate of -2.7%.

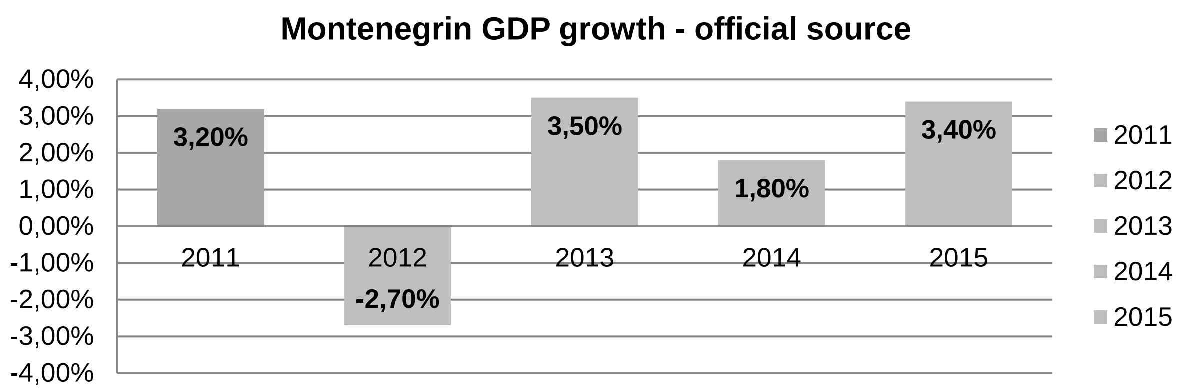


*Chart 1: Montenegrin GDP growth in the period 2011 – 2015 according to the official data*
*Source: Montenegrin Statistical Bureau - MONSTAT*[iii]

Estimated GDP growth in 2016, according to the EBRD projections will be 4% while in 2017 it is projected to 3%.[iv]

## Public debt

Public debt of Montenegro significantly increased in previous years – from 20% of the GDP in 2008 to 60% in 2014.[v] Currently public debt is 2,3 billion Euros, or 61.83% of the GDP according to the official data of the Finance Ministry.[vi] However, estimation of the Government is that the public debt will be 66,5% of the GDP by the end of 2016.[vii]

One of key reasons for significant public debt increase is construction of the highway in Montenegro, which is perceived as problematic, due to risks of overrun costs, as well as potential currency risks associated with this project, which is the reason Moody's downgraded Montenegrin sovereign rating to B1, with additional negative outlook in future.[viii]

In, addition, European Commission emphasized that "rapidly rising public debt and high fiscal deficits, together with high external imbalances and high unemployment are of concern".[ix]

## Inflation

Inflation rate in Montenegro in 2015 was 1,5% according to the World Bank.[x] In March 2016 inflation rate became negative, and in the first seven months of the current year remained flat.[xi]

## Euroization

National currency of Montenegro is Euro. Montenegro introduced German Deutschmarks as a parallel national currency together with Serbian Dinar in 1999. Since January 2001 Deutschmark was the only national currency, till Euro was introduced from June 2002.



## Trade balance

Montenegrin economy, with tourism as key income generator, is highly import oriented. Therefore, each year, trade balance is very negative. According to the Central Bank data, trade balance deficit in 2015 was almost 500 million euro. During last five years, it newer went below 480 million euro, as shown in the table below.

| TRADE BALANCE (EUR) | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|
| | -573,381,000 | -587,644,000 | -486,634,000 | -525,765,000 | -482,796,000 |
| **1. Goods** | **-1,306,246,000** | **-1,389,204,000** | **-1,328,624,000** | **-1,376,404,000** | **-1,463,517,000** |
| 1.1. Export | 476,547,000 | 391,861,000 | 395,712,000 | 357,496,000 | 325,286,000 |
| 1.2. Import | 1,782,793,000 | 1,781,065,000 | 1,724,335,000 | 1,733,900,000 | 1,788,803,000 |
| **2. Services** | **589,262,000** | **612,253,000** | **653,229,000** | **690,345,000** | **789,156,000** |
| 2.1. Revenues | 906,050,000 | 997,569,000 | 994,418,000 | 1,030,642,000 | 1,213,924,000 |
| 2.2. Expenditures | 316,788,000 | 385,316,000 | 341,189,000 | 340,297,000 | 424,768,000 |
| **3. Primary income** | **26,269,000** | **53,827,000** | **65,544,000** | **45,901,000** | **92,803,000** |
| 3.1. Revenues | 192,822,000 | 206,220,000 | 212,668,000 | 226,093,000 | 247,699,000 |
| 3.2. Expenditures | 166,553,000 | 152,393,000 | 147,124,000 | 180,192,000 | 154,896,000 |
| **4. Secondary income** | **117,334,000** | **135,480,000** | **123,217,000** | **114,393,000** | **98,762,000** |
| 4.1. Revenues | 155,840,000 | 179,700,000 | 187,810,000 | 184,074,000 | 171,866,000 |
| 4.2. Expenditures | 38,506,000 | 44,220,000 | 64,593,000 | 69,681,000 | 73,104,000 |

*Table 1: Trade balance of Montenegro from 2011 to 2015*
*Source: Central Bank of Montenegro*[xii]



**Grey economy**

According to the information coming from Business sector, grey economy represents big problem in Montenegro.[xiii] According to the conducted surveys, as well as official data, at least one third of working population is partially[xiv] or fully informally employed.[xv] Key causes of the grey economy in Montenegro are weak rule of law, inadequate regulatory framework, insufficient and ineffective implementation of policies and laws and relatively high business costs.[xvi]

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# SOCIAL INDICATORS

## Poverty

Official data of Montenegro on poverty are very outdated. Last available information shows that in 2013 in extreme poverty lived 8,6% of the population, while the national absolute poverty line was 186,45 Euro monthly, per grown up person. At the same year, Gini coefficient was 26,2.[xvii] In the year before, absolute poverty line was four Euros lower, but much higher percentage of population, 11,3% in total, was living in the extreme poverty conditions. In the year of 2012, Gini coefficient was 26,5.[xviii]

In addition, children poverty is a matter of concern, since according to the UN data, 10% of the youngest population lives in poverty, however relative and not extreme one.[xix] In addition, according to the data of The Borgen Project poverty rate in the northern region of Montenegro averages at around 10.3 percent poverty rates.[xx]

## Unemployment



According to MONSTAT unemployment rate in Montenegro for 2015 was 17,6%. For the first nine months of 2016 unemployment rate was 17,8%.[xxi] In addition, data of the Central Bank show that in 2015 over175 thousand persons were employed, while over 34 thousand did not have any employment. In the first 10 months of the 2016 number of employed raised for over two thousand, but number of unemployed persons was higher for over seven thousand.[xxii] Unemployment rates in the north, according to The Borgen Project are around two times greater than the national average and citizens there have limited access to public services. This reflects an internal problem within the country, namely regional development disparity.[xxiii]

## Drop in foreign direct investments

Montenegrin economic development is primarily oriented towards foreign direct investments (FDI) and economy of services, especially tourism. From 2007 till 2014 FDIs were participating from 30% to slightly above 10% of the GDP. Unfortunately, in recent years, participation of the FDIs in the GDP is decreasing. Until 2010 it was above 20% (with over 30% peek in 2009), while from 2011 it is dropping, and in 2014 it was barely above 10%.[xxiv]

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# TAX JUSTICE

## Taxation in Montenegro

Value Added Tax in Montenegro is 19%, while its reduced rates go to 7% and 0% for some goods and services. In Montenegro, tax rate of 9% is applied for monthly personal gross income below EUR 720 per month, and tax rate of 11% for income above that amount. Corporate Tax in Montenegro is 9% of respective income.

## Tax institutions

Tax Administration of Montenegro is an executive authority, under the Ministry of Finance, that implements tax legislation. In 2015, VAT constituted for the highest share of tax revenues, around 20% of the total, at the amount slightly over 437 million euros.[xxv]

Revenues from Personal Income Tax scored above 104 million euros, while Corporate Tax revenues were 42 million euros.[xxvi]



Customs Administration contributed to the Montenegrin 2015 budget with excises taxes worth over 170 million euros, and taxes on the international trade and transactions worth more than 22 million euros.[xxvii]

## Double taxation treaties

Since its independence in 2006, Montenegro has reached agreements with 41 countries on elimination of the double taxation, including vast majority of neighboring countries such as Albania, Bosnia and Herzegovina, Croatia, Italy and Serbia.[xxviii]

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# CORRUPTION VS DEVELOPMENT

## Corruption perception

According to Transparency International Global Corruption Perception Index for 2015 which covers 168 countries, Montenegro is ranked on 61 place, with the index 44.

## Doing Business in Montenegro

In its 2016 Doing Business report, the World Bank ranked Montenegro in the 46th place out of 189 countries. According to the World Bank, Montenegro has made continued efforts to improve its business environment.

Compared with other countries in the region, Montenegro stands worse than Macedonia (12th place), Bulgaria (38th place) and Croatia (40th place), while it is better compared to Serbia (59th place) and Bosnia and Herzegovina (79th place)[xxix]



## Public employment expenditure

Montenegro has politicized and extensive public service, which is the reason why one of key priorities of our country is to effectively address the de-politicization of public service and right-sizing of the state administration.[xxx] While nepotism and political orientation play a crucial role in appointment in public employment, alongside corruption cases – which have been documented via a series of media reports – Montenegrin situation with the state being the main employer is a matter of serious concern.

In total, over 52 thousand people were employed in the Montenegrin public sector at the end of 2015 out of which 41 thousand at the central level, and remaining 11 thousand in municipalities.[xxxi] Just at the central level, in 2015, expenditures for wages and benefits in public sector were over 396 million Euros.[xxxii]

Prior to 2016 Parliamentary Elections, Montenegro adopted Law on Salaries of Employees in Public Sector in February[xxxiii], raising salaries of civil servants and public officials. However, after elections

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have been held, in December 2016 the same ruling majority amended the Law and decreased salaries[xxxiv], justifying that with need to decrease public debt and increase fiscal stability of the country.

Just in the pre-election period in 2016 over 1500 persons were employed in the public sector at the central and local level.[xxxv]



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# INFRASTRUCTURE AND RELATED PUBLIC INVESTMENT

## Construction

The biggest infrastructure project in the history of Montenegro is highway "Bar – Boljare", which construction formally started in on May 11th, 2015. However, only construction of the first out of three phases of the highway has been agreed so far, which will be built by China Road and Bridge Corporation (CRBC) and China Communications Construction Company (CCCC), with obligation that at least 30% of works is performed by subcontracted Montenegrin companies.[xxxvi] The first phase of the highway will be financed from the loan Government of Montenegro agreed with the The Export-Import Bank of China (EXIM Bank) on October 30th, 2014 with the interest rate of 2%, total payment time of 240 months, including grace period of 72 months.[xxxvii]

Although the official currency in Montenegro is Euro, and all payments for construction of the highway will be done in Euros, the loan itself was indexed in US dollars. At the time of signing, the loan was worth almost 944 million US dollars, which at that time was over 809 million Euro needed to finance the first phase of the highway. [xxxviii] However, just due to the increase of the US dollar value compared to Euro since the loan contract was signed, Montenegro's loan in practice will be over 139 million Euro higher, and our country did not ensure any protection from currency fluctuation.[xxxix]

In addition, this highly problematic construction deal with Chinese companies includes, according to the law, for the purpose of the highway construction, full deliberation from paying VAT, personal income taxes and benefits for workers, capital income tax and all custom taxes and fees on imported goods needed for implementation of the project.

In May 2016, Moody's downgraded Montenegrin sovereign rating to B1, with negative outlook, due to, among other things - fiscal risks related to the highway project, which will increase the government's debt-to-GDP ratio and cost overruns of the highway project that could push the debt burden even higher, thereby reducing the country's shock absorption capacity further.[xl]

In addition, Montenegro spent over 127 million Euro in 2015 for different constructions through the public procurement system.[xli]



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## Energy

Until 2009 Montenegro imported significant amounts of electricity. However, since 2010 this deficit has closed due to the continuous decline of operation of the main electricity consumer – Aluminum Plant in Podgorica (KAP) which has at times accounted for up to 40 percent of the country's electricity consumption.[xlii] In addition, on January 1st, 2015 Montenegro entered regional energy market, enabling KAP to import needed electricity, which increased country's energy surplus.

During the Berlusconi era the Montenegrin government made deals with Italy to construct an **undersea electricity cable** between the two countries and selected Italian company A2A as shareholder and manager of state-owned electricity generation company EPCG. [xliii]

This, one billion Euro worth project[xliv] is made for exporting electricity from Montenegro to Italy. This project obviously encouraged the Government and EPCG to undergo a number of problematic projects in the area of constructing new energy sources.

Government's plan to build second block of the coal-fired energy plant in city of Pljevlja goes against EU climate and nature protection requirements.[xlv] Namely, new facility would increase existing ash waste and water pollution from the current plant, as well as CO2 emission, which would cause additional health problems to citizens of this Montenegrin city, which are already facing serious health issues. Sole construction and equipment installation of this object would cost around 350 million Euros, while overall investment expenses would go over one billion Euros. In addition, estimations are that healthcare and environment protection costs of the 40 years life cycle of the new plant are over 2,5 billion Euro, meaning that the real overall costs of this investment would exceed 3,5 billion Euro, which is absurd for Montenegrin fiscal and financial situation.[xlvi]



In addition, building of several private small hydro plants have been initiated, with significant financial aid from the State. Namely, Montenegro had obligation from the EU accession to ensure at least 20% of energy produced comes from renewable energy sources, therefore had to subsidies construction of such objects. However, currently, participation of energy from renewable sources in the overall balance is over one third, and construction of the new renewables still goes on. Key problem with those unneeded infrastructure projects is the fact that vast majority of them were developed by companies close to former Prime Minister and leader of the ruling party Milo Djukanovic, which are owned either by his son, godfather or close business associates. These companies have guaranteed repurchase of all produced energy by the EPCG, guaranteed price which is significantly higher than one produced by the EPCG which is all in the end paid by citizens through the electricity bills. Actually, there is a separate item on electricity bills defining obligation of the consumers to pay "incentive for production of energy from renewable sources". As such, this represents de facto a significant state aid and goes against Stabilization and Association Agreement Montenegro signed with the EU.[xlvii] In addition, there is no information on the overall cost of such aid provided to private companies constructing small hydro plants.

Moreover, building of 26 wind power plants finished in 2016, worth in total 120 million Euros[xlviii], are also to be funded by citizens through electricity bills, since the investor got guaranteed price of the electricity from the EPCG which is two times higher than electricity produces by the EPCG itself, for the next 20 years.



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# PUBLIC-PRIVATE PARTNERSHIP (PPP)

Monenegro has no separate Law on Public Private Partnership, and this act is currently under preparation.[xlix]

Currently, over 40 sector laws regulate cooperation between the public and private sectors in the provision of public services. Bearing in mind that there is no legal act which regulates the area of public-private partnership (PPP), the institutional framework for the implementation of PPP has not been established and there is no authority which would approve and secure assistance in the preparation of projects and which would monitor the enforcement of contracts. At the national level, the Council for privatization and capital projects determines which facilities and business entities are to be privatised via public tender, through stock market sale or via PPP. Until now, implementation of PPP has not been subject to systematic planning, while the national plan for the development of this area is yet to be adopted.[l]

However, there are announcements from the Government that many important future infrastructure operations will be conducted through PPPs, such as second and/or third phase of the highway, worth billions of euros, which is why Montenegro urgently needs legal and institutional framework in this field.



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