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Weekly Briefing

Montenegro Economy briefing:

Economy developments in Montenegro

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Introduction

Despite some current economic challenges, it seems pertinent to say that comparing to the rest of the countries in the WB Montenegro had undergone the most successful economic transition through which it not only defied some significant geo-economic limitations, but has also managed to climb atop of the regional economies. During the Yugoslav period, Montenegro was part of undeveloped South (low rate of investment, underdeveloped infrastructure, scarce raw materials), with small population to support urbanization and industrialization, heavy reliance on federal subsidies and few, federal-directed industrial capabilities (literally few companies in mining, metal processing, machinery and energy sector). With the break-up of Yugoslavia, those companies mostly lost their markets so during the long stagnation period in the 90s, besides feeble and embargo stricken service sector, whole source of revenue for small Montenegro relied on the black market.

When Djukanovic took control over the ruling DPS in 1997, he launched a set of reforms which aimed at loosed financial and capital market control by severing economic ties with Serbia, gradual economic independence and EU sponsored economic transition. In neoliberalist manner he sought fiscal and economic independence from Belgrade and envisaged Montenegrin prosperity through investment boom that should follow economic independence. The undertone of this ‘brave step ahead’ was a reliance on ‘basic Malthusianism’ (the fact that the country`s size and its geo-economic position coupled with a small population could ‘naturally’ bring high growth rates), keeping the grip over seriously swollen public sector through fiscal injections that arrived from the revenues in smuggling business (controlled by Djukanovic`s oligopoly in the 90`s) or some state-proxy FDI (since the private FDI was virtually non-existent), and the EU sponsored monetary (adoption of DEM as legal tender) and medium-termed plans for macroeconomic reforms (including the fast-tracking the privatization of some SOE, introduction of VAT, cutting the foreign debt and sort of extensive-based measures to curb unemployment).

As it was expected, after the independence Montenegro has experienced real estate boom. In 2008, Montenegro received more FDI per capita than any other nation in Europe. Soon, the government made deridingly called "Monegasque agenda", a long-term plan which sought to balance FDI revenue and gradually transform Montenegro`s economy in service sector dominated, with tourism as the main revenue. Efforts have been made to attract the foreign investors into tourist greenfield investments (Porto Montenegro, Kumbor, Velika Plaza, Ada Bojana) and in a large infrastructure projects to facilitate tourist development (Bar-Boljare motorway, Port of Bar modernization, Adriatic motorway, etc.)

However, the recession that hit Europe in 2009, made the impact on Montenegrin economy. First, it was experienced directly through decreased rate of the inbound FDI. Montenegro was losing European and Russian investors and real-estate prices in attractive coastal area have dropped significantly. At the same time, big developing projects and construction sector experienced a big backdrop. Second, some of the persisting structural problems, such as small and overly rentier-based private sector, lack of non-service sector investments became more ubiquitous. Third, huge public sector and employment programs that has been so far sustained with investment boom backfired and together with the first problems in the privatization of the state-owned enterprises (KAP, Niksic Steel Mill) created significant social problems. These problems augmented the dilemma between the fiscal austerity and the public spending the Montenegrin government faced ever since.

Bar-Boljare highway project

This dilemma seemed to be put aside with the biggest infrastructure project Montenegro has undertaken since the independence – Bar- Boljare highway. In 2009, Montenegrin government made a tender for this EUR 2.7 billion worth project connecting Port of Bar with Serbian border. The highway construction has been the signature project of DPS administration that significantly exceeded Montenegro`s budget and downsized its credit repayment ratings. To be fair enough, the government was seeking the creditor for a more than six years, so the contract made with Chinese Exim Bank in 2014 came as an 'once in the lifetime' opportunity to regain the leverage on the recession ridden economy.

However, aside from objections regarding the financial model of the project ("Chinese package": 2% interest rate, 6 years of grace period, 20 years return period), many political actors objected the fact that it was a project that neglected a more urgent project for infrastructural development (as the Adriatic-Ionian corridor connecting Montenegro with Albania in the south, and BiH and Croatia in the northwest is seen as far more important for Montenegro`s economy); a project that was carried out undemocratically as there was never a public deliberation even though it concerned the first public highway in the country; a project that was economically unjustified, as it involved investing millions of Euros without the clear prospects of return, and moreover, it involved high opportunity cost or "missed chance" for a more lucrative projects.

On the other hand, despite some complaints related to the project deadlines, there is a rather strong 'tacit expectation' that the project should incite positive wave across the whole economy, reverse economic and demographic decline of the North region and to enhance Montenegro`s connectivity with the region. However, due to the financial capacities of Montenegro, signing any other capital project in the near future will be too big bite and the government prepares the list of infrastructure projects that are based on concessions or public-private partnerships.

Keeping the grip over public sector and/ or austerity measures

The current government inherited a rather unfavourable cumulative trends: sluggish growth rate that was mostly based on the service sector and tourism, persisting high structural unemployment, significantly higher debt-to-budget ratio (66.1% as of the end 2016) due to unsustainable government spending and credit line for infrastructure project “Bar-Boljare”, and, lastly, some leftovers of the failed welfare policy. First, the failed privatizations of some big SOEs (KAP, Niksic Steel Mill, etc.) created an expanding ‘small army’ of unemployables that frequently staged protests and posed continuous upward pressure on the government`s distributive role. Also, there is welfare payout obligation to the “Mothers of 3+” that stemmed from the irresponsible buying of “social peace” in 2016 had to be withdrawn in the first months of 2017 and soon backfired with the hunger strikes of ‘Mothers’ in front of the government building.

Despite some contours of the new economic approach visible in a budget proposal for 2018, there is still no coherent strategy – or courage – to proceed with spending cuts, and there has been less coherent synergy of governmental actors in pursuing austerity measures. So far, the Central Bank has warned the government to be more expedient in the budget cuts, while the new government is holding a low-profile and a conservative approach as far as the tacking the failed welfare policies is concerned. For one, the Markovic government agreed to comply with the instructions from the international financial institutions (IMF and WB - also its main creditors) to implement a set of austerity measures that will curb government spending and adjust tax revenue system. According to several amendments to budget proposal, Finance Ministry will coordinate actions with the Central Bank and international institutions to adjust and increase the tax burden. Mainly, it will mean increasing VAT rate from 19% to 21%. However, judging from several motions to amend the budget proposal, the government was very reluctant to strike additional burden, especially due to the shrinking middle class that will be the most sensitive on the change. Also, to increase the tax revenue it went on to beaten path of previous governments and from January 2018 imposed extra levies on consumption of tobacco, alcohol and oil.

As the government had to immediately tackle some inherited capital projects, in particular “Bar-Boljare” highway project, privatization or restructuring of the debt-generating SOEs (Montenegro Airlines) and a few urban construction projects, its performance has been so far inconsistent at best. It wanted to curtail further financial leakages by employing more productive measures to either restructure maintenance costs or halt further spending (especially in the construction sector), yet the fear of losing the grip over public sector has deterred the government to pursue radical measures in debt-generating SOEs. This has shown an early tension between the government`s pro-austerity stance and long-term reliance on extensive public spending to maintain the stability of the public sector.

Carrying on 'Monegasque agenda'

If one looks at the economic agenda of the new government, it is clear that the government has no plans to do a lot of experiments with the main source of the income, i.e. tourism-based service industry. Since the independence, it was only sector that have consistently registered the growth rates, with total revenue in 2017 expected to exceed EUR 1 billion. The government plans to continue and perhaps expand the sponsored programs that seek FDI through direct concessions and PPPs. It unveiled an ambitious vison to lease several attractive coastal locations where the foreign investors would develop high-end resorts. Hence, it can be said, it mainly refurbished some of the past "ideas" on sustainable reliance on 'total tourism', i.e. given the size of the population (circa 650 000) and diverse tourist potential, the idea that Montenegro should count on year turnover that could amount to 15-20% of GDP. The government made some plans to expand and develop transportation and accommodation infrastructure in the North, primarily through foreign financing and partnerships. However, some of its first moves after the obtaining consecutive term was to cater capital investors that had previously expressed intention for the development of exclusive resort, hotels and other tourist facilities. In terms of the provision of tourist service, Montenegro has always had problem with highly unequal and undiversified tourist infrastructure, the consequences of which are felt by majority of the citizens – with only a few being able to ripe the benefits of the 'coast gentrification'. However, with the less favourable concession terms and given the limited size of the coastal line, the 'Monegasque agenda' i.e. existing consensus the government reached with the public on "selling out" some of the most attractive tourist locations is also reaching its limits.