China-CEE Institute
中国—中东欧研究院

ISSN: 2560-1601

Vol. 5, No. 2 (ME)

March 2018

Weekly Briefing

Montenegro Economy briefing:

Economy developments in Montenegro

Ivica Bakota

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.

Szerkesztésért felelős személy: Chen Xin

Kiadásért felelős személy: Huang Ping

1052 Budapest Petőfi Sándor utca 11.

+36 1 5858 690

office@china-cee.eu

china-cee.eu

Introduction

As a WB country with the best record track in negotiations with the European Commission, Montenegro serves as a good example for implementation of economic and structural reforms. However, a great deal more is still needed to complete the important 33rd Chapter on Financial and Budgetary provisions, for which the government and the Central Bank joined the efforts to make a substantial progress by the end of the current term. There are no big changes in furthering the reforms on 32nd Chapter related to financial control, which is currently under "moderately prepared" status. However, based on progress in institutional, legal, and policy settings – opening chapters related to the free movement of goods, workers and services in 2017 - Montenegro will continue to make regional headway towards the EU accession.

On a parallel track, Montenegro intensified regional cooperation. In July 2017, Montenegro participated on the Fourth Summit of WB states in Trieste (aka Berlin Process) which gave an impetus to accelerate trade, customs, infrastructural cooperation with Serbia, Bosnia and Herzegovina and Albania. Nevertheless, this process is still not emancipated from the EU sponsorship so the progress in furthering regional economic integration as well as the multilateral negotiations in removing administrative obstacles still haven't brought many tangible results.

In macroeconomic terms, Montenegro economy is still considered as transitioning market economy in a "post 2008 crisis" period. In 2017, GDP growth continued a year-long post-crisis revival (around 3%) largely due to large capital investment (Bar-Boljare highway) and continuing a double-digit hike in service (mainly tourism and tourist-dependent services) sector, both reflecting the generally positive trends in the WB area. In the last two years, real growth rates gradually increased in tourism with increased demand for tourist-dependent services. However, due to a staggering public debt, low productivity in mostly stagnant manufacturing sector and volatile service sector

Montenegro`s economy despite a slow recovery path is yet to leave the post-crisis period. As the previous report gave an account on tourist-based economy, this report will concentrate on the success in tackling the first two structural problems.

Public debt and budget re-adjustments

Since the Markovic government stepped in late 2016, there is growing awareness of (un)sustainable public debt generated by foreign borrowing (mostly for capital investments and budget servicing). The IMF and the EU institutions have been at the forefront of the efforts to curb further public spending, urging the government to spend “less but better” on current budget obligations and more proactively engage in budget reprograming. As a direct result of the measures to accomplish fiscal consolidation, but more likely giving a free hand to IMF and the World Bank to direct the debt and deficit reprograming, Montenegro`s credit ratings started to register positive change. In October 2017, Standard& Poor`s readjusted the credit rating from B- to B+, emphasizing government`s efforts to decrease the public debt by 2020 and generally positive environment for investment as the main improvements.

As mentioned in the previous report, incumbent government showed not very eager stance in setting austerity measures and is more reliant on international creditors for the financial strategy in the next period. According to Finance Minister (former Board Director in “Prva Bank”) Darko Radunovic, detailed strategy for fiscal consolidation and debt restructuring is emerging, following extensive and multiple consultations with international creditors, private sector representatives and, most importantly, political partners within the government. The strategy for fiscal consolidation entails three points: First, maintaining stable economic growth by the set of policy reforms aiming to improve the impact of service-based (mostly tourist sector) SMEs on overall economic growth and job creation for the long term. Second, to join the efforts with the Central Bank in order to alleviate existing bottlenecks and outstanding

obligations on the current account and, if possible, finish the fiscal year without deficit on current account. Third, to substantially enhance environment for the growth of the real sector – transform system of subsidies to SOEs and/ or support their privatizations on "sustainable basis" and link them with the private sector to create more effective, coherent, and competitive systems.

On the other hand, the government had more problems in fixing the cap on foreign borrowing and, so far, was not consistent in proclaimed austerity regarding the budget servicing. In December, on parliamentary hearing for 2018 and 2017 budget readjustments, Finance Minister Radunovic defended the budget projection within 2 billion EUR, which is insignificantly lower than 2017 budget, with some more optimistic projections regarding the GDP growth (4.4%), overall growth (3%) and foreign borrowing (around 280 million EUR, out of which only approximately 140 million is for servicing loans for capital investments). He claimed that not only current obligations in public sector and towards the foreign creditors are calculated in the projection, but the rise of welfare payouts (pensions and outstanding social welfare) will be also under projected limit. Nevertheless, a couple of days ago (March 8) MoF announced that the government will "go out on the foreign market" and according to the budget readjustments, will borrow 500 million EUR. A clear evidence that hasty makeshifts took place of budget planning were revealed when Finance Minister couldn't provide an answer how would allegedly downsized interest rates on Eurobonds (through which the government plans to realize most of the borrowing) reflect on budget saving.

The opposition didn't spare a moment to criticize the readjustment. According to DF`s Medojevic, this is a clear sign that the government has no feasible solution to finance the growth but to "borrow more money" or to return to the black market and finance the current account deficit with "smuggling dough". Former DEMOS leader Lekic went even further to accuse the government of intentionally misleading the public while continuing to nourish kleptocratic system it created.

Low productivity difficulties: privatization or re-nationalization

In the context of the recent economic downturn, Montenegro was especially vulnerable as a relatively small and service-based economy exposed to foreign markets. In order to have more grip on the economy, successive government cabinets professed increased investment in domestic productivity as a "counter-cyclical instrument to secure new sources of growth". However, being a small economy at the initial stage of the transition, it was broadly believed that TINA solution for Montenegro`s productivity is to resort to "privatization model". Comparatively speaking, Montenegro was neither the only country that experimented with the privatization nor the only country where state-led privatization project completely failed. The difference, however, was the size and scale of Montenegro`s economy and the fact that each time privatized capital tried to exploit the limited capacity its of Montenegro`s economy it had social and political consequences deeper than expected. Coming too late to reverse the privatization failures, the government mostly "re-nationalized" the control over the former SOEs as well as their debts, outstanding loans and obligations towards the workers. On top of that, the government spent a great deal of energy trying to decrease the pressure coming from disgruntled workers and circumvent public scrutiny from dubious deals through which the privatizations were offset at the first place.

Apart from Aluminum plant of Podgorica (KAP) and Niksic Steel Mill, the third "big deal" privatization was Montenegro`s Electric Company (EPCG). In 2009, prior to Montenegrin parliamentary elections, the government announced to sell off "non-controlling package" in EPCG. The 430 million EUR bid by Italian A2A was accepted for 41.7% shares even though Greek electric corporation made initial bid 30% higher for approximately same number of shares. The deal was widely rumored to be a concession Djukanovic made to one of the companies under Berlusconi`s business clout in return for political

support. A2A agreed to have a “lock-up” shares with a provision to activate so called “put-option” towards the main shareholder, i.e. government.

Within a few years the frictions between the government and the Italian shareholder came close to the withdrawal of the latter. Newly appointed management was also rumored to engage in embezzlement of company`s property assets. The main “stumbling block” however was the financing the construction of the second unit of TE Pljevlja thermal plant, the biggest coal-fired power station and supplier of a third of state`s electricity. The second unit was envisaged to replace the existing one (to be phased out in 10 years) and boost existing power capacity and use more efficient means to decrease the impact on environment. The construction of the second unit entailed political, environmental, communal, but mostly, economic concerns as 366 million EUR (according to government estimation in 2013) would be too risky investment.

From 2014 onwards, government negotiated the safe withdrawal of A2A using “put-option”. However, due to largely non-transparent process of negotiations, there are only speculations regarding the legal difficulties the government encountered with the Italian shareholder, the amount that should be paid in order to retrieve the full share control, as well as the impact some small individual shareholders (Aco Djukanovic, older brother of Milo Djukanovic) have on the process. In December 2017, Minister of Economy Dragica Sekulic claimed that the government has negotiated 230 million EUR as a ‘withdrawal fee’ with A2A, triggering suspicions in the public because the amount is significantly lower than initial share package. Notwithstanding the “success” in put-option negotiations, there are concerns that the government won`t be able to find international creditor (even for 230 million EUR) without significant budget readjustments and breaking debt solving commitments.

In parallel, the government is having difficulties finding alone the main financier for the TE Pljevlja project. In January 2018, Czech Skoda Group was written off as potential investor since it couldn`t find bank guarantees after the Czech Export Bank withdrew from the project. In spite of re-emphasized

commitment from the government to find an investor (with solid bank support), the project is in “preparation stage” more than five years, while given the current public debt rate the chances for the government to find international creditor are more slimmer. Unless, the government activates “Chinese option” again. Of the three shortlisted offers for the project, the other two are coming from China Machinery Engineering Corporation (CMEC) and Powerchina Hubei Electric Power Survey, both with admittedly solid financial backing. Although the signal from the EU might not be favorable to the “Chinese option” (just as it was for highway construction project), the lack of financial alternatives coupled with political urgency might determine the contractor (or even shareholder) being Chinese company.