



Evropski pokret
Crna Gora

“EUROBLOK” COALITION

PROJECT:
**“STRENGTHENING CIVIL SOCIETY CAPACITIES TO CONTRIBUTE
TO THE EUROPEAN INTEGRATION AND ACCESSION PROCESS”**

Policy Study

STATE AID IN MONTENEGRO

Bisera Turković, LL.M.



Podgorica, July 2012

This project has been financially supported by the European Union. This study has been produced with the financial assistance of the European Union. The contents of the document are the sole responsibility of EMIM and can under no circumstances be regarded as reflecting the position of the European Union.



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Publisher

European Movement in Montenegro

For the publisher

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Design and printing

Studio Mouse - Podgorica

Circulation

50

Translation of all studies produced within the project “Strengthening of the capacities of civil society to contribute to the European integration and accession process” has been financially supported by the **British Embassy Podgorica**.

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Introduction

What is state aid?

State aid is any form of aid granted from public revenues on selective basis to a specific market participant, placing such participant into a preferential position, which undermines or may undermine free competition in the market.

Aids may be in the form of public expenditures or reduced revenues, but their common feature is that they place a specific economic entity, product or service in a preferential position and thus threat to undermine not only market competition within the country of the donor, but also regional and international trade. The funds given from public revenues may be the resources of the state, local community or a legal entity that manages the state or local funds. One of the basic features of the state aid is selectiveness, meaning that assistance is not equally accessible to all participants in the market, whether such selection is made based on geographic advantage, economic sector, type of a company or individually at the discretion of the of the donor.

Specific types of public donations do not belong to the state aid realm just for the reason that they lack the element of adverse effect on competition, and they are mostly investments, or reduction of revenues of the donor of the state aid that are carried out on the market principles that do not provide the beneficiary with economic advantage, then investing in infrastructure of general use that is not in exclusive interest of one economic entity, purchase and sale of immovable property at properly determined market price, then the state guarantee for the loan of the beneficiary that meets detailed conditions of solvency and good business standing.

Some types of state aid have no adverse effect on competition, or if they do, their positive effects exceed such adverse effects. Such aid is considered allowed in most EU countries, with clear regulation of conditions for its granting and control of use. Allowed state aids

are mostly intended for improvement of economic development of certain areas or regions that are insufficiently developed, elimination of serious disruptions in economy, improvement of development of specific economic activities or specific areas, preservation of cultural and historical heritage, various uses of social character, elimination of damages caused by natural disasters or emergency circumstances; performance of tasks of public interest to the extent required for performance of such tasks and the like.

State aid in Montenegro

State aid in Montenegro was regulated for the first time by the Law on Control of State Support and Aid (Official Gazette of the Republic of Montenegro 26/07), while the current Law on the Control of State Aid was adopted in 2009 for the purpose of harmonisation with the rules of the European Union concerning state aid, and additionally harmonised by the Law on Amendments to the Law on Control of State Aid adopted on 17 November 2011.

Circumstances in Montenegro in the past were such that the control of the state aid was not paid significant attention. Given that planned economy which dominated on the territory of former Yugoslavia which originated even from the period of the SFRY, a large number of companies remained under state ownership until recently. Many of them had monopolistic position, and some still do, which implied significantly lower level of competition in the market. The process of privatisation and partial deregulation resulted in new problems of restructuring, and a number of privatised companies due to unsuccessful privatisation still represent burden for the state and threat to jeopardise its financial stability by excessive increase of the public debt.

The first comprehensive report on the situation in the area of state aid in Montenegro was produced in 2005 for the period 2003-2004, then the following one for the period 2005-2006, and since then regular annual reports have been produced.

By signing of the Stabilisation and Association Agreement on 15 October 2007, Montenegro committed to fully harmonise its state aid related regulations with the EU rules, which is specified in Article 73, paragraph iii, as well as special Protocol V which regulates state aid for steel industry as a particularly sensitive sector of the Montenegrin economy. Thus, it became necessary to adjust those state aids that had already existed at the moment of assuming the harmonisation obligation, for which purpose the State Aid Control Commission produced the Programme of Harmonisation of the Existent State Aids that was adopted by the Government of Montenegro which also passed a conclusion imposing an obligation on line ministries to harmonise the regulations from the Programme with the measures proposed by the Commission. The Programme identified regulations based on which state aid is granted, which came into effect prior to signing of the SAA and continued to be valid after the provisions from Interim Agreement came into force. The Programme clearly specifies the manner in which such regulations should be harmonised with the obligations under the SAA.

The Government of Montenegro detailed the obligations undertaken by the SAA in the National Programme of Integration of Montenegro in the European Union for the period 2008-2012, namely in Chapter 3.8.2.

The essence of the reform of the state aid structure in Montenegro is the need to reduce the share of sectoral assistance, which has the greatest impact on competition, and to increase



the share of horizontal state aid, in particular the aid intended for small and medium size enterprises, employment, innovations and environmental protection. Such process is also greatly hampered by the financial crisis, which together with bad privatisation results led to the requirement for large allocations for rescue of companies, primarily in the sector of metal production (steel and aluminium), which failed to result in expected effects. Now, resolving of such problems requires primarily political will, great expertise in forecasting effects on Montenegrin economy of each possible scenario, and strategy for resolving social problems that may arise as side effects.

In the course of several months during which this study was developed and transformed from a presented working document into the final version, some improvements also took place. The State Aid Control Commission passed several new decisions, of which one on partial refund of state aid, and some secondary legislative acts have been amended, and novelties have been included in the findings of this study.

Research goals and methodology

The goal of this Study is to provide an overview of the situation in the area of state aid control in Montenegro in light of fulfilling the obligations stipulated by the Stabilisation and Association Agreement (SAA). Such overview comprises the analysis of the legal and institutional framework, as well as the application of regulations in practice by competent authorities.

In addition to the assessment of the harmonisation of the legal and institutional framework, it will be considered what the most significant problems are in the area of state aid control, both from the aspect of the system and the issue of existing state aids that are problematic in view of compliance with the EU regulations or that are threatening to become problematic in the coming period and be challenging for Montenegro in the negotiating process in respect of the Chapter no. 8 concerning competition policy.

Methodological base of this study comprises factual and legal analysis of the harmonisation of Montenegrin regulations regarding state aid with relevant EU rules and obligations envisaged by the SAA. For this purpose, the Montenegrin law on State Aid Control and relevant regulations and rulebooks passed for its implementation have been analysed. On the other side, the provisions of the Treaty on the Functioning of the European Union and the most significant secondary legislation have been analysed. For comparison purposes, the provisions of the most important regulations of the Republic of Croatia in this area have been analysed too.

In addition, in-depth interviews have been carried out with the representatives of the relevant bodies¹ dealing with state aid control, as well as the competent and interested ministries, state aid donors, economic sector, and foreign and domestic experts for the area of state aid who have been monitoring this area in Montenegro for a specific number of years.

In the course of developing the study, the research of public opinion was carried out with the focus on business sector, where the state aid knowledge was measured as well as the awareness of the rules and options for applying for specific state aids, and the perception of the quality of the state aid control in Montenegro.

1 Schedule

The following is what this study will assess and based on what conclusions and recommendations will be drawn up:

- Existence of a relevant legal framework (including the law and all secondary regulations and guidelines) and their compliance with the EU rules;
- Institutional framework and procedures for granting and approving state aid, including institutional design, administrative capacities and independence of such bodies, and the scope of their competencies;
- Observance of the EU principles and methodology in the area of state aid;
- Resolving of cases in practice and existence and application of sanctions;
- State aid structure in Montenegro.

Note: The Study does not comprise the area of liberalization, i.e. companies entrusted with special rights.

1

LEGAL FRAMEWORK

EU regulations on state aid and their function

Rules on state aid control in the European Union primarily have a function to protect single internal market. Illegal and non-compliant state aid may place specific business entities, sectors or regions in advantageous economic position over their competitors, not justified by realistic market attributes of those entities. Furthermore, this may artificially maintain in life non-functioning and non-profitable enterprises, which may distort the economy of the member state and consequently, due to tight economic links in the single market and spill-over effect, the economy of other member states and the entire Union.

Due to that reason, the control of state aid is primarily governed by the Treaty on the Functioning of the European Union (TFEU), specifically Articles 107 and 108. Article 107 establishes general incompliance with the Union law of those state aids which distort or threaten to distort competition, and it also stipulates which state aids are exempted from such prohibition, as well as which may be exempted provided that meet certain requirements. Aids allowed *per se* are those having social character and granted to individual beneficiaries, provided they are granted without discrimination related to the origin of the products concerned; aids to make good the damage caused by natural disasters or exceptional occurrences; and aids covered by a rather archaic provision allowing the support for certain areas in the Federal Republic of Germany, for the purpose of mitigating disadvantages caused by the past division of Germany. On the other hand, paragraph 3 of Article 107 covers areas of state aid which *may be* considered to be compatible with the Treaty, and those are: aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment; aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest; and under the same conditions aid could be granted to promote culture and heritage conservation. The Council retains the right to approve other categories of aid upon proposal from the Commission.

Article 108 stipulates the procedure for application of Article 107, as well as the discretionary right of the Council to derogate Article 107 and to declare certain aid to be in compliance with the Union law, upon request of the member state.

Implementation of Articles 107 and 108 is governed by individual secondary regulations adopted by the Council upon proposal from the Commission and in consultation with the European Parliament. Two Protocols to the TFEU² are important for implementation of these Articles, and those are the Protocol No 26 on services of general interest and the

² Treaty on the Functioning of the European Union

Protocol No 27 on the internal market and competition.

Regulations for application of the state aid rules are: the Council Regulation No 659/1999, the Commission Regulation No 794/2004 implementing the previous Regulation, the Council Regulation No 994/98 concerning certain horizontal aid, the Commission Regulation No 1998/2006 governing *de minimis* aid; the Commission Regulation No 800/2008 stipulating group exemptions, as well as other Regulations, Directives, Guidelines, notifications and other secondary legislation governing aid at the time of financial crisis, certain horizontal aid, aid for small and medium-sized enterprises, employment training, regional aid, etc. Particular important is the area of regulations governing state aid to specific sensitive sectors, such are: agriculture, fisheries, telecommunications, radio broadcasting, sectors of coal and steel, energy, shipbuilding and transport.

Montenegro's commitments from the SAA

Obligations of Montenegro in the process of stabilisation and association concerning the state aid are stipulated by Article 73 of the SAA, and the Protocol 5 on state aid to the steel industry, as well as by Article 24 of the SAA governing special aid for agriculture and fishery.

Harmonisation of legislation

Montenegro's obligations from the SAA are concerning the harmonisation of legislation, i.e. establishment of a legal framework for the state aid control and implementation of such regulations, on one side, and the provision of appropriate institutional framework that will perform the state aid control activities, on the other side. The objective of legal framework harmonisation is the adoption of the law and secondary legislation to enable evaluation of state aid according to the criteria contained in the Lisbon Treaty and secondary legalisation of the EU.

Article 73 (iii) of the SAA stipulates that proper functioning of the Agreement, to the extent that can affect trade between the Communities and Montenegro is incompatible with *any State aid which distorts or threatens to distort competition by favouring certain undertakings or certain products*.

Paragraph 2 of this Article stipulates that any practices contrary to this Article are to be assessed on the basis of criteria arising from the application of the competition rules applicable in the Community, and, in the case of state aid, in particular Articles 86 and 87 of the EC Treaty (now Article 106 and 107 of the Treaty on the Functioning of the European Union – TFEU) and interpretative instruments adopted by the Community institutions.

Montenegro also undertook to prepare a comprehensive inventory of aid programs instituted before an independent authority for state aid control was established and to align such aid programs with the criteria referred to in paragraph 2 within a period of no more than 4 years from the entry into force of this Agreement.

Montenegro and the EU have agreed that during the first five years after the entry into force of this Agreement, any public aid granted by Montenegro shall be assessed taking into account the fact that Montenegro shall be regarded as an area identical to those areas of the Community described in Article 87(3) (a) of the EC Treaty, being one of the low standard of living and high unemployment.



Within four years from the entry into force of this Agreement, Montenegro shall submit to the European Commission its GDP per capita figures harmonised at NUTS II level. The authority for state aid control and the European Commission shall then jointly evaluate eligibility of the regions of Montenegro as well as the maximum aid intensities in relation thereto in order to draw up the regional aid map on the basis of the relevant Community guidelines.

Protocol 5 sets the rules on state aid in the steel industry. This Protocol establishes rules to be applied in case the restructuring aid is granted to the steel industry, empathising special character of such aid, as well as the fact that the aid would be limited in time and linked with the reduced capacities within viability program. The aid to this sector is conditional upon the development of a National Restructuring Plan, as well as individual business plans for each company granted with aid.

One of the important requirements is the one stipulated in paragraph 3, which deals with transparency to be ensured by the Community, on one side, and Montenegro, on the other, in the area of state aid by submitting regular annual report or similar document to another party, amongst others, using the methodology and presentation of the Community's overviews of state aid. Such reporting is accompanied with the obligation of Montenegro to provide information on specific state aid case upon request of the EU.

Administrative capacities

Montenegro's commitment under the SAA, in terms of the institutional framework, is to establish operationally independent authority which is entrusted with the powers necessary for the full state aid control and so within one year from the date of entry into force of this Agreement.³ This authority shall have, inter alia, the powers to authorise State aid programs and individual aid, as well as the powers to order the recovery of State aid that has been unlawfully granted. SAA is not specific in terms of what should be the structure and composition of such authority, or the manner of appointment of its members, the only requirement being its operational independence.

Meeting obligations from the SAA and NPI priorities

In order to meet obligations from the SAA, in June 2008, the Government of Montenegro adopted a strategic document called the National Plan for Integration of Montenegro in the European Union (NPI). NPI is developed as a five-year plan of activities (2008-2012) which are to be implemented in order for Montenegro to be ready to assume the membership obligations, and included political criteria, economic criteria, ability to assume the EU membership obligations, administrative and judicial capacities, national version of the *acquis*, as well as financial assessment for the NPI implementation. Unfortunately, after its adoption in 2008, the NPI has never been updated, even though it was envisaged to do it annually based on the results of monitoring of its implementation. This is the reason why today it is not sufficiently relevant for comparison, since the dynamics of the process was different from the one envisaged at the time of its adoption, however, we will address commitments imposed by it.

Present situation and plan of activities for the state aid were covered at the time by Chap-

³ SAA, Article 73, paragraph 4

ter 3.8.2, part of Chapter 3.8 – Competition Policy. Less than two pages cover the State aid status, followed by short-term and medium-term priorities, employment plan and financial needs.

As far as the short-term priorities are concerned, those were implemented in line with the NPI. Secondary legislation for implementation of the Law on State Aid Control was envisaged for adoption, and the following were adopted: Decree on detailed criteria, conditions and manner of awarding state aid (Official Gazette of Montenegro, No 27/10 and 34/11); Decree on the Manner and Procedure for Submission of State Aid Application (Official Gazette of Montenegro, No 27/10 and 34/11); Decree on the Manner of Keeping Records on State Aid (Official Gazette of Montenegro, No 27/10 and 34/11); and Rulebook on the Content of Annual Report on Awarded State Aid (Official Gazette of Montenegro, No 31/10 and 22/12). These regulations are harmonised to a large degree with relevant secondary legislation of the EU, but state aid for specific sectors needs either more detailed regulation, if possible by separate pieces of secondary legislation, or the system of transposition of individual EU regulations into our legal system on the other side.

Capacities of the Division for State Aid Preparation within the Ministry of Finance were not sufficiently strengthened and are insufficient for the successful performance of all tasks assigned to this body in the forthcoming period. Transparency was increased through regular publication of annual reports of the State Aid Control Commission, decisions on the website of the Commission, as well as of the Inventory of State Aid Awarded, and it needs to be further strengthened, in particular concerning the level of information about state aid matters within the state authorities.

Employment Plan envisaged for the State Aid Control Commission to have 7 members at any time. However, that number was increased to 9 by the Law from 2007, to be reduced to 5 by the Amendments to the same Law in December 2011, which we believe is not sufficiently for effective decisions to be made about such complex matters. Number of employees in the Division for State Aid Preparation is 4, which is one more than the planned number.

It could be stated that the short-term priorities under the NPI were met, while the medium-term priority is set rather vaguely as “continued strengthening of the state aid framework” and further harmonisation of legislation and implementation of the EU standards in order to align with the EU market competition rules, thus it is difficult to quantify if those were met or not, but it is safe to say that job in this area is not yet done and it will require constant work for further alignment of the legal framework, especially in light of coming changes in the EU rules; capacity strengthening of the Commission and the Division for State Aid Preparation, as well raising awareness with other state authorities about the need not only to control legality of state aid but also to ensure that it is meaningful and efficiently allocated, as well as to apply good practices of the EU member states. It is expected that the new National Program for the Adoption of the European Union Acquis (NPAA), expected to be adopted in the autumn of 2012, would specify more precisely further objectives and priorities for improvement of the state aid control system.



Montenegrin legislation on state aid

The first law in Montenegro to govern the general requirements for the state aid preparation, award and control was the Law on Control of State Support and Aid (*Official Gazette of the Republic of Montenegro*, No 26/07). The objective of this Law was application of the market economy principles and protection of competition, and it was partially aligned with the EU rules on the state aid. Present Law on State Aid Control was adopted on 9 November 2009 (*Official Gazette of Montenegro*, No 74/09), and it is further harmonised by the Law on Amendments and Supplements to the Law on State Aid Control Adopted on 17 November 2011.

Law on State Aid Control

The Law on State Aid Control (*Official Gazette of Montenegro*, No 74/09, 57/11) is the second Law adopted by Montenegro in this field, which was revised by the Law on Amendments of Law on State Aid Control in November of last year in order to achieve better harmonisation with the EU rules in the field of state aid.

This Law, as it is stated in Article 1, governs the conditions and the procedure for granting and controlling the use of state aid, by applying the principles of market economy, preservation of competition and ensuring transparency in fulfilling the obligations assumed under ratified international treaties. The areas to which the state aid does not apply are those intended to promote the development of agriculture and fisheries, in line with the EU rules where these areas are also treated by separate regulations.

Since the state aid is defined in Article 2 as “expenditures, reduced revenues or reduced assets of the State or municipality that distort or may distort free competition in the market and that may affect the trade between Montenegro and the European Community or a member state of the Central European Free Trade Agreement (CEFTA) by conferring a more favourable market position on certain economic entities, products or services”, and Article 4 prohibits such aid that distorts or may distort free competition in the market, we may derive general prohibition of state aid, which is in line with Article 107 of the TFEU declaring such aid as incompatible with the internal market. In the same Article, the Law states that exceptions to the prohibition will be the aid permitted under this Law, as well as the aid not considered to be the state aid within the meaning of this Law. Such aids are listed in Article 5 and those are:

- 1) Investment or reduction of revenues of the state aid provider on the basis of *market principles*⁴, that do not provide the beneficiary with an economic advantage;
- 2) Investment of the provider of the infrastructure in *general use*, if the construction of such infrastructure is not in exclusive interest of the economic entity;
- 3) Purchase and sale of immovable property by the state aid provider, if a purchase/sale price is determined on the *market principles*, by an auction and on the basis of an appraisal of independent appraiser;
- 4) State guarantee for beneficiary’s loan, which did not show in financial reports in two years preceding the issue of guarantee increase in losses, reduction of revenues, increase of inventory, reduction of cash inflow, increase in indebtedness and reduction of asset value, provided that:

4 Italic B.T.

- Loan beneficiary may obtain a loan under market conditions on the financial market;
- State guarantee is provided for a defined amount of credit, for a defined period of time;
- Amount of guarantee does not cover more than 80% of the credit liability;
- Guarantee is based on the market price.

In addition to listed schemes not considered to be the state aid, the Law also envisages the aid which in exceptional cases may be excluded from the prohibition if directed towards the following purposes:

- 1) Improvement of the economic development of Montenegro;
- 2) Removal of serious disturbances in the economy of Montenegro;
- 3) Improved development of certain economic activities or certain regions in Montenegro, where such aid does not significantly affect market conditions and competition in the market;
- 4) Preservation of cultural and historical heritage;
- 5) Purposes having a social character, granted to individual consumers, under equal conditions;
- 6) Mitigation of damages caused by natural disasters or exceptional circumstances;
- 7) Implementation of activities of public interest in performing economic activities delegated to legal persons to an extent necessary for carrying out such activities.

The listed exceptions are in line with the exceptions envisaged as permitted under Article 107, paragraph 2 of the TFEU, or envisaged as possible exceptions under Article 107, paragraph 3 of the TFEU. A Decree of the Government of Montenegro prescribes more detailed criteria, conditions and manner for granting state aid, which will be discussed below.

In addition to the listed provisions, the Law in its first part of General provisions defines meaning of specific terms as used in the Law, and then lists explicitly forms in which state aid may be granted, even though the list is endless, and defines reference interest rate and subsidy equivalent. Part II of the Law includes the provisions governing the State Aid Control Commission, which will be discussed in more details in the segment addressing the institutional framework. Part III governs the procedure for reporting and control of the state aid use. The Law establishes an obligation to report to the Commission on every proposal for state aid and prohibits granting of the aid until the Commission decides about the compliance of aid with the Law, which is adherence with the *standstill principle*. After the reporting party reports a state aid scheme or individual state aid, the Commission may adopt a conclusion that the aid is not considered to be state aid, decision on compliance of aid with the Law, decision that aid is not permitted, or in case that aid is not in compliance with the Law but still permitted, it may set a period for reaching compliance, and once expired in case of failure to comply – a decision on incompliance.

Articles 20 and 21 of this Law are of particular importance, as they deal with authorisations of the Commission to act *ex officio* and to gather information and decide in cases of irregularities in granting and using state aid. If the Commission suspects that aid is granted or used contrary to the rules, it is entitled to request information from the provider, and even to temporarily suspend the granting of state aid if it evaluates that there



is danger of distorting market competition. In the event that the aid provider fails to submit the requested data, the Commission is entitled to make a decision on the basis of the available data. Maybe one of the key Articles of this Law, in terms of the Commission's authorisations, is Article 21 which stipulates that if the Commission during the control procedure determines irregularities in granting and using of state aid, it gives a deadline within which the state aid provider is obliged to remedy the established irregularities and notify the Commission in writing thereof. If the state aid provider fails to remove the established irregularities within the specified deadline, the Commission adopts the decision on incompliance of the state aid with this Law, where it may order the state aid provider to take measures, without delay to refund the granted amount of the state aid and to suspend further granting of unused portion of the state aid.

If the state aid provider fails to take the measures referred to in paragraph 3 of this Article within the specified deadline, the Commission shall inform the Government or competent local self-government authority, and propose measures that should be taken.

The problem with this Article is that it leaves room for subsequent co-validation of aid granted without notification if the provider remedies irregularities within a specified deadline. Subsequent co-validation of state aid not initially granted and used in line with the rules is a bad practice which reduces efficiency of the provision that any aid must be reported *ex ante*, should be used only in exceptional circumstances, while stating relevant justification for untimely notification and possibly additional provisions which would stipulate the refund of certain portion of aid which was awarded contrary to law.

Main objections of the EC concerning the Law from 2009 were dealing with inability for third party, interested party to lodge a complaint⁵, as well as absence of explicit provision stipulating the finality of decisions of the Commission, even though such decisions were *de facto* of such nature, as claimed by authorities.

Due to the above stated reasons, in cooperation with the EU experts working on the project providing technical support under an IPA project, the Law on Amendments to the Law on State Aid Control was prepared and adopted on 17 November 2011. The main change instituted by this Law is the right of interested parties (i.e. third parties) to act before the Commission for the purpose of submitting information and documentation about the state aid which they deem was granted against the law or is used against the law or outside of intended purpose. The Commission is obliged to decide upon such complaint, after statement of the provider in question or in case of the provider's silence based on available data. Interested party is defined as a state aid beneficiary or legal or natural person or association thereof that may have its interests affected by the state aid.

Another positive addition is paragraph 7 added to Article 19, which stipulates that decisions of the Commission are final and that an administrative dispute may be initiated against them. One area that remains unregulated is what the rights of an interested third party are in case of "silence" of the Commission, i.e. if the Commission fails to decide upon complaint within the set deadline. Entities that have lodged a complaint in such a case have a right to initiate an administrative dispute according to Article 241 of the Law on Administrative Procedure, but the question remains if such right belongs to a party based on whose information the Commission initiated an *ex officio* procedure, if it does not have a legal capacity to sue and be a party in a dispute.

⁵ Analytical Report accompanying the Opinion on Montenegro's Application for the European Union membership

Introduction of the term “existing state aid” creates differentiation between the aid in effect before the entry into force of the Interim Agreement on Trade and Trade-Related Matters on 1 January 2008 and remaining in force as such and those granted after that date. This division is important in the context of Montenegro’s obligation from the SAA⁶ to prepare a comprehensive inventory of the aid granted before the establishment of an independent authority for aid control and to align regulations based on which the aid is awarded in line with the rules on state aid within 4 years from the effective date of that Agreement (1 January 2012).

One of the less positive new items instituted by the Law on Amendments is the reduction of the Commission members number from nine to five members. Shortcomings of this provision will be discussed in more details in the chapter on institutional framework.

Secondary legislation

The Decree on detailed criteria, conditions and manner of awarding state aid (Official Gazette of Montenegro, No 27/10, 34/11), adopted on 8 April 2010 and amended on 16 June 2011, is the most important piece of secondary legislation for the implementation of state aid regulations in Montenegro. It contains general provisions on compliance of the award and use of state aid with the Decree and Article 73 (iii) of the SAA, as well as the provision on the manner of calculating subsidy equivalent for loans with interest rates lower than market rates, for deferred tax payments, as well as for guarantees issued by the state or local self-governments.

In its second part, the Decree contains rules on horizontal state aid, as follows:

- For regional development support (state aid for initial investments, justified costs for opening new jobs, state aid for large-scale investment regional development projects, and operational state aid for business organisations);
- State aid for research, development, and innovation;
- State aid for business organisations with difficulties (aid for rescue and aid for restructuring);
- State aid for environmental protection;
- State aid for training and professional development;
- State aid for employment in the form of wage subsidies;
- State aid to small and medium-sized enterprises;
- State aid for culture;
- State aid as compensation for public services.

In its third part, the Decree defines the aid to specific sectors and covers the rules on state aid for closing steel mills, winding down permanently the production of steel products, closing a steel mill under control of another business organisation operating in the steel production sector, aid to steel mills in line with horizontal objectives; aid for coal production, shipbuilding (modernisation of shipyards, closing, in form of export loan, or in line with horizontal objectives); land and railroad transport, combined transport, construction

⁶ SAA, Article 73, paragraph 6



of port infrastructure, and air transport activities. A possibility for state aid to be provided in the form of special state aid instrument is also provided. That is, for example, export aid in form of guarantees for export loans (insurance against non-market risks), while it is not allowed to grant aid to business organisation for subsidising export and current export costs.

The Decree also stipulates that provisions concerning aid for regional development to large business organisations will be in application until the end of this year, i.e. until 31 December 2012. The Decree is harmonised with the EU rules, the only objection referring to insufficient details on rules for granting sectoral aid. Also, provisions for determining reference interest rate in cases of state aid refund are missing.

The Decree on the Manner and Procedure for Submission of State Aid Application (Official Gazette of Montenegro, No 27/10, 34/11) stipulates the manner and required documentation for submission of a scheme or individual state aid instrument. Along with the completed form and scheme/project of individual aid, the applicant also submits financial statement with balance sheet of the beneficiary for previous three years. Missing element in this framework for submission of state aid application is indicator of state aid justifiability being provided and its expected effects, in accordance with a guiding principle for the state aid reform in the EU – “less and better targeted state aid”. The applicant should have the obligation to state expected objective and effect of the aid with regard to the entity’s condition at the time of application submission, in the form of some kind of cost-benefit analysis to show what should be the effects of this manner of using the public funds. There are announcements that this Decree will be amended to achieve that before the end of 2012, and that the provider will be required to provide precise indicators to be used to monitor the expected and realised effects of the awarded state aid.

The Decree on the Manner of Keeping Records on State Aid (Official Gazette of Montenegro, No 27/10; 34/11) is amended with the Decree on Amendments and Supplements to the Decree on the Manner of Keeping Records on State Aid and contains rules on keeping records of reported and records of awarded state aid. The records are kept in electronic format and the Decree contains mandatory elements of the records. Website of the State Aid Control Commission contains the Inventory of awarded state aid being updated by the Commission. The objective of such public Inventory is to contribute to the obligation of increasing transparency of state aid.

The Rulebook on the Content of Annual Report on Awarded State Aid (Official Gazette of Montenegro, No 31/10 and 22/12) stipulates, as could be seen from its name, the content of annual report on awarded state aid in Montenegro. This document is necessary for Montenegro to meet obligations from Article 73, paragraph 5 of the SAA to submit to the European Union regular annual reports in line with the methodology and presentation of overview of the Community on state aid. The Rulebook on Amendments to the Rulebook on the Content of Annual Report on Awarded State Aid, adopted in April of this year, envisages the obligation of providers to submit to the State Aid Control Commission data on expected and realised effects of awarded state aid, and a number of such analyses were already included in the Annual Report on Awarded State Aid for 2011. To that end, it would be more important to include such request from providers in the Decree on the Manner and Procedure for Submission of State Aid Application, in order for both providers and the Commission to have a clear idea on what would be the results of aid awarded from the very beginning i.e. before the aid is awarded.

Annual Reports

As far as the obligation concerning development of annual reports on awarded state aid in Montenegro (hereinafter referred to as the Annual Report) is concerned, drafting of the report according to the EU methodology commenced with the drafting of the report for 2008. Report for 2008 was the fourth report prepared in Montenegro. The first report covered data for 2003 and 2004, the second report covered all direct and indirect subsidies paid from the Budget of Montenegro in 2005 and 2006, while the third report for 2007 covered data sent by the state aid providers. In the case of the Report for 2008, the methodology stipulated by European Commission for reporting on state aid was followed, in accordance with the new legal framework for state aid control – The Law on Control of State Support and Aid (Official Gazette of the Republic of Montenegro, No 26/07). Since then, the reports were regularly produced for 2009 and 2010, and the latest report for 2011 was published in June. The latest report is the most comprehensive and of best quality in terms of contents, and includes also the analysis of effects of specific state aids, as well as recommendations for providers on how to improve quality of programs, as well as general recommendations for improving the state aid control system in Montenegro.

State Aid Inventory

The State Aid Inventory is developed pursuant to Article 15 of the Law on State Aid Control. It is updated on regular basis and it should contain every approved state aid based on the Commission's decision. Inventory is sent to the European Commission once a year, in October, and represents a base for development of annual report. Following data must be stated for each state aid listed in the inventory: provider, legal basis, title of the program, number of aids, date of the decision, duration of aid, primary objective, sector, type of aid, aid instruments, amount of planned state aid, and amount of awarded state aid. The existing Inventory is missing the item of planned state aid, as compared to the awarded state aid provided individually in amounts for 2007, 2008, 2009, and 2010.

The primary objective of keeping the state aid inventory is to strengthen transparency of the aid awarding process. Thus, it is highly important for the Inventory to be kept updated in a regular and accurate manner. Considering that the Division for State Aid Preparation maintains the Inventory updated on a more regular basis i.e. with each individual decision, being body performing tasks for the Commission, and Inventory not being subject to adoption by the Government and the Parliament as opposed to annual reports, since it is a technical type document. Unfortunately, the updated Inventory is published once a year, after being submitted to the European Commission.

Program of alignment of existing state aids

Article 73, paragraph 6 of the SAA states that there is an obligation to prepare a comprehensive inventory of existing state aid schemes and align measures contained in existing schemes with the EU standard within a period of 4 years from the entry into force of the Agreement (in case of trade and trade-related matters – 1 January 2008). This process was implemented through the Program of Alignment of Existing State Aid Programs with criteria referred to in Article 73 of the Stabilisation and Association Agreement, and the stated obligation and deadline for complying with it are also stipulated by provisions of



Article 26 of the Law on State Aid Control.

Report of the Ministry of Finance for 2011⁷ states that for such purpose the Division for Preparation of State Aid scanned the entire legal system of Montenegro, identified regulations, prepared a list of regulations in which elements of state aid matters were found, and sent them to line ministries together with the measures and rules to be followed. The report also states that line ministries have fulfilled their obligations and that, as of 31 December 2011, the following legislation was amended and harmonised: Law on Personal Income Tax, Law on Corporate Profit Tax, Law on Ports, Law on Professional Rehabilitation and Employment of Persons with Disabilities, Law on Theatrical Activity, Law on Sport, and Law on Communal Service Activities. It should be noted that the mentioned Law on Ports has not yet been adopted in the parliamentary procedure, and its adoption is expected at the next session. The reason provided to us by the Commission is of the procedural character, since the Ministry of Transport, Maritime Affairs and Telecommunications initially omitted to send the Law to the Commission for its assessment of compliance and thus the Law could not be adopted by the Government either. After this omission was corrected, the Commission's assessment, stated in its decision dated 18 November, was that the Law is in compliance; however, this omission resulted in delaying the final adoption of the Law in the Parliament and hence in exceeding the deadline for meeting the alignment obligations by 31 December 2011. Even though it is of procedural nature, this omission is important in terms of highlighting how harmful it can be if procedures are not complied with and the State Aid Control Commission is bypassed by the state authorities.

Furthermore, the Law on State Aid Control stipulates that providers were obliged to submit regulations containing state aid elements to the Commission for compliance assessment, which was done by the ministries of finance, transport and maritime affairs, and labour and social welfare, while the ministries of culture, science and sport and sustainable development and tourism have not done so, but have only answered on the Commission's query.⁸ Also, as far as the secondary legislation is concerned, the Ministry of Finance has not yet harmonised the Rulebook on Use of Tax Reliefs under the Corporate Profit Tax in Underdeveloped Municipalities⁹, and this regulation is still in preparation.

Regional Aid Map

Article 73, paragraph 7, item b envisages that after the assessment of eligibility of Montenegrin regions by the European Commission based on GDP per capita figures harmonised at NUTS II level, Montenegro should adopt a regional aid map. First it should be said what the regional aid map is: it is a document that defines the regions of a Member State eligible for regional investment aid, as well as establishes the maximum permitted levels of aid in the eligible regions. Regional aid map is a pre-condition for determining maximum intensity of permitted aid to specific regions and aid awarded to enterprises from those regions. The Division for State Aid prepared a Proposal of the Decision on Regional Aid Map and submitted it to the EC in June 2011. In November 2011 the EC provided suggestions that were included in the Proposal, which was sent as the final version to the EC for its approval in December 2011. *The Decision was finally adopted on 15 March 2012* and

⁷ Report of the Ministry of Finance for 2011, chapter: State Aid in 2011, pages 54-56

⁸ Information on Realisation of the Program on Alignment of Existing State Aid Programs with criteria referred to in Article 73 of the Stabilisation and Association Agreement, the Government of Montenegro

⁹ Official Gazette of the Republic of Montenegro, No 03/03

it defines the entire territory of Montenegro as a less developed region if compared to the EU-27 average¹⁰, since its GDP per capita, measured by purchasing power standard, is less than 75% of the EU average. The Map is defined for the period from 1 January to 31 December 2013. Based on the list, Montenegro is able to grant regional state aid up to maximum intensity of 50% of the value of investment for large business organisations, or 60% for medium-sized and 70% for small business organisations. Regional investment aid also has to be in line with maximum permitted regional aid intensity, as follows: for the projects up to 50 million euro – up to 100% of maximum regional intensity, between 50 and 100 million euro – up to 50% of maximum regional intensity, and for a share in excess of 100 million euro – up to 34% of maximum permitted regional intensity.

¹⁰ Pursuant to Article 107 (3) of the TFEU

INSTITUTIONAL FRAMEWORK FOR STATE AID CONTROL

2

The Ministry of Finance is in charge of the state aid policy in Montenegro. In April 2005, it has created a Monitoring team to monitor and control state aid, with a task to report on the realised state aids. As it was already stated, Montenegro assumed an obligation under the SAA to establish an operationally independent authority entrusted with the powers necessary for the full application provisions concerning full compliance of state aid with the EU regulations. For that purpose, Montenegro has established the State Aid Control Commission (hereinafter referred to as the Commission), and the Division for Preparation of State Aid, an organisational unit of the Ministry of Finance, carries out professional, technical and administrative affairs for the Commission.

State Aid Control Commission

The Commission has a difficult and ample task to control whether the entire state aid system in Montenegro is aligned with the EU regulations, being the authority tasked to control the overall state aid, both regulations containing elements of aid matters as well as schemes and individual aids awarded by entities in Montenegro. Key qualities that the Commission must have in order to perform its duties are independence and administrative and professional capacity, as well as finality and authority of its decisions.

The Decision of the Government of Montenegro dated 8 November 2007 established the Commission for Control of State Support and Aid, which at the time of its establishment had seven members. The Commission was composed of chairperson, proposed by the state administration authority competent for finances, and six members proposed by authorities competent for finances, economic development, European integration, and agriculture, the Union of Municipalities and representative of association of employers. The Law from 2009 established the State Aid Control Commission, changed its composition to certain extent and increased number of members to nine. In addition to the chairperson of the Commission, proposed by the Ministry of Finance, it included also representatives of ministries competent for economic development, European integration, agriculture, forestry and waster resource management, maritime affairs and transport, and tourism, as well as one representative each from the Union of Municipalities and association of employers. The latest Law on Amendments and Supplements of the Law on State Aid Control has reduced number of the Commission members to five. In addition to the chairperson of the Commission, proposed by the Ministry of Finance, it includes also members proposed by ministries of economy, sustainable development and tourism, and maritime affairs and transport, as well as representative from the association of employers. The reason for such

reduction of the Commission's capacities is certainly reduction of budget costs, but it could have very negative effects on the work of the Commission, which within its powers has to resolve rather complex matters and problems Montenegro is facing when the state aid is in question. The Commission provided the explanation that reduction of member numbers will not affect the quality of work of the Commission, and that representatives of the most important interested parties were retained (Ministry of Agriculture, Forestry and Water Resource Management was excluded, even though the largest provider, since that kind of aid is granted under special rules). According to the new Rulebook of the Commission, the decision-making quorum is four members, and the Commission decides on the basis of majority of present members. Having in mind a legal provision that a member who is representative of a state aid applicant is not entitled to vote¹¹, and that members of the Commission are representatives of most frequent aid providers, it is to be expected that the Commission will often decide with four members. Regardless of the capacity, knowledge and expertise of individuals in the Commission, four persons deciding on very complex matters of state aid compliance, quite often subject to disagreement among the Commission members, could be too little for making effective decisions.

As far as the independence of the Commission is concerned, there are several relevant factors. Representatives of relevant institutions, the Commission and Ministry of Finance are stating that the personal integrity of the Commission members is crucial for independence of the Commission. Even though that factor is of the highest importance, certain procedural prerequisites need to be provided as well, in order for the Commission's independence to be based on objective criteria. Such prerequisites are of financial and material nature. The Commission has its premises, meeting there on *ad hoc* basis two to three times a month, on as needed basis. Funds for its operation are provided from the Budget of Montenegro, the Government determining the amount of the remuneration for the chairperson and members. Highest possible obstacle is dependence of the Commission from the Division for Preparation of State Aid, which is part of the Ministry of Finance, as well as from the Ministry of Finance in general, since the Ministry provides premises and other conditions for work of the Commission.¹² Such institutional setting of bodies engaged in state aid was one of the possible solutions Montenegro chose based on the Slovenian experience, and the EC accepted such solution. The EC, on the other hand, is constantly highlighting a need to strengthen independence of these bodies by strengthening capacities of the Commission to use its powers of investigations and decision-making. The Analytical Report states that

*"efforts need to be invested to strengthen the institutional capacity and independence of the State Aid Control Commission. Its records of enforcement and quality of decisions would need to be closely monitored in future"*¹³

In 2011, the Commission was working on 26 cases¹⁴, and the first *ex officio* cases were initiated in connection to the aid program of the Ministry of Culture. In June of this year, the Commission adopted first decision in Montenegro ordering return of part of granted state aid; this was the case of the Aluminium Plant Podgorica which will be discussed in sections to follow.

The Law on State Aid Control stipulates powers of the Commission in the process of the state aid control and gives it wide powers for carrying out the control procedure, request-

11 Law on State Aid Control, Article 13 paragraph 3

12 Law on State Aid Control, Article 14, item 2

13 Analytical Report, page 65

14 Report of the Ministry of Finance for 2011



ing information from aid providers and issuing mandatory instructions for the removal of irregularities found in state aid procedures within the specified deadlines. Furthermore, the most important powers of the Commission allow it to order termination of the aid award while such award is under the compliance assessment, if established that the further award of such aid would cause significant distortion of the market competition and, upon establishing incompliance with the Law, to order to the provider to return the awarded aid amount and suspend further award of unused amount of the aid, if any.

One of the most important assumptions for independence of this body is finality and effectiveness of decisions of the Commission, which could be voided only in an administrative dispute, and such assumption is reinforced with the Law on Amendments to the Law on State Aid Control.

Division for preparation of state aid

The Division for preparation of state aid (hereinafter referred to as the Division) carries out professional affairs in the field of state aid within the Ministry of Finance. Such affairs are pertaining to¹⁵: gathering, processing and monitoring of data on state support and aid; keeping records on state aid; participating in drafting legislation concerning the state aid; monitoring compliance of laws and secondary legislation in the field of state aid with standards and regulation of the European Union. This Division carries out professional, technical and administrative affairs for the State Aid Control Commission. Likewise, this Division carries out development, professional and technical, and legislative and legal affairs pertaining to the preparation of the Annual Report on Control of State Aid, as well as receipt and processing requests for notifications on the state aid. As it could be seen, the Division carries out large number of tasks i.e. covers all tasks at the level of state influencing the state aid control. Five employees are working in the Division to cover those needs, out of which two are directly involved in the tasks of state aid preparation, which may be too few for these activities to be carried out successfully. This number is especially low in light of the needs for *ex officio* monitoring of state aid, and it seems that the Division needs at least five officers, lawyers and economists, who will be engaged only in preparation and control of state aid, in order for it to function in a satisfactory manner. The latest Montenegro Progress Report for 2011 concludes that

“The limited number of employees is insufficient for the SAMU¹⁶ to carry out its tasks and hinders the creation of a credible enforcement record of adequately reasoned decisions.”

It is stated that the actual operational independence of the Commission and the Division needs to be further guaranteed.

If observed in a comprehensive manner, Montenegro has now established a good institutional framework for the state aid control, but it needs to work on strengthening capacities and independence of these authorities and their actual importance in the process of granting and control of state aid. There is room to deliberate about the selected institutional solution. Creating an independent institution which would include both the Commission and the unit that would carry out tasks for the Commission currently performed by the Ministry of Finance would be the best solution, but it is the least realistic considering the

15 Rulebook on Internal Organisation and Systematisation of the Ministry of Finance, Article 13

16 Division for Preparation of State Aid – State Aid Management Unit

budget constraints.

The model adopted by Croatia, where the state aid control is situated within an independent agency for control of market competition (which we hope in our case will soon be the Agency for Competition Protection) is the second possible solution which is worth considering. Competition and state aid are closely related fields, controlled by one Directorate in the EU, and such model could have added advantages in terms of strengthening and protection of competition.

However, it seems that for Montenegro it is presently less important what institutional setting for the state aid protection authority would be. Matters that are more important are: further capacity strengthening of those authorities, the delivery of training, and the recruitment of additional staff that will be qualified to deal with matters in question, which implies expertise in legal and economic field, as well as specific knowledge of competition law and state aid law.

STATE AID IN MONTENEGRO – THE PRACTICE

3

Structure of State Aid in Montenegro

The share of the state aid in the gross domestic product (GDP) has progressively increased since 2008, when it was 1.49%, going up to 1.70% in 2009 and 2.32% in 2010¹. According to the latest Annual Report for 2011² the previous year's figure amounted to 2.03% of GDP or 66.441 million euro, which makes a reduction of 7.62% compared to 2010 in absolute terms. When we make comparison with the EU-27 average for 2010 (0.5% of GDP) and with Croatia (1.15% in 2010), then we can see how high this amount is.

Horizontal state aid (aid schemes)

Horizontal state aid is the aid intended for the widest ranges of beneficiaries and not being selective in terms of predetermined sectors of the economy, beneficiaries, or products and services, which makes it a type of state aid which has the lowest possible negative impact on the development of market competition. Thus horizontal aid, especially the one intended for development objectives, should be encouraged at the expense of sector-based aid.

The share of the horizontal state aid in the total state aid in 2010 was sizeably increased compared to 2008, from 4.93% to 67.14%, which is a positive trend. *What is not a positive trend is that 94.1% and as much as 97.02% of that amount in 2009 and 2010, respectively, was allocated for rehabilitation and restructuring purposes*, being the amount allocated for electricity subsidies for the Aluminium Plant Podgorica (KAP). Small share was directed to small and medium-sized enterprises – 1.90%, 0.93% for employment, while no part of this amount of the state aid was allocated for development and research or for the environmental protection. The latest data for 2011 indicate that the share of horizontal state aid has been reduced to 31.52% of the total state aid, which means 59.89% less than in 2010. Out of that amount, the highest portion was allocated for rescue and restructuring – 28.46% of the total state aid amount.

On 2 April of this year, due to unpaid liabilities by KAP the Deutsche Bank called on a guarantee of the Government of Montenegro, which in turn paid 23.4 million euro, where 22 million euro was the principal and 1.4 million euro accrued interests and credit costs, which was a new aid for rescue and restructuring not being in compliance, and this case will be discussed separately. Aid for rescue and restructuring purposes in 2011 was also allocated to the Bega Press company, based on the Restructuring Plan, in the form of a subsidy in the amount of 880,802.32 euro, to the Fabrika Elektroda „PIVA“ Plužine (FEP) in the form of a guarantee in the amount of 1,500,000 euro, to the business organisation Javorak in the form of a guarantee subsidy equivalent in the amount of 70,000.00 euro,

¹ Source: Report on allocated state aid in Montenegro in 2010

² Report on allocated state aid in Montenegro in 2011, the Commission for the State Aid Control, June 2012

and the business organisation Lenka also in the form of a guarantee subsidy equivalent amounting to 52,500.00 euro. The realization of these aids, as well as the aid to KAP, was analysed in terms of planned and expected effects (for all the stated business organisations except for Lenka), and aid to Bega Press, Javorak, FEP and KAP was evaluated as insufficiently successful.

On the other hand, data indicated that no portion of the state aid was allocated for important development and research, environmental protection or training purposes.

The State Aid Control Commission provided us also with the information that certain amount of the state aid was allocated for research and development, however, in spite of efforts of the Commission lasting several months, the Ministry of Science has refused to notify such aid, even though such aid would be assessed compliant with regulations due to its intended use. Consequently, that aid is listed as unidentified aid in the Annual Report for 2011. The Ministry of Science has been allowed a 60-day deadline to align the regulation based on which the aid was allocated, or otherwise the Commission will declare such aid incompliant with the Law.

With respect to the aid schemes intended for employment, the Employment Office of Montenegro was the entity providing aid, under programs for the Subsidized Employment of the Young for 2011 and the Practice through Work for University Graduates.

As far as the small and medium-sized enterprises (SME) are concerned, providers of the aid are presently the Investment and Development Fund (IDF) and the Directorate for Small and Medium-sized Enterprises (DSME). The IDF is allocating the state aid based on its Annual Work Plan, currently the Plan for 2012, which is in line with the Medium-term Work Program, Financial Plan for 2012, current economic policy of the Government aimed at combating the economic crisis and the Rural Development Strategy and the Law on Regional Development. In 2012, 20 million euro has been allocated for this purpose, and will be available in the form of **loans**, as: *loans with intermediation and guarantees of commercial banks, direct loan facilities, stand-alone and co-financing with commercial banks, and loans for infrastructure, environmental and strategic projects*. The IDF also has the **ability to issue guarantees** for guarantees of up to 10 million euro, as well as the latest aid instruments introduced in 2011 – **factoring** i.e. purchase of debt of 10 million euro as well, as support to small and medium-sized enterprises, and will also purchase debt in cases when the state of Montenegro is debtor. Based on the analysis of effects of awarded state aid, the state aid awarded based on the IDF Annual Plan for 2011 was successfully implemented, with 200 successfully implemented loan approving decisions out of 204 made in total. Due to restrictive policy of the banking sector during the previous year, majority of these projects were implemented with direct loans from the IDF funds.

The DSME has reported *the State Aid Program to Small and Medium-Sized Enterprises for 2012 – Financial Support to Development of Competitive and Innovative Small and Medium-Sized Enterprises through the Voucher Scheme Project*, evaluated by the Commission as being in compliance with the Law by its decision of 18 May 2012.

The Ministry of Economy has reported state aid under the *Program of Incentives for Development of Competitiveness of Entrepreneurs, Micro, Small and Medium-sized Enterprises in the Northern Region of Montenegro and underdeveloped municipalities covering period from March 2012 to the end of 2015*, which was also evaluated by the Commission as being compliant.



Sectoral State Aid

In terms of the state aid given to specific sectors, in the period 2008-2010 it recorded a slight decline, accounting for 32.86% in 2010, however in absolute terms it was by 37.49% higher in 2010 than it was in 2009. Majority of this aid was allocated for financial services, culture and public broadcasting, steel industry, and agriculture and fisheries. The latest data for 2011³ show that the share of sectoral aid in the total state aid in the previous year recorded an even higher jump, from 27.41% to 64.06%, or to 42.564 million euro. In absolute terms, it is a 115.90% increase in comparison with 2010, and as high as 148.23% if compared to 2009. This increase is mainly the result of the fact that guarantees issued to Steel Plant Niksic (Željezara Nikšić) were called on and paid.

In the area of financial services, the state aid has been a response to the financial crisis through two schemes: “Program for Removing Harmful Effects and Protecting Banking Sector against Consequences of the Global Financial Crisis and Preserving its Safety and Stability” and “Guarantee and Credit Schemes”, both of them submitted by the Ministry of Finance. Only one bank used the program of measures and that is “Prva Banka Crne Gore – Osnovana 1901”, which received a liquidity loan of 44 million euro.

Support to the steel sector pertains to the support provided to Steel Plant Niksic. The first aid to Steel Plant Niksic was provided based on the Subsidy Contract of 28 December 2007, and the next one after the signing of the SAA based on the Restructuring Plan of Steel Plant Niksic proposed by the Ministry of Economy and approved by the Commission by its decision of 3 February 2010. State aid provided to Steel Plant Niksic distorted the EU principle “one time, last time”, which also proved to be very expensive for the state of Montenegro. Steel Plant Niksic went to bankruptcy after that and its property was recently sold. Opening of bankruptcy proceedings was caused by guarantees issued to Steel Plant Niksic being called on and paid by the state in the amount 32,922,888.90 euro to the banking institution Credit Suisse. This amount of 33 million euro, along with deferred tax liabilities for VAT of 613,631.86 euro in 2011 and deferred customs debt of 509,150.00 euro, were made part of the bankruptcy estate of Steel Plant Niksic. Unfortunately the amount Steel Plant Niksic was sold for to the Turkish company Tosçelik was not sufficient to cover claims of the state.

The aid planned for 2012 includes the Institut Za Crnu Metalurgiju (Black Metallurgy Institute), which is to receive 181,000 euro for restructuring.

In the area of culture, the Commission’s evaluation of the Draft Aid Program of the Ministry of Culture for 2012 was that it was insufficiently compliant with the Law.⁴ One of the items in the Program envisages the payment for the transmission of the broadcasting signal of RTCG on the territory of Montenegro via broadcast relay stations. The decision states that the Ministry of Culture, upon request of the Commission, submitted the letter stating that RTCG does not keep separate accounting records for radio and television public broadcasting services from other activities. Having in mind the above stated, as well as provisions of Article 43, paragraph 2 of the Decree on Detailed Criteria, Conditions and Manner of Awarding State Aid, stipulating the obligation of keeping separate accounting records, the Commission evaluated that item as non-compliant, which presupposes that the Ministry is not entitled to award envisaged aid until conditions are met.

In addition to the steel sector, the sector of agriculture and fisheries had a large portion of allocated sectoral aid, i.e. 2,872,539.20 euro in 2010, while the state aid awarded in 2011

³ Annual Report on allocated state aid in Montenegro for 2011, the Commission for the State Aid Control, June 2012

⁴ Decision of the State Aid Control Commission of 27 February 2012.

was somewhat smaller and amounted to 1.668 million euro.

During the previous year, 3.551 million euro was allocated to the transport sector, which accounts for 5.28% of the total state aid. Even though this aid was stated in the Annual Report for 2011 as sectoral and regional aid, it was actually for rescue and restructuring. Aid provided to the company Montenegro Airlines caused majority of problems, since guarantees issued to this company were issued contrary to the rules on state aid, and this example will be also discussed separately in the analysis to follow. In 2011, the Ministry of Maritime Affairs and Transport awarded a regional state aid to the company Kontejnerski Terminal (Container Terminal), as a net element of aid for the loan approved by EBRD, amounting to 787,000.00 euro for the loan of 4 million euro.

Regional state aid

Regional state aid, as aid for underdeveloped areas and mitigation of regional development imbalances, was not awarded in 2010. Adoption of the Regional Aid Map will provide an adequate framework to enable providers of this type of aid to report it in the next period. However, the aid to regions was awarded through various projects within the horizontal aid schemes, in particular for agriculture and small and medium-sized enterprises. In the previous year, the regional aid amounted to 2,934,835.44 euro. It was awarded under the already mentioned programs of the Ministry of Culture, i.e. 2,148,174.81 euro for maintaining the media pluralism and financial sustainability of the media presently facing financial difficulties, as well as to the Kontejnerski Terminal Bar.

In the public opinion survey we have implemented, both citizens and businesses have agreed that the aid in Montenegro is most needed to the northern region.

Problematic state aid cases

In spite of the alignment of the existing aid and the fact that new aid is awarded in accordance with rules harmonised with the EU rules, there are a few cases of concern in the dialogue with the EU. Those are the Aluminium Plant Podgorica (KAP), Bauxite Mines Nikšić, Steel Plant Niksic and the national air carrier Montenegro Airlines. Here we will present the cases of KAP and Montenegro Airlines. Since Steel Plant Niksic has just been sold, it is not a problem anymore in terms of the need for new state aid. The Bauxite Mines are sharing the destiny of KAP, and the state aid awarded to that company on the basis of their restructuring program totalled 11,131,753.00 euro.

The Aluminium Plant Podgorica Case

The Aluminium Plant Podgorica (KAP), in the state aid context, is one of the largest problems for Montenegro, which was confirmed both by the collocutors from the Government of Montenegro and the EU. KAP makes a large portion of the Montenegrin economy, and even though a specific percentage is unknown, the assumption is that it makes around 3% of the Montenegrin economy along with the affiliated companies. It was privatised in 2005, and since 2008, it had recorded a significant increase in losses and is not able to maintain production without assistance, which up to date has significantly affected the growth of the public debt in Montenegro.

The aid to KAP was implemented based on the “Program of Financial Restructuring of the Aluminium Plant Podgorica (KAP)”, which was evaluated as being compliant with



the Law on Control of State Support and Aid in force at the time by way of the decision of the Commission of 24 November 2009. (Still, individual aid was provided before the KAP Restructuring Program and implemented by 31 December 2008, for writing off taxes on personal earnings and contributions for employees incurred before the privatisation in the amount of 897,394.00 euro.) Duration of the aid, according to the Restructuring Program, was envisaged to last from 24 November 2009 until 31 December 2013. Along with the Restructuring Program, an agreement was reached on entering into the Settlement Agreement with CEAC, the owner of KAP, according to which 50% of ownership was returned to the Government of Montenegro, which also appointed a member of the management board with veto rights. According to this Program, the measures of aid of the Government of Montenegro were:

- **Guarantees** – 23,827,976.00 euro; equivalent to subsidy for guarantees and loans calculated according to the formulae used in the European Union for guarantee equivalent;
- **Deferring taxes and contributions** – no subsidy equivalent, since the interest on the said amount, according to the Tax Administration information, is 0.03% daily, or 10.8% annually, and is higher than the reference interest rate which is 8.71% annually (Central Bank of Montenegro);
- **Write-off of taxes and contributions** – 10,000,000.00 euro;
- **Subsidies** – 150,923,396.85 euro;
- **Assumption of the customs debt** – 104,020.00 euro.

Total amount of the state aid was 184,855,392.85 euro.

On 2 April of this year, due to unpaid liabilities by KAP the Deutsche Bank called on a guarantee of the Government of Montenegro, which in turn paid 23.4 million euro, where 22 million euro was the principal and 1.4 million euro accrued interests and credit costs. The process of termination of the Settlement Agreement was initiated due to default in meeting obligations by the CEAC and bringing back KAP into the state ownership, after which a new solution for the company's sustainability would be sought. At this time the situation in KAP is uncertain, since the Government refused to continue with subsidies for electricity after the amount of 60 million euro was reached, envisaged by the Program. On 24 May 2012, Elektroprivreda Crne Gore (EPCG) reduced supply to KAP, with possibility to completely discontinue supply, as the debt of the company to EPCG is more than 40 million euro.

Since due to unpaid liabilities by KAP the Deutsche Bank called on a guarantee of the Government of Montenegro, which in turn paid 23.4 million euro, where 22 million euro was the principal and 1.4 million euro accrued interests and credit costs, the Commission had to make special decision on compliance of that aid with the Law, and specifically about the question whether that is a new aid or the aid covered by the Restructuring Program. On its session held on 1 June 2012, the Commission adopted the decision⁵ establishing irregularities in implementation of the Program of Financial Restructuring of KAP, and the calling on and payment of the guarantee was evaluated as possible incompliance with the Law on State Aid Control, since it was a new aid which was not covered by the restructuring program. The same decision ordered repayment of incompliant aid, as well as termination of possible further aid to the Aluminium Plant. The Ministry of Economy was instructed to undertake activities to enforce the decision and to inform the Commission thereof within a shortest possible timeframe, which was not specified.

⁵ www.kkdp.me

The Ministry of Economy has provided the State Aid Control Commission the report on analysis of effects of the aid to KAP, based on the Model of Financial Restructuring of KAP⁶, where it could be noted that there were numerous discrepancies from planned restructuring effects, one of the most important being a new indebtedness of KAP on the account of new debt, in spite of debt right off of CEAC and the Government of Montenegro under the Settlement Agreement of 102 million euro, and earlier debt write-off on the account of taxes of 8 million euro. Social program of the Restructuring Model was also not implemented successfully and the number of employees was not reduced to an optimum level. In the Progress Report for 2011, the European Commission concluded that the amount of State aid provided to the KAP and its compatibility with Montenegro's obligations under the SAA remain unclear, in spite of data provided by the Government. It was stated that Montenegro provided *"only limited evidence on the considerations taken into account for establishing the risk premium charged for the State guarantee issued"*, and additional data were needed to calculate the exact amount of aid given in the form of State guarantees for the loan. In any case, the risk premium charged when issuing guarantees should have taken into account special risk the guarantee bears, considering losses and lack of liquidity at the time when it was issued. On the contrary, all indicators show that a detailed risk assessment was not made before issuing the guarantee. That has resulted in an increase of the already enormous state debt of Montenegro. As of 31 December 2011, thus before the KAP guarantee was called on by the Deutsche Bank, the state debt arising from KAP was 124,198,234.59 euro⁷.

The Case of Montenegro Airlines

Another Montenegrin company operating at sizeable loss and having very high level of indebtedness is the national air carrier – Montenegro Airlines (MA). As far as the state aid given to the company is concerned, we have indentified the following aid data in the Inventory of the State Aid: individual aids in the form of subsidy realised by 31 December 2009, in the amount of 825,761 euro, and individual aids in the form of excise taxes written-off, totalling 1,800,000 euro. In June 2011, a debt of 3.2 million euro was written off, which was subsequently covered by the restructuring plan of this company.

The Ministry of Transport and Maritime Affairs submitted to the State Aid Control Commission on 10 March 2011 a request to assess the compliance of issuing a guarantee for a loan to Montenegro Airlines for 9.6 million euro. The Commission rejected this request by way of a conclusion, stating in the explanation that the reported state aid was not considered a state aid. Such conclusion is based on the proposal of the submitting entity, the Ministry of Transport and Maritime Affairs, and Article 5, paragraph 4 of the Law stipulating when an aid is not considered to be state aid, and supporting documentation provided by the Ministry. However, this conclusion was based on future expectations rather than on realistic situation in which the company was at that time, involving an increasing loss and enormous indebtedness, where only debt to the Airports of Montenegro was around 6 million euro and debts to the Air Traffic Control Agency of Serbia and Montenegro (SMATSA) was also more than 6 million euro with an upward tendency. Conclusion that the guarantees issued to the Montenegro Airlines were not state aid was based on the confirmation of the Ministry that the debt towards SMATSA would be reduced, as it was the case for the reduction of debt of the JAT Airways company⁸. In this manner, as it was

6 Report on allocated state aid in Montenegro in 2011, the Commission for the State Aid Control, June 2012

7 Annual Report of the Ministry of Finance for 2011, Report on the State Debt of Montenegro as of 31 December 2011

8 Debt of this company, which was 10.5 million euro in 2010, was settled through intermediation of the Government



stated in the appendix of the Ministry of Maritime Affairs and Transport prepared by an independent auditor, the debt reduction would result in correction of financial statements for 2010, which in turn would mean a reduction of losses of the company, which is a prerequisite for a company to be issued a guarantee which is not classified as the state aid. Furthermore, the conclusion states that the company Montenegro Airlines could receive a loan under commercial terms as well, which would meet the requirement referred to in Article 5, paragraph 4 of the Law, and argument used is that such loan agreements were entered into 2010 without the intervention of the state. Such conclusion could be treated at least as speculative since the debt of the company records a constant growth.

In any case, according to the information provided by the Ministry of Finance, none of these conditions was met, even though Montenegro Airlines received the guarantee of 9.6 million euro, and there was no subsequent reduction of debt or hence also the losses of the company.

Taking into account that the airline companies across Europe and especially in the region are suffering extensive losses, it is expected that Montenegro Airlines too requires new aid from the state in order to survive. However, this aid must be based on the realistic and sustainable restructuring plan that will enable survival of the company and be at the same time the last state aid provided to that company as an opportunity to become sustainable. In any case, the Government of Montenegro cannot be put in a situation to propose, and especially the Commission cannot be in a situation to approve state aid or to declare that an aid is not considered state aid based on future hypothetical situations. In such a manner, it may happen in the future, when the EU strengthens the controls of such cases, that the state aid will have to be returned.

The Government of Montenegro adopted in June of this year and submitted to the Commission for evaluation the MA Restructuring Plan. The Commission's assessment of the Restructuring Plan was that it was in compliance with the Law on State Aid Control.

The decision, following the analysis of the market and operation of MA, states that *"the MA is in serious financial difficulties, which are the result of various factors of external and internal character. Internal factors are: poor financial standing of the company, endangered current liquidity, high share of borrowed resources in the financing breakdown, high level of fixed and variable operation costs, insufficient use of capacities on a significant number of lines, impossibility to generate positive net cash flow from regular (business) activities and similar. External factors affecting the poor performance of MA are the market downturn, decline in the level of activities caused by the global financial crisis, inability to procure financing sources at the international market under favourable terms, deterioration of the country credit rating and similar."*⁹

Furthermore, it is stated that in the period from 2007 to 2011, MA had unsatisfactory liquidity indicators with a deteriorating trend, high level of indebtedness, as well as unsatisfactory financial structure, along with the high overall risk ratio.

The Plan envisages the following measures of state aid:

Conversion of the MA debt towards the Air Traffic Control Agency of Serbia and Montenegro (SMATSA) into share capital, or repayment of the MA debt towards the Air Traffic Control Agency of Serbia and Montenegro d.o.o. (SMATSA) by debt assumption, in such a manner that SMATSA is provided the use of the hotel Park in Bijela the value of which is

of the Republic of Serbia, by SMATSA assuming the JAT assets in Vršac (former school for pilots). Similarly, the Government of Montenegro plans to transfer to SMATSA assets of the hotel Park, former building of HTP Boka.

9 Decision of the State Aid Control Commission concerning the Restructuring Plan of Montenegro Airlines AD Podgorica, page 13, www.kkdp.me

7,275,874.64 euro, for the purpose of debt regulation.

Resolving the debtor-creditor relations between MA and the Airports of Montenegro: Present obligations towards the Airports of Montenegro amounting to 9,753,073.23 euro will be resolved in the following manner: debt of 702,921.68 euro, under an enforceable court ruling, will be paid over a 2-year period, the repayment starting from June 2013, the remaining amount of **3,052,617.54 euro** will be written-off and the debt amount of **5,997,534.01 euro** will be converted into the share capital.

Assumption of loans: in case that such a possibility would be envisaged by the Law on Budget, the Government of Montenegro may assume financing of one out of four new airplanes Embraer 195 type, if so proven as necessary for unimpeded operation of the MA on the market in the forthcoming period. Amount that would be assumed by the Government is **13,320,000.00 euro**.

Deferring liabilities arising from taxes and contributions: The Ministry of Finance will ensure restructuring of liabilities arising from taxes and contributions in accordance with the Decree on Conditions for Payment of Tax and Non-tax Liabilities (*Official Gazette of Montenegro* No 67/09). This restructuring will defer payment of liabilities for taxes and contributions for a period of one year with possibility of extension. Liabilities arising from taxes and contributions on the monthly level are 320,000.00 euro, whereby it is not possible to calculate the total amount since the default interest rate (according to the Tax Administration data 0.03% on daily and 10.8% on annual level) is higher than the reference interest rate (effective reference interest rate according to the Central Bank is 9.17%). The Government of Montenegro has already written off the MA debt of **3,233,336.56 euro**, which was generated in the period from 2002 to 2006.

The Ministry of Finance, acting in line with the conclusions of the Government of Montenegro (based on an earlier decision of the State Aid Control Commission), has provided guarantees for obtaining loan funds for MA of 9.6 million euro from commercial banks. Due to changed circumstances with regards to the financial standing of the company, the Commission has initiated *ex officio* control of awarded state aid to Montenegro Airlines, and the guarantee was not utilised in full amount. Amount of 9.6 million euro for guarantees is part of support measures of the Government to this company in the restructuring process. Remaining amount for which the loan is not yet taken is 5,200,000.00 euro (net equivalent 520,000.00).

Total amount of state aid will then amount 35,654,622.45 euro.

Even though the Restructuring Plan envisages also specific compensatory measures, while taking into account that in 2010 Montenegro Airlines carried out around 52.90%¹⁰ of passenger transport from and to the Montenegrin airports, it is more than advisable to make a study of the effects of such preferential treatment of the company on the competitiveness of the air transport in Montenegro, and, coupled with prices of airport services, on the lack of interest of foreign companies, especially low-cost companies, to enter the Montenegrin market.

A certain period of time would need to pass in order to consider the results of the Restructuring Plan and scenario which will be realized. Unfortunately, the quality of the company management to date does not leave room for optimism unless major changes in the management structure and priorities take place.

¹⁰ Decision of the State Aid Control Commission concerning the Restructuring Plan of Montenegro Airlines AD Podgorica, page 6, www.kkdp.me

EXPECTATIONS WITH REGARDS TO NEGOTIATIONS IN THIS CHAPTER

4

Negotiations between Montenegro and the EU were officially opened on 29 June 2012 starting with Chapters 23 – Judiciary and Fundamental Rights and 24 – Justice, Freedom and Security, for which the screening was already completed. State aid will be negotiated under Chapter 8 – Competition Policy, which will most likely be opened in October 2012, this being one of the most difficult chapters for negotiations. Croatia had such experience as well, as it opened and closed this chapter among the last ones, along with four requirements for opening the chapter and four for closing it. Since the state aid control is of vital importance for preservation of the single market, it is one of the chapters were Montenegro will need to meet all requirements in order to close it, and there are almost no possibilities for meeting the conditions subsequently or for negotiations on exceptions.

During the analytical screening (explanatory and bilateral meeting), the EU will screen the entire system of the state aid control in Montenegro and produce a report on it, where they will point to the current state and what Montenegro will need to do in order to advance in this field. Their evaluation will include the general legal framework (the Law and secondary legislation), the rules on reference interest rate and interest rate in case of return of the aid (which is not yet regulated), financial transfers to public enterprises, state guarantees, rules on sale of public land, export credit insurance, fiscal reliefs (rules on the profit tax) and direct taxation of entrepreneurs, rules for assessment of compliance of state aid with horizontal objectives, as well as for assessment of regional supports (aid map is already adopted), rules on aid for rescue and restructuring (there are no special regulations here), privatisation rules, and then in particular the state aid in specific sectors, notably in the steel sector, shipbuilding, postal services, radio and television broadcasting, audio-visual production where the EU has special rules which must be incorporated in our legal system as well. It is expected that we will have a lot to do in the area of harmonisation of legislation in the area of rescue and restructuring and compliance with the principle “one time, last time”, as well as in the steel, aluminium and air transport sectors.

It could be realistically expected that in this area Montenegro will receive new benchmarks for opening the chapter. For Croatia, the key benchmark was the restructuring of the shipbuilding sector, and we can expect that for us it will be the steel industry and the restructuring of KAP, Bauxite Mines Nikšić and other manufacturing companies. It is to be expected that Montenegro will have to develop a national restructuring plan, which is to guarantee sustainability of this sector.

The European Commission will also, considering very few cases concerned, monitor closely all the cases to be brought before the State Aid Control Commission and request the strengthening of administrative capacities, transparency in proceedings and primarily – increase in number of cases being heard before the Commission.

5

PUBLIC OPINION SURVEY ABOUT STATE AID

As part of this Study, the public opinion survey was carried out within the general population of adult citizens, as well as a special one for the business sector (sample of 180 enterprises was used, at the management level). Here we will present a brief overview of most important findings of the survey. Familiarity with the state aid concept and rules by companies is very important, both for better utilization of available programs by the entities which need them and are able to use them efficiently, and for assisting the Commission in implementation of the new legal framework by using third party rights in the procedure before the Commission.

Based on the self-assessment, representatives of the business sector have exceptionally poor knowledge of the state aid award procedures. As many as 83% of managers of enterprises in Montenegro have very little or no knowledge of the state aid. Every tenth representative of business is mostly and every 17th is fully informed about the state aid award procedures. Enterprises who have received state aid before, enterprises with predominant manufacturing activity, those with lowest revenues and those from the central region have managers who have better understanding of the state aid award. Micro enterprises (less than 10 employees) have exceptionally poor knowledge of this topic.

Out of all state aid instruments, subsidies (51% of managers aware of them) and fiscal reliefs (42%) are the best known. Almost one third of business sector representatives have not heard about any other types of state aid.

Almost one third of business sector representatives could not name any institution engaged in the state aid matters. Every third respondent named the Government of Montenegro and every fourth the Ministry of Finance. Less than 10% mentioned other institutions.

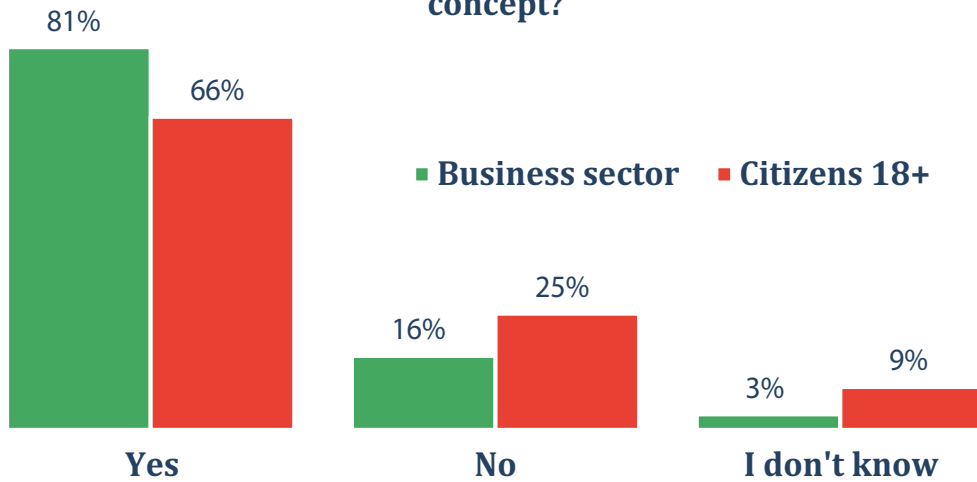
Large majority of business sector representatives (81%) generally supports the state aid principles. However, regional differences could be clearly noted: managers from the southern region express lowest support for the state aid idea, while most of the support comes from those working in the north of Montenegro. Those managers who are in general not supportive of the state aid are most often listing liberal argument that companies should fight alone on the market (25%).

General support of the state aid concept by managers is indicated also by the fact that a large majority of them agrees with the statements positively valuing its impacts (74% believe that the state aid contributes to development of underdeveloped regions, and 71% that it contributes to addressing difficult economic situation). At the same time, majority of the economic elite members are rejecting claims questioning justifiability and efficiency of such measures (state aid leads to keeping enterprises alive artificially, state aid represents



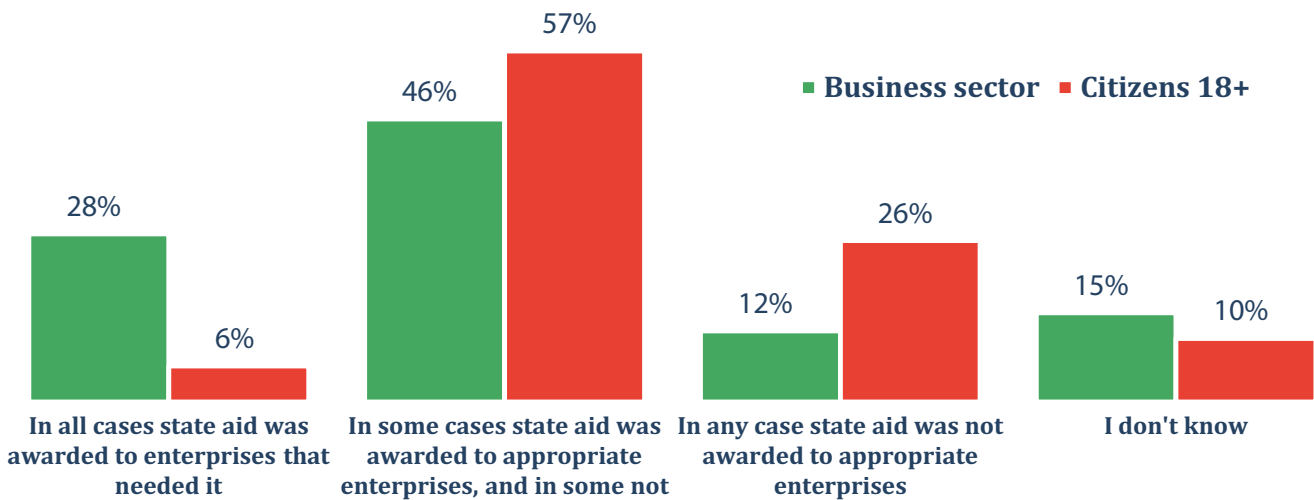
a source of misuse/corruption, state aid is harmful to efficient enterprises as it distorts market competition, state aid may lead to inefficiency of enterprises).

Graph1: In general, do you support the state aid concept?



As opposed to the business sector, citizens of Montenegro are somewhat less supportive of the state aid: while two-thirds are supportive of this concept, every fourth citizen is opposing it.

Graph 2: Do you think that state aid was awarded to enterprises that needed it?

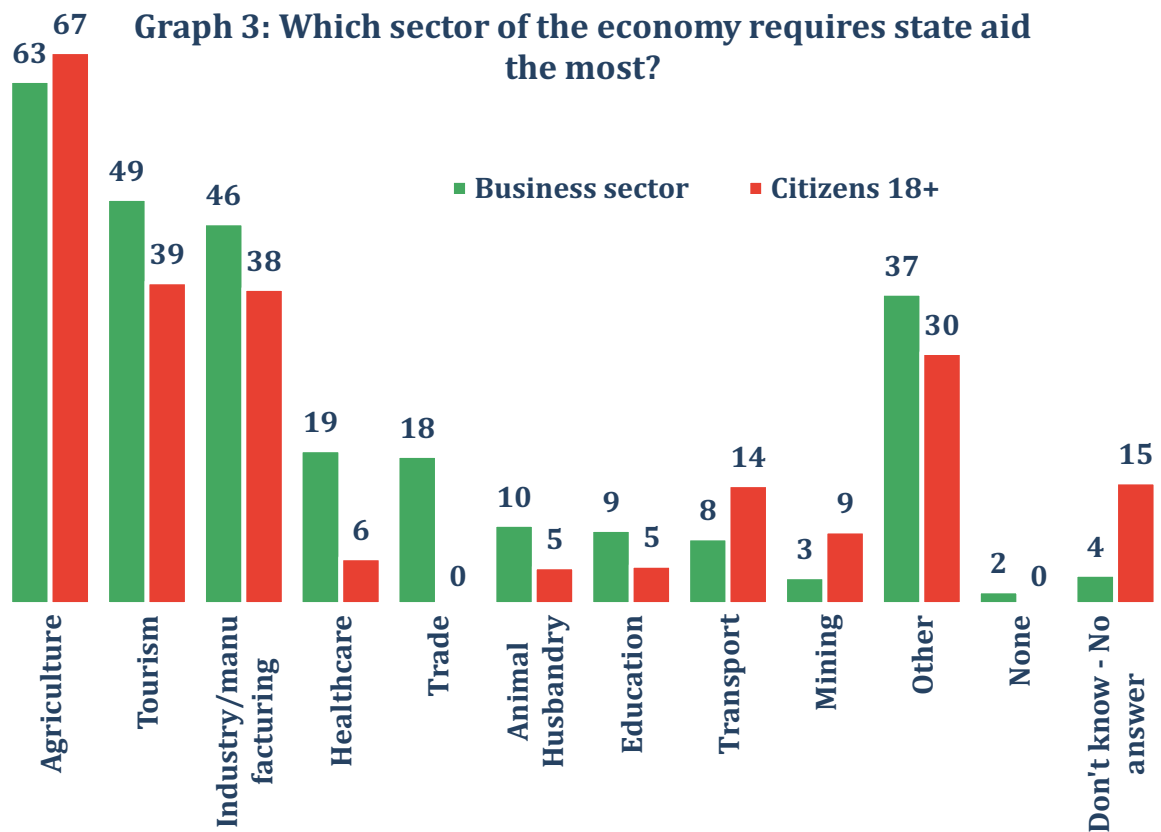


Furthermore, a clear differentiation in position of citizens and the business sector is noted in terms of the assessment of quality of the awarded state aid in Montenegro. While citizens undoubtedly believe that these government measures are implemented in line with partisan (65%) and personal interests of individuals (63%), managers of enterprises believe that in spite of particular interests involved the state aid award process may be described as planned, expert, legal, autonomous, in line with the public interests and real possibilities. However, both population groups agree that it is difficult to say that the state aid award is transparent, fair, unbiased, and objective. Representatives of enterprises that have received state aid so far are evaluating these state measures with considerably higher scores. Some

28% of representatives of managers and only 6% of citizens believe that in all cases the state aid was awarded to enterprises that needed it the most. The highest percentage of both populations (46% of business representatives and 57% of citizens) believe that the state funds reached the right hands only in selected cases, while each fourth citizen and each eighth business sector representative is of the opinion that in none of the cases the state aid was awarded to appropriate companies. Those managers who believe that the state aid has not been adequately awarded point to the Aluminum Plant Podgorica (35%) and as far as the sectors are concerned, the tourism and hospitality industry (12%), metallurgy (9%) and manufacturing/industry (7%). The Aluminum Plant Podgorica is recognized by 8% of business sector representatives as an example of abuse of otherwise properly allocated state aid. *Managers are estimating that the effect of state aid awarded so far in Montenegro was mainly short-term and local: 57% believe that the awarded state aid contributed to mitigating the damage caused by natural disasters or extraordinary circumstances, and 49% that it has contributed to upgrading the development of regions or local self-government units or the development of certain business activities. More than half of managers do not believe that awarded funds have contributed to resolution of structural and macro-economic problems.*

Vast majority (73%) of managers believes that Montenegro has done little in terms of harmonizing its legal framework for the state aid control with the European Union law. Only 11% agrees with evaluation that a lot has been done in this field.

The Ministry of Finance is the institution recognised most often by the business sector representatives as the state authority overseeing the use of state aid (28% of managers, but





when the question included a reminder, this percentage went to 89%), while much lower degree of recognition, for the question with the reminder, referred to the State Aid Control Commission (51%) and specifically Division for Preparation of State Aid (37%).

Both citizens and business sector representatives define agriculture, industry/manufacturing and tourism as the sectors that need the state aid most badly. Also, positions concerning investments in various regions are almost identical: that the state aid is most needed in the north is the opinion of 82% of business representatives and 83% of citizens, followed by the central region (7% of the economic elite representatives and 8% of citizens), while the littoral region was selected by the lowest percentage of managers (4%) and citizens (5%). However, their positions on which companies are most in need of funds are somewhat different. While citizens do not single out any specific type of companies by size, as they are of the opinion that all companies need state aid equally, most managers believe that it is necessary to invest in small enterprises (39%). Every fourth business representative has opted for a medium-sized enterprise, and every seventh citizen has done the same, while 9% from both populations believe that the investment of state funds is most needed in large enterprises.

The highest percentage of managers (71%) is not satisfied with the percent of GDP allocated for state aid, as many as 71% believing that (exceptionally) low share of funds from the state budget is allocated for this purpose. Even 90% of managers are not aware of legal limits determining the state aid amounts depending on the size of an enterprise.

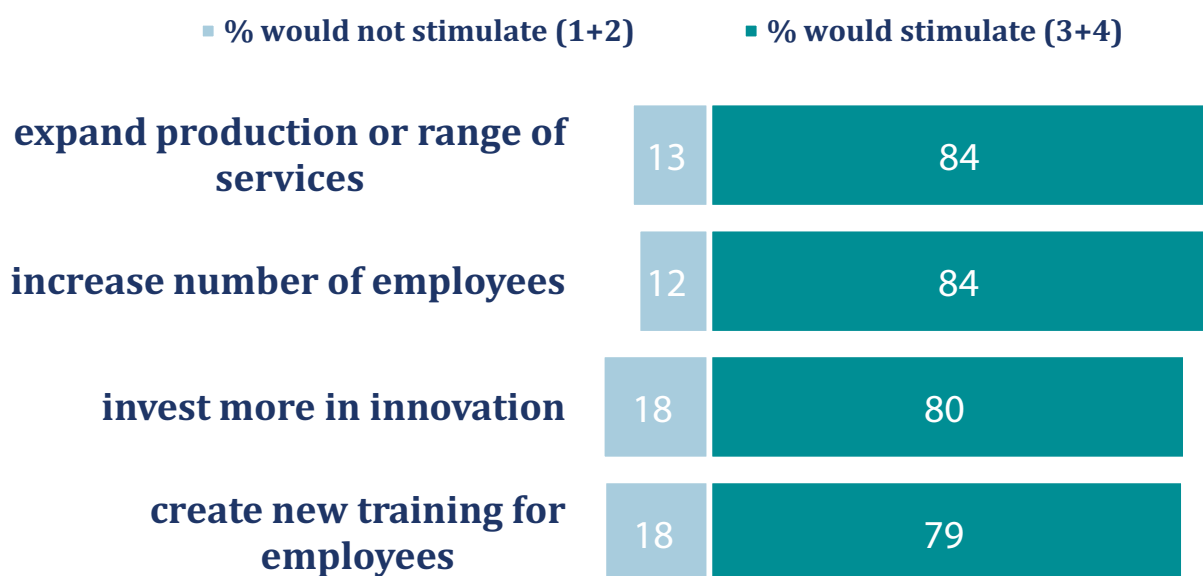
Moreover, opinions are divided on the comparison of share of GDP allocated for state aid in Montenegro and the EU member states. The highest percentage of managers does not have a clear idea about that (40%). Those with a position about this question are most often stating that the share in Montenegro is lower than the one in the EU countries (36%). On the other hand, the highest percentage of citizens believes that Montenegro is setting aside lower share of GDP than the other countries (42%).

Two thirds of managers who commenced the procedure for receiving the state aid are satisfied with the very application procedure. Those who have not applied so far for allocation of state aid as the main reasons for not applying mention that there was no need (40%) and they were unaware/uniformed (33%). Statistically notable regional differences are: enterprises from the central region are more often stating that they did not have a need for that (62%), while companies from the littoral region are more often without sufficient information (59%).

Out of enterprises that have applied, 75% became users of the state aid. Vast majority of beneficiaries are satisfied (mostly or completely) with the amount their company has received (82%).

Managers of those enterprises that have not received state aid, even though they have submitted the documentation (4% of the target population) say that the main reason for them being rejected is the tough competition (37%), while as the second reason they indicate lack of understanding, corruption, and lack of knowledge of the authorities (26%). Representatives of enterprises that have applied but not received funds from the state mention that receipt of such assistance would provide incentives to expand production or range of services (84%), increase the number of employees (84%), invest more in innovation (80%) or create new trainings for employees (79%).

Graph 4: To what extent the state aid received now would stimulate your company to...?



Vast majority of managers (96%) believes that state aid that was allocated so far to competitors has not jeopardized in any way the position and interests of enterprises they come from.

Some 40% of the business sector representatives know at least one enterprise that has received state aid. Every second manager mentioned KAP as an example, every third – Steel Plant Niksic, and every fourth – the Bauxite Mines Nikšić.

General conclusion, based on the survey results, is that the knowledge about the state aid in the business sector is insufficient, and that awareness needs to be increased within that target group both about rules and procedures and about importance of the state aid control.

RECOMMENDATIONS AND CONCLUSIONS

6

After the conducted analysis on the legal and institutional framework, and interviews and consultations with representatives of key institutions and interested parties, a general positive impression could be reached about the implemented reform the state aid control system, commenced by Montenegro in 2007. It could be concluded that there are no systemic problems in Montenegro that would disable adequate control of allocation of public funds for the state aid. The most important obstacle is lack of political will and/or expertise to resolve several key problems, relating to enterprises drawing most of the funds from the state budget such as the cases of the Aluminium Plant and Montenegro Airlines described in this document. The state aid is a complex and sensitive area where opposing desires from different entities clash and often there is a need for political courage and sacrifice of certain interests in order to stop the provision of aid and view available options through lenses of what is a long-term interest of the state.

Furthermore, difficulties will continue to arise as a result of still insufficiently experienced institutions dealing with this area for only a few years now and progress can be certainly expected in this area as the Montenegro's EU integration process advances.

Conclusions and recommendations to follow are created in order to provide incentives to institutions to fully align the state aid control as efficiently as possible with the framework applicable to the EU member states, and for the state aid policy to be guided towards the economic development objectives and incentives for positive changes in the Montenegrin economy.

Conclusions

1. Legal framework for the state aid control is now largely aligned with the EU rules, but this process has not been completed. Secondary legislation is not sufficiently detailed to enable full implementation of the Law.
2. Institutional framework is established, as well as procedures for granting and approving state aid. Even though progress has been made in this field, the administrative and expert capacities and independence of these entities is not yet at the desirable level.
3. Transparency in the state aid award has increased with the development of the website of the Commission for State Aid, publication of the State Aid Inventory, and publication of individual decisions and conclusions of the Commission.
4. State authorities, primarily ministries, have insufficient and sometimes not even elementary level of knowledge of the state aid concepts and procedures, conduct insufficient communication with the State Aid Control Commission and provide incomplete and inaccurate data.
5. The EU principles in the area of state aid are not complied with to a satisfactory degree.
6. Significant progress has been made in terms of quantity and quality of cases being resolved by the State Aid Control Commission. However, number of the Commission members is insufficient for effective decision making. The Commission very often does not react in a timely manner and does not have sufficient authority before ministries – state aid providers.
7. Allocations of Montenegro for state aid are too high in comparison to GDP, in particular if compared with the EU average. For more realistic comparison, the state aid allocation in Montenegro in 2010 were twice as high as the allocations in Croatia.
8. Structure of state aid in Montenegro is bad, almost hundred percent is allocated for rescue and restructuring and sectoral aid. Horizontal aid allocations directed towards incentives for research and development, environmental protection, training and employment and development of small and medium-sized enterprises are too small or non-existent.
9. State aid provided to the Aluminium Plant Podgorica (KAP) is disputable in terms of amount of risk premium calculated at the time of issuing the guarantees, as well as the amount of aid calculated as subsidy equivalent after guarantees were called on. The Ministry of Economy still has not taken measures to retrieve aid provided to KAP as instructed by the Commission's decision.
10. Aid to Montenegro Airlines has been provided in the form of a loan guarantee contrary to rules before the Restructuring Plan was adopted and has potentially bad influence on the competitiveness of air-transport. Several years will be required for results of the company's restructuring to be seen under the Restructuring Plan, which has just been adopted.



Recommendations

1. Harmonisation of state aid legislation with the EU rules needs to continue, particularly secondary legislation. It is recommended to find mechanisms for detailed adoption of the EU's secondary legislation in this area and more efficient adjustment to frequent changes of rules and new rules being adopted in the EU.
2. Capacities of the State Aid Control Commission and Division for Preparation of State Aid need to be strengthened, and guarantees for their operational independence need to be ensured. For that purpose, the number of the Commission members needs to be increased to at least seven, and the number of employees in the Division engaged in specific state aid affairs needs to be at least five (including those with expert knowledge in the fields of both law and economy).
3. Increase transparency in the award and approval of the state aid, by keeping the State Aid Inventory regularly updated, from case to case, and accessible as such on the website of the Commission. In addition to data about amounts of state aid provided, the Inventory should also include the amounts of state aid planned.
4. It is recommended that the Government should invest efforts in order for the state administration authorities to comply to a higher degree with the state aid notification procedures, and to advance their knowledge about the state aid. To that end, it is particularly important to strengthen capacities of the Ministry of Economy, as a large provider of mainly sectoral aid, since its present capacities in this field are highly dissatisfactory.
5. It is recommended that each ministry and other authority acting as the state aid provider or interested party assign at least one officer to be tasked with detailed monitoring of this field.
6. Establish certain measures for the providers not complying with notification rules or awarding the approved aid contrary to an aid scheme or plan, demanding for example disciplinary or misdemeanour liability of responsible person.
7. Avoid ex-post approval of state aid and use it only in highly justified cases of missed notification.
8. Stipulate in more details rules on state aid reimbursement, with enforceable powers for relevant authorities, as well as rules on determining interest rate for aid reimbursement.
9. Ensure major compliance with the EU principles concerning the state aid control, especially those explicitly listed in mandatory acts. In order to ensure compliance with the principle "less and better targeted state aid", it is necessary to supplement the Decree on the Manner and Procedure for Submission of State Aid Application and by doing so introduce a requirement for providers to submit an economic needs analysis,

- together with the state aid application, for the objective which is aimed to be achieved with the specific aid, explain how the objective will be achieved and that the aid is not only legal, but also meaningful (in cases where market failure can be clearly identified).
10. Take care to avoid breach of maximum allowed amount when cumulating aid from several providers, especially in case of small and medium-sized enterprises and in particular over the coming period when regional aid will be also allocated.
 11. It is recommended that secondary legislation should stipulate an obligation for the state aid provider to submit an independent auditor's report on implementation of the aid program after completion of the aid.
 12. National plans for state aid for specific sectors need to be developed, in the form of a strategy which will define needs and target the aid to where it is necessary, and only in the required amount, and all in line with objectives of the economic policy, social policy, and employment policy in order to increase the economic growth and ensure better management of reforms and public expenditures, and not to increase public debt and burden taxpayers.
 13. Special national plan on restructuring metal processing industry needs to be developed as well, in line with realistic economic circumstances and expectations, and then decisions should be accordingly made on either maintaining or winding-down companies in difficulties.
 14. Total amount of state aid allocations needs to be reduced, allocations for rescue and restructuring and sectoral aid also need to be decreased, and the share of state aid for research, development and innovation, environmental protection, employment and incentives for entrepreneurship should be increased.
 15. Emphasis should be placed on the economic analysis when issuing state guarantees and detailed rules should be stipulated for risk assessment before those guarantees are to be issued.
 16. Work on raising awareness of state authorities, companies, and citizens about the importance of the state aid control and its primary goal to enable equal market conditions for all business entities and provide incentives for growth and development and not to favour enterprises which are not able to survive independently on the market.
 17. In case of the Aluminium Plant, after the ownership issue is resolved, it is necessary to develop a study on sustainability of this company before planning any provision of aid, and in accordance with that subsequently develop a restructuring plan.



Annex:

In-depth interviews were held with:

- Mitar Bajčeta, Chairman of the State Aid Control Commission and Marjan Junčaj, State Aid Control Commission
- Šefika Kurtagić, Head of the Division for State Aid Control
- Damir Rašketić, Secretary of the Ministry of Finance
- Zoran Perišić, Deputy Minister for Internal Market and Competition, Ministry of Economy, member of the State Aid Control Commission
- Goran Nikolić, Ministry of Economy, Department for Industry and Entrepreneurship
- Darko Konjević, Montenegro business alliance, member of the State Aid Control Commission
- Milovan Đuričković, Director, Airports of Montenegro
- Branislav Janković, Deputy Executive Director, Investment and Development Fund
- Donka Prodanova, Delegation of the European Union to Montenegro, Task Manager for Internal Market
- Zvezdan Čađenović, expert, TRIM and AIM projects in Montenegro
- Lea Lekočević, expert, TRIM and AIM projects in Montenegro, Slovenia

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EU integracijama i procesu pristupanja

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The project is co-funded by European Union and managed by Delegation of European Union to Montenegro. This study has been produced with the financial assistance of the European Union. The contents of the document are the sole responsibility of EMIM and can under no circumstances be regarded as reflecting the position of the European Union"

ISBN 978-9940-624-02-6



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