

LAD CASE STUDY

The European Silk Road: Montenegro's Decision to Build a New Highway

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LAD

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Introduction

It is the fall of 2015 and Milo Djukanović, Prime Minister of Montenegro, sits in his office with a draft of a Memorandum of Understanding (MoU) in front of him. The Memorandum of Understanding proposes a public-private partnership between the Chinese Pacific Construction Group (CPCG) and the governments of Montenegro and neighboring Albania for the construction of a shared portion of what is known as the “Adriatic-Ionian Highway,” a future piece of road termed the “Blue Corridor.” If Djukanović agrees to the memorandum, it will be signed publicly at the upcoming meeting in Souzhou, China. Djukanović must decide: should Montenegro sign the Memorandum of Understanding with the CPCG and Albania for the development of a private-public partnership for the development of the “Blue Corridor” project?

Country Introduction

Montenegro (known locally as *Crna Gora*) is a small country located in Southeastern Europe, with a size of 13,452 square kilometers and a population of 622,159.¹ Located on the Adriatic Sea on its southwestern border, its neighbors consist of Bosnia and Herzegovina to its northwest, Serbia to its northeast, Kosovo to its east, and Albania on its southeastern border. (See Appendix C for a map of the region). Formerly a republic of socialist Yugoslavia, then a member of the state of Serbia and Montenegro, the country officially gained its independence in 2006 through a popular referendum. Under their long-time leader Milo Djukanović, this newly democratic and capitalist country has steadfastly pursued European integration and NATO accession since 2006. Although the tourism industry on the country's picturesque coast has boomed, sustained economic growth in other areas has not occurred. There has been significant investment in the coastal tourism industry from countries such as Russia.² Long-term infrastructure projects remain difficult to finance, however, as they are generally considered unable to generate sufficient revenue to support their costs. In October 2014, Montenegro agreed to a loan from Chinese EXIM Bank in order for the China Road and Bridge Corporation (CRBC) to build the Bar-Boljare highway from the Montenegrin coast to Serbia.³ Now the country is considering a second agreement with a Chinese company to build a highway, but this time under a private-public partnership agreement.

Economic Overview

Montenegro has a small, open economy typical of a “transition” country that is vulnerable to external shocks due to its size and its reliance on capital inflows from abroad to produce growth. It is costly for Montenegro to run national institutions, and the country lacks capacity to generate appropriate economies of scale. There is currently a dearth of local employment and economic

Emily Gray conducted interviews and prepared this case under the supervision of Francis Fukuyama of Stanford University. This case was developed solely as a basis for class discussion. It is not intended to serve as a historical record, a source of primary data, or an illustration of effective or ineffective management.

opportunities.⁴ The country's economy is concentrated in a few sectors (tourism, energy, and hard commodities), dependent on external financing, and suffers from a rigid labor market, stressed pension system, and high public sector expenditures. The state remains heavily involved in most enterprises.⁵

The country has significant needs in terms of new infrastructure development. However, it currently does not have the budget, nor does it foresee having the budget, to pay for the construction of large infrastructure projects. This limits it to loans and other methods of financing for such ventures. Montenegro's most serious economic concern is its high level of public debt. The country's debt-to-GDP ratio in 2015 is 69.3%, a rate that has been increasing since 2008.⁶ The causes of this debt are high levels of public spending, elevated levels of non-performing loans, and high cost of a 2014 loan made from the CRBC for the construction of the Bar-Boljare highway.⁷ In fact, the debt level spiked, moving from 58.7% in 2013 to 63.4% in 2014 and finally up to its high in 2015, after the loan agreement for the Bar-Boljare Highway was made. The International Monetary Fund (IMF) projects that over the next three years the public debt to GDP ratio will rise to 80%.⁸ (See Appendix A).

Montenegro's experience with financing the Bar-Boljare highway informs its current decision on the MoU for the Blue Corridor project. The government originally sought to procure the Bar-Boljare highway as a public-private partnership and in 2009 selected a Croatian consortium to complete the project, but the consortium was unable to obtain bank financing for the project by the required date in the contract. The government then cancelled the contract award and began negotiating with the bid runner up, a consortium between a Greek developer and an Israeli developer. That consortium, though, was also unable to raise debt financing for the project. Finally, the government turned to partner with the China Road and Bridge Corporation to develop the project, which came with an offer to finance the project by the China EXIM Bank. The terms negotiated with China EXIM, though, were different from the original procurement for the highway. Under the loan terms, Montenegro's government would collect toll revenues from the road after it was developed, but would also be responsible for repaying the loan itself. Thus the loan would not be recourse to only the project itself and its future revenues, but under a sovereign guarantee from the Montenegrin government. The loan payments were further U.S. dollar denominated. This meant that, in addition to taking the risk that toll revenues would be too low to service the project debt, the Montenegrin government was also taking on the risk of currency fluctuations.

High levels of public debt place strains on Montenegro's economy and its political goals. In 2014, the IMF noted in their 2014 Article IV report that regardless of sustained growth driven by large investment project-driven growth, Montenegro would need fundamental structural reform to public financing in order to allow the country to endure external shocks and meet its financing needs.⁹ The World Bank states that the poor state of public financing may in the long run hinder the growth of the local private sector.¹⁰ As a prospective EU member state that has signed a Stabilization and Association Agreement (SAA), Montenegro has a debt ceiling imposed by the Maastricht criteria for EU candidates. One of these "convergence criteria" is sustainable public finance, measured by debt as a percentage of GDP. The specific criterion, as provided by the European Central Bank, is that this debt-to-GDP ratio must not be greater than 60%.¹¹

Montenegro passed a law in 2014, mandating fiscal responsibility in an attempt to shore up the country's public finance management. However, because Prime Minister Djukanović termed Bar-Boljare a project of national interest, Parliament passed the debt increase for the highway despite the 2014, allowing the government to take on additional debt and surpass the EU's debt limit.¹² To accommodate this increase, Parliament instead introduced fiscal tightening measures, including a 2% increase in value-added tax and a 4% income tax for above-average earnings.¹³ The government's decision to allow the debt increase in order to take the loan for the Bar-Boljare highway was controversial (discussed in detail below) in international institutions such as the World Bank, which withdrew \$50 million in direct budget loan support as a result of the deal, and the IMF, which claimed that the increased debt would greatly burden public finances and negate all recent fiscal balance improvements.¹⁴ In October, 2014, Moody's downgraded the country's government bond rating from stable to negative, primarily due to the Bar-Boljare loan.¹⁵ The Bar-Boljare highway was scheduled to be completed in 2019, but by 2018 the cost of the project had already increased by approximately 20%, primarily due to increasing U.S. dollar exchange rates since the original loan for the project was issued.

Montenegro unilaterally adopted the Euro in 2002. As a result, they do not have an independent monetary policy. This facilitates internal stability, business with foreign investors, costless transactions, and future EU integration. However, should there be any shocks to the Euro, the Central Bank of Montenegro would not be able to make adjustments to the currency to cushion the effects of such shocks as they lack independent monetary policy. They are also more vulnerable to any economic difficulties experienced in the Eurozone.

The Project: The Adriatic-Ionian Highway

The Adriatic-Ionian Highway (AIH), an idea considered in some form or another for centuries, first took its modern shape with a proposal from the European Union. The European Commission launched the Trans-European Transport Network (TEN-T), beginning with plans made in the 1990s, in order to implement and develop a European network of transportation infrastructure. This consists of nine Core Network Corridors, as well as two Horizontal Priorities (railway management and maritime infrastructure), within a larger Comprehensive Network (See Appendix C, Figure 2).¹⁶ Although the Adriatic-Ionian Highway is not included in these core plans, the European Union has long defined the Adriatic and Ionian region as one of great importance. In 2014 the European Council endorsed the EU's third macro-regional strategy, the EU Strategy for the Adriatic and Ionian Region (EUSAIR), in partnership with the Adriatic-Ionian region countries. The strategy covers Croatia, Greece, Italy, Slovenia, Albania, Bosnia and Herzegovina, Montenegro, and Serbia. The goal of EUSAIR is to promote economic and social growth as well as European integration in the region through cooperation and connectivity. This is done through four thematic pillars: (1) Blue growth; (2) Connecting the region; (3) Environmental quality; and (4) Sustainable tourism. In their 2014 explanation of the second pillar, which is intended to connect the region through transport and energy networks, the EU highlighted the completion of a highway from Trieste, Italy to Patras, Greece, as a priority.¹⁷

Europe's plans for development of the Western Balkans coincide with the Chinese economic development plans as part of "One Belt, One Road." In order to promote regional cooperation and development, in 2012 China instigated the Initiative of Cooperation between China and

Central and Eastern European Countries, better known as the 16+1 Forum, for the countries of central and eastern Europe, one of the central goals of which is to stimulate transportation infrastructure investment.¹⁸ The AIH is a key component of China's proposed trade routes.

According to the EU's proposal, the highway is intended to run approximately 1550 kilometers from Trieste, Italy, through Slovenia, Croatia, Bosnia and Herzegovina, Montenegro, and Albania, to Patras and Kalamata, Greece. Portions of the planned highway are at different stages of development: Italy, Croatia, Albania, and Greece already have much of the proposed route constructed as part of national or regional highways; Bosnia and Herzegovina and Montenegro, on the other hand, have very little constructed, and the planned route in these countries goes through some of the most difficult terrain in the region. Furthermore, the exact route, particularly through Croatia into Bosnia and Herzegovina, as well as through Montenegro and parts of northern and southern Albania, has yet to be agreed upon.¹⁹ The central difficulty facing this project is the lack of central coordination and a stable funding source. Despite encouragement from the EU and China, there has been no comprehensive effort to plan and fund the construction of a complete highway that meets European standards.²⁰

Nevertheless, the idea picked up diplomatic traction in August 2014, when prime ministers from Croatia, Montenegro, Bosnia and Herzegovina, and Albania met in preparation of the annual Berlin Process conference. All agreed the project was important and should be discussed at the upcoming conference.²¹ Then, in 2015 following a CPCG visit to Albania, Montenegrin Prime Minister Đukanović and Albanian Prime Minister Edi Rama met in Brussels, on the sidelines of a meeting of the Western Balkans Six (Albania, Bosnia and Herzegovina, Kosovo, Montenegro, Macedonia, and Serbia), and discussed their support for the joint implementation of the Adriatic-Ionian Highway in order to achieve "better connectedness and more dynamic economic development of the entire region." They discussed other joint projects and European integration processes, and Rama stated that Albania (currently a NATO member) "strongly support[ed] Montenegro's NATO bid" as an action that would increase regional stability.²² The project is to be further discussed at the upcoming 16+1 Summit in Suzhou, China, where China will announce a new "maritime Silk Road."

At this point, all prime ministers of the related countries have discussed the project. Although it remains on their plans for transportation, very little progress has been made. In particular, this is likely due to disagreements in each of the countries. In Croatia, for example, the government is refusing to allow any highway to run through their southernmost city of Dubrovnik. It is further speculated that Croatia is interested in retaining control over various ports on the Adriatic Sea, and is thus unwilling to allow for certain coastal highway routes. Slovenia, which borders the proposed end point of the highway in Trieste, Italy, similarly does not favor its progress, due to a desire to control the flow of traffic inland to Europe and to support their port at Koper. Bosnia and Herzegovina is willing to construct the road, particularly in the Republika Srpska, but the project will require significant investment for this resource-strapped country to build. Montenegro is considered one of the greatest bottlenecks due to its small size, lack of financial resources, and internal disputes over the road. For Albania, the issue is primarily specific sections of the route, as planners (Albanian, European, and Chinese) have had difficulties creating feasible plans that respect environmental and community concerns.²³

The Adriatic-Ionian Highway in Montenegro: The Memorandum of Understanding

The specific project on the table before Djukanović is a portion of the AIH between Montenegro and Albania. The concrete plans for this segment of the road came about when a CPCG delegation visited Albania in April 2015 and had a meeting with Minister of Transport and Infrastructure in Albania, Edmond Haxhinasto. The CPCG representatives said at that time that Albania had strategic geographical position and high potential in several sectors.²⁴ Later that month, Rama brought the idea to Djukanović at the Western Balkans Six meetings in Brussels, and the project was included in the joint statement of the prime ministers following that meeting.²⁵

Prior to these discussions, both countries have engaged consultants in research on the AIH. In Montenegro, prior to 2010 the Ministry of Sustainable Development and Tourism in collaboration with the London-based engineering consulting firm Ove Arup and Partners, International Ltd. (ARUP), and the Podgorica-based firms “SIMM Inženjering” and “Centar za Arhitekturu i Urbanizam” (CAU), produced a “Detailed Spatial Plan for the Adriatic-Ionian Highway” which detailed concerns surrounding construction, topography, geographic route, economics, traffic, and sustainability. Released in 2012, this report suggested that the route travel from the border with Bosnia and Herzegovina through Grahovo, Čevo, Podgorica, and finally via tunnel through Dečić, at the Albanian border. This document included some initial feasibility studies. Total construction costs, according to this report, would be €1,020.2 million.²⁶ However, no concrete action, other than the proposed Memorandum of Understanding (MoU), has been taken on this research. (See Appendix C for a map of the proposed route).

In the MoU (Appendix B), the CPCG, the government of Albania, and the government of Montenegro will set forth the basis for a partnership under which to begin the construction of the Adriatic-Ionian Highway between these two countries on the basis of a private-public partnership. The MoU recognizes China’s increased role in Central and Eastern Europe since 2012, including the securing of a special credit line between China and these countries, and notes that this highway will be important for economic development and connectivity. The text of the memorandum stipulates that CPCG will propose a public-private partnership for the project on the basis of data, a time frame for construction, and field tests conducted. This partnership will be negotiated with all parties, a concrete project proposal will be made, and a subsequent contract for development will be signed by CPCG and the respective ministers. The MoU requires CPCG use the maximum possible local resources and the countries will support CPCG’s requests for funding from Chinese banks. The MoU stipulates that Albania and Montenegro will not have any financial obligations in the realization of the proposal. The MoU does not include any details about the project itself.²⁷

Once signed by the transportation ministers, the MoU is put to the parliament for amendments and must be ratified in order to go into effect. MoUs are commonplace in the Western Balkans, and it is well known that they are not taken as serious commitments by leaders.²⁸ However, this does not mean that Djukanović is taking the signing of this document lightly. In fact, he is closely considering several factors in making his decision, as there are a number of potential problems and unknowns for his country if he signs without consideration.

Factors for Consideration

Other Infrastructure Projects

Montenegro is in the process of undertaking or discussing the development of several other infrastructure projects: the Bar-Boljare Highway, the Trans Adriatic Pipeline, and a railroad. These have positively and negatively impacted considerations for the AIH.

- *Bar-Boljare Highway*

The Bar-Boljare highway is a 169.2 km stretch of motorway between Montenegro and Serbia. It will ultimately connect ports on the Adriatic Sea in the West with ports on the Danube River in Serbia. A 41 km stretch of this road (from Smokovac to Mateševo) was agreed to be built with the China Road and Bridge Corporation (CRBC, a subsidiary of the China Communications Construction Company (CCCC)) in a contract signed on October 30, 2014 and is under construction. Of the 809.6 million Euro total required for the construction, the EXIM Bank is providing a 689 million Euro loan given for a 20-year period, with a 6-year grace period and a 2% fixed interest rate. Montenegro is responsible for paying 121.44 million Euros.²⁹ The project requires 30% of the work to be done by local companies. This project is also tax- and custom-exempt by law.

In 2013, Prime Minister Djukanović declared that the motorway was “the most important infrastructure project for the future economic development of Montenegro.”³⁰ It is considered critical for Montenegro’s integration with the European Union, connecting the harbor of Bar with European roadways. In addition, the highway will provide connection between the Adriatic Sea and the Danube, extend the Pan-European Corridors network, and create the shortest connection between Hungary/Romania and Southern Italy/Albania (through Serbia and Montenegro). The government and economic experts in Montenegro are confident that even though the highway has a steep price, the benefits accrued from the country’s development will lead to even more development, and the investment will be overall beneficial for Montenegro.³¹ Bar-Boljare is highly desired by most in Montenegro, as it is seen to be important for tourism and stopping unwanted emigration of Montenegrins out of the country. It is believed that highway and its associated economic benefits will help keep people in the country.³²

The general desire for the Bar-Boljare highway, however, ran in conflict with the project’s expected microeconomics. Twice the government had issued concessions to finance the project non-recourse, but the private partners had been unable to source debt financing for it. Presumably this was due to the fact that projected toll revenues for the project were expected to be too low to compensate for the project’s risks and costs. International development lenders like the IMF and World Bank likewise wouldn’t lend Montenegro funds to develop the project under a sovereign guarantee, as this would have increased the country’s debt significantly. With years of effort spent trying to procure the project and considerable general public support, Djukanovic turned to another option – the loan from China EXIM – to make the project a reality.

Djukanović’s insistence on this project led him to borrow almost \$1 billion for the project, increasing public debt over the 60% limit and violating debt restrictions placed by the European Union.³³ As a result, in March 2014, the World Bank withdrew \$50 million in direct budget loan support to Montenegro because of the deal. The IMF warned this would greatly burden public

finances and negate all recent fiscal balance improvements, projecting a primary surplus of 2.7% in the absence of a highway but a primary deficit of 3-5% with the highway.³⁴ The European Bank for Reconstruction and Development (EBRD) cited this event in claims that the country's recent growth was disappointing. Despite the legal barriers to taking on additional debt, Montenegrin political leaders emphasized that Bar-Boljare was a project of national interest, and thus this became a legal rationale for allowing the country to take on additional debt. Montenegro adopted the Law on the Bar-Boljare Highway on December 8, 2014 with vote of 44 (with 22 in the opposition and 2 abstentions).³⁵ To accommodate the debt, the government introduced fiscal tightening.³⁶

The project began May 11, 2015 and is projected at this time to take 48 months to complete.³⁷ Thus far, the CRBC has a positive reputation in Montenegro. Work has gone smoothly and they have fulfilled their commitment to use local labor.³⁸

- *Trans Adriatic Pipeline (TAP) and Ionian Adriatic Pipeline (IAP)*

Construction on the TAP, a pipeline that will bring Caspian natural gas to Western Europe, is scheduled to begin in 2016. As a critical portion of the Southern Gas Corridor, TAP will connect the Trans Anatolian Pipeline (TANAP) at the border of Greece and Turkey with the Italian natural gas pipelines by way of Greece, Albania, and the Adriatic Sea.³⁹ TAP's shareholders are: BP - UK (20%), SOCAR- Azerbaijan (20%), Snam – Italy (20%), Fluxys –Belgium (19%), Enagás –Spain (16%) and Axpo - Switzerland (5%). Although the TAP itself will not cross Montenegro, it will have important implications for the country: countries in the Western Balkans, Croatia, Bosnia and Herzegovina, Slovenia, Albania, and Montenegro, are all supporting the TAP with their involvement on the proposed Ionian Adriatic Pipeline (IAP). The IAP would connect directly to the TAP and bring Caspian gas into these markets. Members of these counties formally supported the TAP in 2013 with a declaration of support.⁴⁰

The goal of the IAP is to connect Croatia's gas pipelines with the TAP through Montenegro and Albania, providing these countries with a natural gas supply totaling 5 bcm/y. It will have a bidirectional gas flow possibility.⁴¹ A feasibility study for the project was completed in 2014, funded by the EU's Western Balkans Investment Framework (WBIF). This initiative, which brings together the European Commission, the Council of Europe Development Bank, the EBRD, the European Investment Bank, and other donors, was designed to facilitate the development of the region through financing and technical assistance for strategic investments related to energy, environment, social, transport, and private sectors.⁴²

Thus far, the Montenegrin government has undertaken a joint Ministerial Declaration on the pipeline (2007); an MoUC signed by Plinacro & TAP AG, BH-Gas and TAP AG, the Ministry of Economy of Montenegro & TAP AG and the Ministry of Economy, Trade and Energy of Albania & TAP AG (2011); an MoU for the implementation of the TAP and IAP between Albania, Bosnia and Herzegovina, Croatia and Montenegro (2013); an MoU between Azerbaijan, Albania, Bosnia and Herzegovina, Croatia and Montenegro, for the development of the Southern Gas Corridor (2014); and a joint statement between the Ministers of Foreign Affairs of Albania, BiH, Croatia, and Montenegro on the IAP (2015).⁴³

- *Railroad*

The last of Montenegro's infrastructure priorities is modernizing its railways. Montenegro has several proposed railway projects, but the country is particularly interested at this time in those which would be part of the South-East Europe network (SEETO), including a portion of the international line between Belgrade, Serbia and Bar, Montenegro (on the Adriatic coast). The part that Montenegro is interested in building is between Vrbnica (at the Montenegro-Serbia border) and Bar (a city on the Adriatic coast) and is intended to be implemented between 2016-2018 with approved loan funds from EBRD, EIB, IPA, and WBIF (totaling 20 million Euros of the necessary 40 million to complete the project from the WBIF IPA 2015).⁴⁴ Modernization of the railway system involves undertaking expensive rehabilitation and overhaul projects of infrastructure such as railways, bridges, tunnels, stations, and safety systems. The government states that these improvements will positively impact business, decreasing transport times for goods and increasing railway transport's competitiveness. They will also contribute to improvements in traffic reduction on roadways.⁴⁵

Domestic Pressures

Milo Djukanović began his political career as Montenegro's prime minister in 1991, when the country was still a part of Yugoslavia, as a protégé of then-president of Serbia Slobodan Milošević. However, he quickly broke from his connections to Milošević and has since overseen the country's peaceful independence from Yugoslavia and Serbia. Djukanović served as Prime Minister from 1991-1998, then as President from 1998-2002. He served as Prime Minister three more times following his presidency for a total of six terms: from 2003-2006, from 2008-2010, and from 2012 until the present time.⁴⁶ Throughout the 1990s and early 2000s, he gained full control over the ruling Democratic Party of Socialists (DPS), administrative bodies, and the police force.⁴⁷ At the time of his ascent to power and independence from Serbia, Djukanović chose to single-mindedly pursue a pro-European path for the country, and he has held to this, supporting European Union accession measures and membership in NATO, despite the country's historic ties and contemporary economic relations with Russia. Their goal is to join NATO next year and the EU by 2020, although there is no indication at this time as to how realistic those goals are, given concerns about domestic, NATO, and EU support.⁴⁸

Despite this orientation, Djukanović has held a long grip on power (his reign is known as the "government of continuity"), and has been accused of heavy involvement in corruption and organized crime throughout his career. He is viewed locally not as a prime minister, but rather as a businessman. In particular, he has been accused of being at the center of a cigarette smuggling operation with the Italian mafia. Many believe that Djukanovic used the smuggling to produce revenue for Montenegro's government operations and to generate personal wealth. He and his family have amassed large amounts of wealth from unknown sources, and have been accused of using this money to purchase and control local businesses, namely the privatized state bank and a large stake in the tourism industry.⁴⁹ It is believed that Djukanović may have several conflicts of interests in his business operations, and he has been accused of laundering money, using state funds to give out unauthorized loans, controlling legal prosecution, and using state newspapers to smear journalists who uncover corruption.⁵⁰

The current government consists almost entirely of members of Djukanović's party, and as a result he single-handedly directs every action the government takes with minimal opposition. As

the leader of the most powerful party in the country, he is the most important figure in any decision made. Djukanović is supported by the EU, which sees him as a “factor of stability.”⁵¹

Montenegro’s government is a parliamentary republic, with a president (largely ceremonial, today filled by Filip Vujanović, an ally of Djukanović), an 81-member parliament led by a Prime Minister, and a judicial branch with several layers of courts including a Supreme Court and a Constitutional Court.⁵² The key political parties in the country are Djukanović’s DPS, successor to the League of Communists of Montenegro, which has been the ruling party for over twenty years. The Social Democratic Party (SDP), although small, is important as a coalition partner of the DPS. In recent years they have, however, increasingly become critics of the government. Also in the current government are the Croatian Civic Initiative, HGI, the Bosniak Party (BS), and the Positive Party. The opposition consists of a coalition of parties established in 2012 under the name Democratic Front, a group whose aim is to replace the DPS (describing it as “authoritarian, retrograde, criminal, and oligarchic”). These parties include Civic Movement URA, DEMOS, Movement for Changes PZP, New Serbian Democracy NOVA, part of the Socialist People’s Party, and non-Parliamentary independent individuals.⁵³

Although Djukanović does not expect serious opposition from the government that is in place currently, domestic political tensions have been rising over the past several months. Opposition parties have boycotted parliament for several months since the rejection of proposed electoral reforms that promised to create a fairer voting process, targeting irregularities in voter lists and abuses of party budgets during elections. In October 2015, thousands of protesters took to the streets in Montenegro’s capital, Podgorica, calling for the government’s resignation and early elections, claiming that the government was involved in corruption and election fraud. Protests were initiated at the end of September in relation to the proposed reforms. Led by the Democratic Front, which includes not only opposition parties but also NGOs and students, protests lasted for over a month. They initially demanded that Prime Minister Djukanović resign and that new elections according to the reformed process be held.⁵⁴

Protests continued peacefully through the month of October. When state police asked protesters to move from the square after the expiration of their permit to protest on October 10, they ignored the requests. On October 17, key opposition leaders and members of parliament were injured and others, alongside journalists, activists, and professors, were arrested when the protests resulted in violent clashes with riot police.⁵⁵ Later, on October 24, police used tear gas and stun grenades against protesters throwing torches and fireworks in an attempt to break into the parliament building. Approximately 5,000 had gathered that day to demand Djukanović’s resignation, a new government, and early elections with cries of, “Djukanović thief!”⁵⁶ For his part, Djukanović and the Montenegrin government claimed that the protesters were anti-NATO and supported by Russia and Serbia. These claims were vehemently denied by Democratic Front leaders.⁵⁷ Protesters claimed that the protests were not about NATO, but rather about the poor quality of life, claiming that Djukanović himself was responsible for the destruction of Montenegro through corruption, crime, and dictatorship.⁵⁸ Montenegro’s expected offer of NATO membership in the upcoming months has increased tensions and played a role in the public’s calls for Djukanović to resign.

Observers consider that the country is in domestic political crisis, with the absence of a functioning Parliament. However, regular parliamentary elections are scheduled for 2016. Eligible Montenegrins will vote for their 81 members of Parliament, each of whom will serve a four-year term, in a single nation-wide constituency via a proportional representation system with closed lists.⁵⁹ This crisis is worrisome for Djukanović, who is now pursuing strategies to keep himself and his party in power.⁶⁰

In order to do this, Djukanović is interested in sending the message that he is keeping the Montenegrin people's interests in mind. He hopes to demonstrate through a high-visibility project that he will create jobs and increase trade.⁶¹ He particularly hopes to target the poor farmers in the north, whose economic situation has been neglected with the economic development of the coastal resort and shipping areas. Farmers there are unable to collectivize legally, and therefore have no way to guarantee sales or increase their own production.⁶² There is also limited access to public service, education, and ways to generate income, and unemployment in the northern regions is approximately double the national average.⁶³

Economic Pressures

Montenegro is a small country, and as such does not have many possibilities for economic development. The economic development that has occurred has been concentrated in industries such as tourism, development of the coastline, and real estate. The tourism industry is, in fact, the single engine of growth in the country. The economic benefits that individuals connected to these industries have seen has not been realized in other areas, such as small farmers who have no way to collectivize and therefore grow.

Furthermore, Montenegro's debt is a serious concern. (See Appendix A.) It is considered by international monitors to be "highly-indebted." The "Network for Affirmation of NGO Sector," an NGO funded by the European Union and IPA Civil Society Facility Programme, and supported by Balkan Monitoring Public Finances, notes that this is mostly due to the "construction of the [Bar-Boljare] highway, interest rates for previous loans, state guarantees for private companies and salaries for oversized public administration."⁶⁴ They also note that Parliament and the Government have regularly failed to exercise oversight over this arena, and that the Government has even ignored reports made by the State Audit Institution. Rather than provide straightforward information about the public debt, the Government instead focuses on how it will manage the debt situation.⁶⁵

As a small country, the government has always struggled to produce enough revenue and has a history of taking on debt in order to make payments, particularly for social goods, and has been accused of having an oversized public administration. However, the government took on an increased public debt, over 60% of its GDP, with the Bar-Boljare highway contract. Not only is this in violation of EU accession standards, but it is also concerning for the future health of Montenegro's economy and makes lenders and donors to Montenegro wary of the leadership's financial responsibility.⁶⁶ Also of concern for the country's internal capability for infrastructure development, Montenegro's transportation ministry lacks expertise, and it is necessary to get this skill in engineering and construction from other countries with greater development experience.

Montenegro's desires for economic growth, while supported by the Chinese, are limited by their European aspirations, which places restrictions on their financial decisions in an attempt to guarantee baseline economic health before allowing EU accession. However, as Montenegro desperately seeks increased economic growth, improved transportation infrastructure is a critical component. Building highways such as Bar-Boljare and the AIH are essential for Montenegro's development, and have the potential to bring significant economic benefits to the country.

Pressures from the EU

Montenegro's chief interest is in joining the European Union. In order to officially join the EU, states such as Montenegro must meet a set of criteria known as the Copenhagen criteria, which stipulate political, economic, and other requirements for EU membership. There is an extensive process of reporting, monitoring, bilateral treaties, dialogue, and technical assistance in the accession/EU enlargement process. The EU furthermore has stipulated a set of economic criteria known as the Maastricht criteria which EU countries must meet in order for the Euro currency to be introduced in the country. This is meant to ensure stability in the Eurozone. The indicators include:

- Price stability, to show inflation is controlled;
- Soundness and sustainability of public finances, through limits on government borrowing and national debt to avoid excessive deficit;
- Exchange-rate stability, through participation in the Exchange Rate Mechanism (ERM II) for at least two years without strong deviations from the ERM II central rate;
- Long-term interest rates, to assess the durability of the convergence achieved by fulfilling the other criteria.⁶⁷

The countries of the Western Balkans are part of what is known as the Berlin Process, which has the aim of integrating these states into the European Union. They hold an annual summit, as well as several other joint and individual meetings throughout the year, to discuss key issues in the integration process. Montenegro has had a Stabilization and Association with the European Union since 2007 and Schengen visa-free travel since 2008. The country applied for EU membership in 2008 and accession negotiations began in 2012. Montenegro is in the process of negotiating various chapters of their accession with the EU, but they already have free access to the EU market for their exports.⁶⁸ Montenegro has provisionally closed two chapters, Science and Research and Education and Culture, at this time. In 2015, negotiations have been opened on Taxation, External Relations, Financial Services, TENs (Trans-European Networks), Transport Policy, and Energy.⁶⁹

As mentioned previously, Montenegro unilaterally adopted the Euro as their currency without significant pushback from the EU. However, they did not fulfill the Maastricht criteria prior to adopting the currency, and thus they are still being measured against these standards in order to finalize and approve their accession. For Montenegro's purposes, the most concerning criterion at this time is "sustainable public finances," which is measured via government debt as a percentage of GDP (discussed above).

Despite the EU's promises to support Montenegro, there is a pervasive opinion in the country that the EU has enthusiastically asked Montenegro to join it, requiring many reforms, but has not

provided much support or help in achieving these goals. Many believe that this indicates a lack of seriousness on the part of the EU.⁷⁰

Djukanović runs a pro-European government, and for him and the leaders of the other Western Balkans countries also in the process of EU accession, much stock is put in positive public relations. At joint meetings, such as the annual summits as part of the Berlin Process, as well as at other various meetings throughout the year, Djukanović and other Western Balkan leaders are interested in demonstrating their commitment to regional and European cooperation. For Djukanović, one important public relations partnership is with his neighbor to the south, Albanian Prime Minister Edi Rama, who is pro-European and the leader of a NATO member state.

Relationship with China

Montenegro first established diplomatic relations with China on July 7, 2006. China's interest in this country, as part of the wider Eastern European region, has grown since that time. In 2012, China established its first platform for cooperation with Central and Eastern Europe (CEE) known as the 16+1 Forum. China is particularly interested in developing the countries in this region as a "gateway" to the European market as part of their "One Belt, One Road" initiative, possibly to evade EU anti-dumping regulations, as well as part of a global play for dominance in a region previously under the economic influence of Russia. CEE countries were eager at this time, during the global financial crisis, to cooperate with China, which represented a fresh source of financing and energy. At the 2014 16+1 meeting, China announced the creation of a \$3 billion investment fund for the region. China is willing to provide more flexible funding conditions to those countries to upgrade their infrastructure as long as they used Chinese equipment and products.⁷¹ Trade between China and Southeastern European countries has increased significantly in the past ten years, and China opened trade centers in Belgrade, Serbia and Zagreb, Croatia in 2010.⁷²

The Western Balkans region, in particular, is seen as an important region for connection due to its geographic location. China foresees the future benefits of this region's European integration and views this as the most ideal place to access EU markets and Western Balkans ones, as shipments via sea remain the least expensive way to transport goods. Thus, the Western Balkans serve as a key port and transport corridor which would greatly increase China's shipping times to Western Europe.⁷³ Although China has little historical experience and investment in the region, the forum has established concrete collaboration in areas such as the economy and infrastructure. China has sought to attract Balkan partners with promises of loans, contracts, and plans for massive infrastructure projects.⁷⁴ Nevertheless, this move from China presents some risks for all parties, as China's lack of experience in the region as well as their optimism in expectations from projects considered there may be met with the reality: difficulty in terrain, lack of development, and political challenges.⁷⁵

The EU is concerned about this activity, seeing China as an economic threat and expressing concerns about the country's lack of transparency in their business deals. The EBRD notes that many countries have resisted China's efforts to invest in Europe and build a "Balkan Silk Road," yet that it is critical the European Union is involved in the process of this construction as it can ensure its standards are maintained and full benefits received from the process. Such an effort

from the Chinese governments and banks has the potential to help transform the Western Balkans region, but it must be monitored by and done in cooperation with the European Union.⁷⁶ Countries such as Montenegro have welcomed China's advances, seeing them as a feasible route towards the economic and infrastructure development and that the EU requires of them in order for them to join the EU and have access to the EU's financial resources. China offers feasible terms to reach European goals where Europe cannot offer enough. Thus, Montenegro is using Chinese investment not to further their goals vis-à-vis China, but rather the EU.⁷⁷ Projects undertaken with China send a message to the EU that Montenegro is committed to development. However, this funding is seen as a complement to, rather than a replacement of, EU funds.⁷⁸

Montenegro has already benefitted from loans from China's Exim bank, mentioned above. Chinese investor's such as Poly Group Corporation and Norinco have both shown interest in investing in energy projects in the country, including hydropower plants on the Moraca and Komarnica Rivers, as well as a thermal power plant at Pljevlja.⁷⁹ In particular, the plant at Pljevlja is an example of the Chinese investing in a project that the EU will not, due to the EU's higher environmental standards.⁸⁰ China has also invested 100 million Euros in renovating the Montenegrin ship fleet.⁸¹ Many view this cooperation as positive, and there is some enthusiasm for continuing this type of cooperation. However, China is still not a top investor in Montenegro. In terms of total FDI, in 2014 it was the 34th largest investor in the country, whereas the Russian Federation, Switzerland, the Netherlands, Slovenia, Serbia, the United Kingdom, and Germany were top investors.⁸² Montenegro's government and parliament have acknowledged the risks and cultural opposition to working with China. In addition, China has a competitive disadvantage investing in Montenegro, as Chinese tourists do not regularly travel to Montenegro due to visa regulations.⁸³

In June, 2015, the fifth session of the Joint Committee for economic and trade cooperation between Montenegro and China was held in Ningbo, China and attended by Deputy PM Vujica Lazović and Minister of Transport and Maritime Affairs Ivan Brajović. They noted the progress made on joint projects such as the Bar-Boljare Highway, as well as the increase in trade between the two countries. They also affirmed their joint commitment to increased trade, project implementation in the energy sector, and Chinese companies' participation in transportation infrastructure.⁸⁴

Albania has historic ties with China reaching back to their communist period. The Chinese Everbright Company bought the Tirana International Airport and Geo-Jade Petroleum purchased Banker's Petroleum. Other companies have invested in Albania's mineral resources.⁸⁵ China is currently working in the Arber motorway between Albania and Macedonia (FYRoM) and an industrial park in Durres.⁸⁶

The CPCG

The Chinese government has supported what is termed the "Go-out" policy, which encourages domestic firms to look overseas for business opportunities.⁸⁷ As part of this policy, the CPCG is pursuing its project in Montenegro. CPCG, founded in 1995, has as its main activity the design and construction of infrastructure, particularly roads. It is one of the biggest Chinese companies in terms of annual turnover. They are trusted and have a good reputation. Furthermore, they are a private company. They are therefore able to conduct this type of business with Montenegro, whereas public Chinese firms are not. In their April 2015 visit to Albania, the CPCG stated that

they believe that Montenegro and Albania have strategic geographic positions, as well as significant potential in many sectors.⁸⁸ Montenegro, for example, with its natural coastal and mountainous beauty, has had rapid growth in tourism. They also have a favorable business environment, including low taxes for businesses. Their preexisting relationship with Chinese investors is also seen as a positive.⁸⁹

In October, Yan Jiehe of the CPCG visited Montenegro and met PM Djukanović, Minister Brajović, and other officials. Yan shared information about the CPCG's success and dependability as well as China's development strategy, and Montenegrin officials shared information about their own economic development. The two parties were greatly impressed by the other, and left the meeting strongly interested in pursuing further cooperation on projects.⁹⁰ This followed their April 2015 visit to Albania, when a delegation from the CPCG met with the Minister of Transport and Infrastructure Edmond Haxhinasto.⁹¹

Regional Pressures

Despite the number of outstanding diplomatic issues between countries in the Western Balkans, Montenegro is notable for its good relations with its neighboring countries. The EU has put significant pressure on the Western Balkans to resolve regional disputes and reduce barriers to regional trade; as a result, Montenegro has actively sought good bilateral relationships and participates in many regional organizations, such as the Central European Free Trade Agreement (CEFTA). It has sought to resolve most of its border disputes via compromise, referring a maritime dispute with Croatia to the International Court of Justice (ICJ). In addition, despite its historic relationship to Serbia and its population, which continues to self-identify as ethnically Serbian, Montenegro formally recognized Kosovo in 2008, demonstrating its desire for European recognition through regional cooperation.⁹² Montenegro has generally good relations with Croatia, which has some investments in Montenegro and would share a portion of the AIH. Montenegro also has positive diplomatic relations with Albania, although the two have had historically poor relations and have very limited trade.⁹³

Cooperation on infrastructure such as roads, which all sides agree to be mutually beneficial for economic development, is one way that countries in the Western Balkans can circumvent other difficulties in regional cooperation. Active participation in building regional roads sends a message to Montenegro's partners in the region that it is serious about making a substantial contribution to regional connectedness and development.

The Memorandum of Understanding

The MoU calls for CPCG to work with the governments of Montenegro and Albania to establish a public-private partnership for the completion of the project and to secure funding from Chinese sources. The countries must provide all information necessary for the development of the project, and CPCG is responsible for the implementation of field tests and the details of the partnership. They will agree to use the maximum amount of local labor as possible. The MoU also states that there are to be no financial obligations on the part of Montenegro and Albania. The MoU is only valid for eighteen months, and should expire at the end of that time unless it has been replaced by a public-private partnership agreement.⁹⁴

Memorandums of Understanding are common occurrences in the Western Balkans, and although they usually indicate a future project will take place they by no means are understood as a commitment. Rather, MoUs are signed for the purpose of optics, and unless there is an enforceable contract, there is no assurance that anything will come of the agreement. Given the weak rule of law in Montenegro, even a contract might not guarantee any results.⁹⁵ Thus, there is a lack of risk in signing the MoU for the Montenegrin government. They stand nothing to lose by signing the document, as it places no obligations on them to actually get anything done.

Conclusion

Djukanović has very little time to consider how best to proceed with the proposal from the CPCG. Signing the MoU would have several benefits for the country, primarily due to optics. Infrastructure development is desired by all of Montenegro's international partners, including the European Union and China. The Chinese are generally offering good terms for the project's development in the proposed MoU, and this would give the country a chance to deepen its connections—business, diplomatic, and personal—with China. It demonstrates regional cooperation and sends a message to other countries in the region that Montenegro is interested in such cooperation. It is also a positive step in Montenegro's relations with its neighbor Albania, and may prompt other countries who are to be involved in the AIH to make more progress on the road. Montenegro may come out a regional leader. It also sends the message domestically that the government is working to improve the economy and could serve as a campaign promise to help Djukanović's party win the next election. Most importantly, signing the MoU commits the country to nothing—and in that sense it is not risky.

However, Djukanović knows that Montenegro cannot pay for the project, and that to commit to potentially increasing public debt for the second time will place serious tensions on relations with the EU and may jeopardize the accession process. EU integration and accession are his primary goals for the country. Following through with the project may in effect increase the country's debt, and not only does this strain relations, but it is dangerous for economic health. Chinese companies are a risky choice, because their terms for construction are less transparent and outcomes less assured. There has already been internal opposition expressed towards the plan due to perceived cultural differences between the Montenegrins and the Chinese. Furthermore, this may strain business and diplomatic ties with Russia, Montenegro's top investor, who may see Chinese investment as a threat. (However, this depends on the state of Chinese-Russian relations, which may not remain constant going into the future.) Working with China certainly doesn't do anything to strengthen ties with the EU and NATO countries, and perhaps there is a better deal that could be struck in order to do so. Furthermore, the MoU itself provides no guarantee of realistic implementation. There may be some negative repercussions, both domestically and internationally, if the country does not eventually follow through with the MoU within the deadline. Relations with Albania, in particular, may suffer if Montenegro cannot uphold its end of the MoU.

Prime Minister Djukanović must balance these compelling interests to determine how to proceed with the construction of the Blue Corridor.

Appendices

Appendix A: Montenegro's debt to GDP ratio

Figure 1: Montenegro GDP, 2000-2015 (Current USD, Billions)

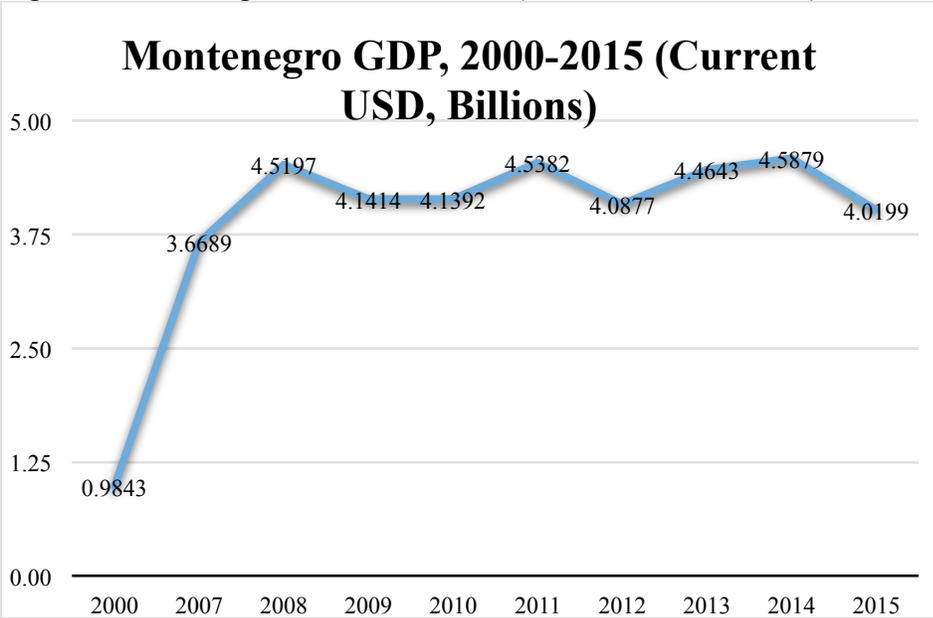


Figure 2: Montenegro Public Debt, 2006-2015 (% of GDP)

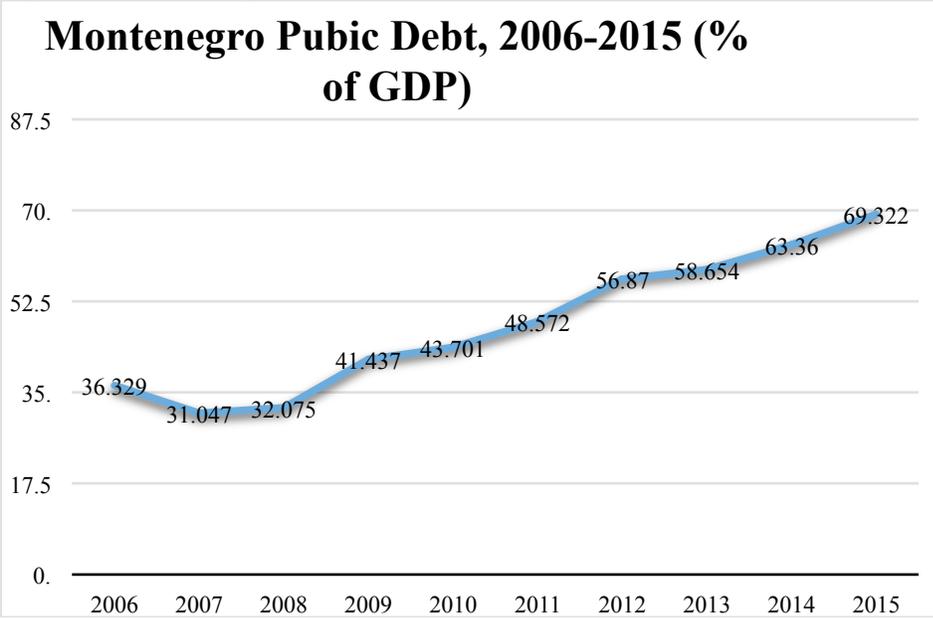
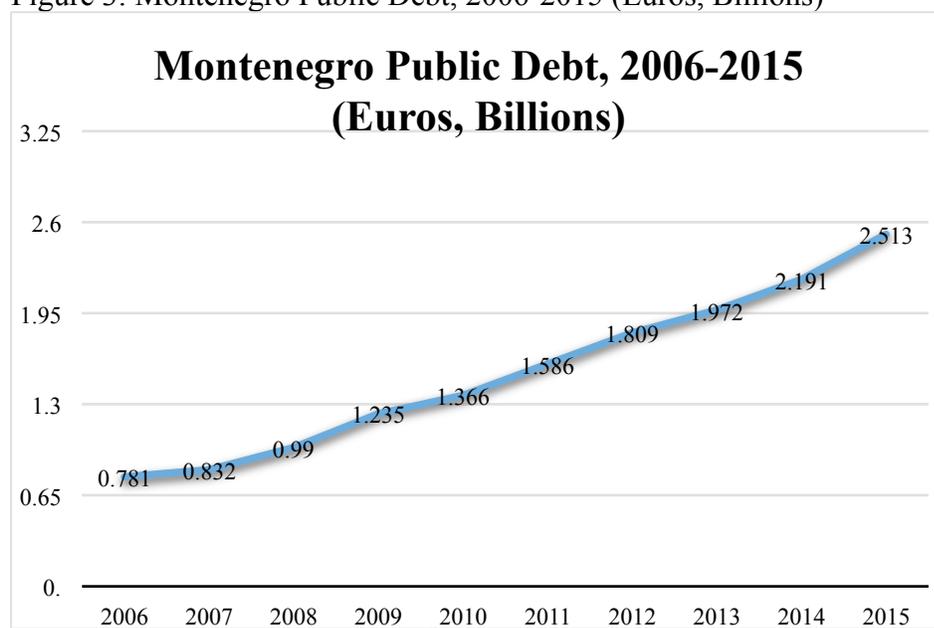


Figure 3: Montenegro Public Debt, 2006-2015 (Euros, Billions)



Source: World Development Indicators⁹⁶

Table 1: Trade volume between China and SEE, 2014

| | Exports to China | | | Imports from China | | | Trade with China | | |
|-------------------|------------------|--------------------|----------|--------------------|--------------------|----------|------------------|------------------|----------------|
| | In Million USD | % of total exports | % of GDP | In million USD | % of total imports | % of GDP | In million USD | % of total trade | % of total GDP |
| Albania | 164 | 6.7 | 1.2 | 382 | 7.3 | 2.9 | 546 | 7.1 | 4.1 |
| Montenegro | 3 | 0.8 | 0.1 | 176 | 7.4 | 3.8 | 179 | 6.4 | 3.9 |

Source: UNCTAD⁹⁷

Appendix B: Partial Text of the Memorandum of Understanding (English translation)⁹⁸

**Memorandum of Understanding
Between
The Ministry of Transport and Infrastructure of the Republic of Albania
and
the Ministry of Transport and Maritime Affairs of Montenegro
and
PACIFIC CONSTRUCTION GROUP CORPORATION LIMITED
IN CONNECTION WITH THE ADRIATIC-IONIAN HIGHWAY**

In order for the achievement of sustainable, comprehensive, competitive, and innovative development,

In order for the promotion of economic relations between countries,

On the basis of the common desire for the development of cooperation between countries in the area of the development of transport infrastructure,

Expressing full commitment and support for the integrated approach to the realization of the Adriatic-Ionian Highway (AIH), which is of strategic importance from the aspect of economic impact and connectivity,

In order to build and realize the Adriatic-Ionian highway (herein after: the Project) in the Republic of Albania and in the Republic of Montenegro and for the promotion of the socio-economic development of their countries,

Recognizing as a necessity and one of the priorities of the construction of the Project on the basis of a private-public partnership (PPP),

With the consideration that the cooperation between China and Central and Eastern Europe has been strengthened with securing a special credit line which the Chinese Prime Minister announced in Warsaw on April 26, 2012,

In this context,

The Ministry of Transport and Infrastructure of the Republic of Albania and the Ministry of Transport and Maritime Affairs of Montenegro (hereinafter: Ministries) which are represented by their respective ministers responsible for transport, infrastructure, and maritime affairs
And

Pacific Construction Group Corporation Limited (hereinafter: Pacific), the company which is registered and does business in accordance with the laws of the People's Republic of China, based at this address: No.1, Wutaishan, Nanjing City, Jiangsu Province, 210029, The People's Republic of China

Hereinafter: Sides/Parties

Have agreed in the following

[Article 1: Joint Start (*omitted*)]

Article 2

Principle obligations of the contracting Parties

1. After the entry into force of this MoU, the countries shall ensure compliance with national legislation:
 - i. All available information and data, which exist, in connection to the Project; and
 - ii. information and data about traffic on existing roads; and
 - iii. a time frame for road construction
2. Pacific implements the necessary field tests, for which the countries provide the necessary support to the project, in accordance with the national legislation.
3. Pacific develops and submits a proposal for a public-private partnership for the project on the basis of information and data collected in accordance with paragraph 1 of this article, and the field tests in accordance with paragraph 2 of this article. The contracting parties will then negotiate and agree on the Public-Private Partnership Agreement. The private-public partnership contract is signed by Pacific and the respective ministers, on the basis of a concrete project proposal.
4. Pacific, in accordance with commercial justification and technical availability, in the maximum use of local resources for building projects after the Private-Public Partnership Agreement has been signed with Pacific.
5. The Countries will support Pacific, in accordance with the provisions of their national laws, in obtaining funding from a Chinese bank/banks.
6. The countries do not have any financial obligations in the realization of the proposal.

[Article 3: Legal Framework (*omitted*)]

Article 4

Various

Validity: This MoU enters into force on the date of signature of the sides of the Parties and remains in force for 18 months and automatically expires on the date of signing of the Public-Private Partnership Agreement on the project. The parties may require and agree mutually about the extension of the validity of this MoU by referring the application 30 (thirty) days before the expiration of the same. Such an extension shall be recorded in written form and the Parties shall sign it.

Termination of the MoU: This MoU is terminated in case of any of the following events:

- i. Replacement of this MoU by the Public-Private Partnership Agreement; or

- ii. The expiry date of this MoU, in accordance with Article 4; or
- iii. Mutual agreement of the Parties to terminate this MoU.

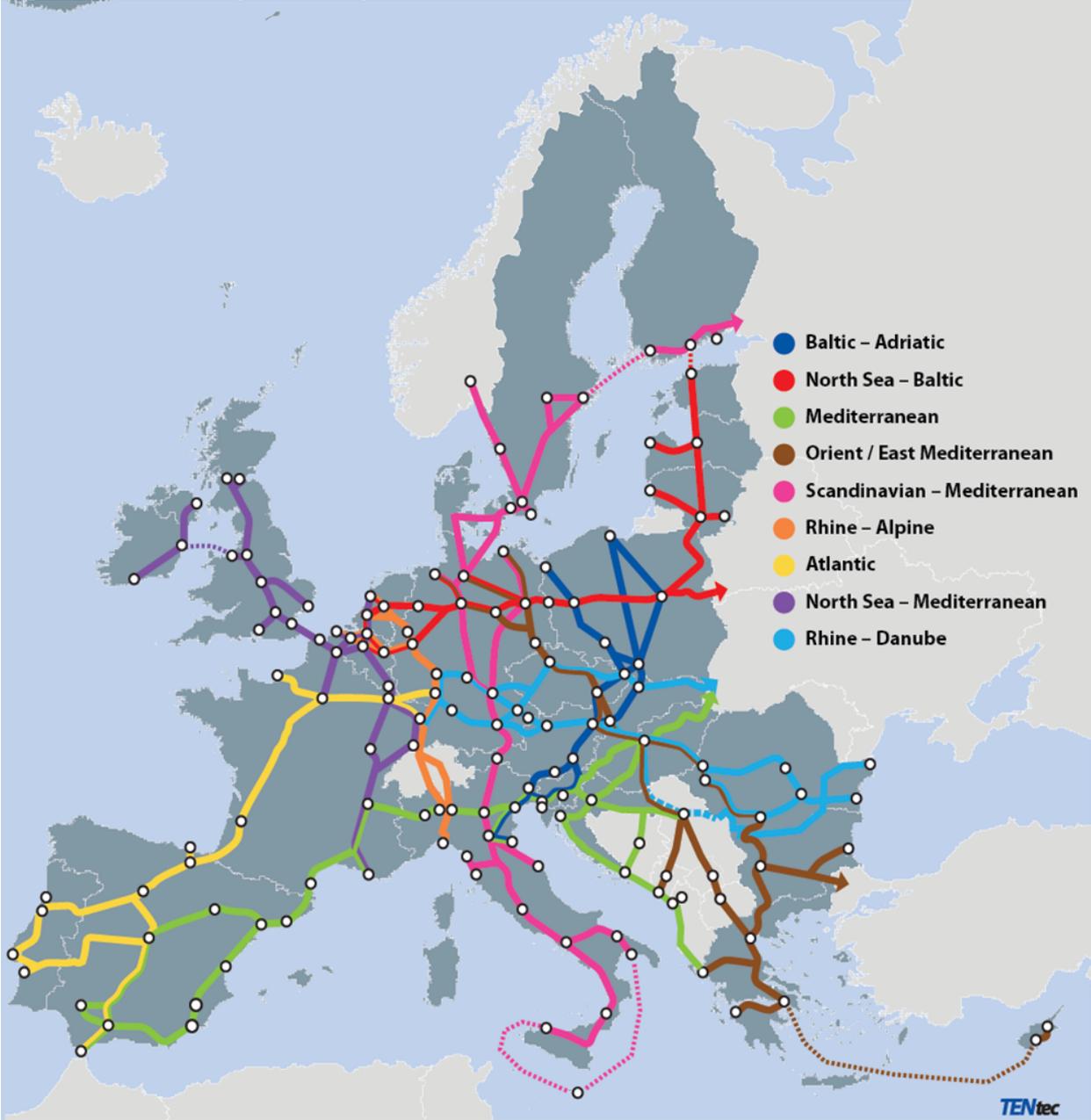
... Done in Beijing, China on November 25, 2015, in three original copies, in Albanian, Montenegrin, and English languages, all texts being equally authentic. In the case of differences in interpretation, the English version is authoritative.

Appendix C: Maps

Figure 1: Adriatic-Ionian Region⁹⁹



Figure 2: Trans-European Transport Network¹⁰⁰



Note: the nine TEN-T core network corridors are based on the CEF and TEN-T Regulations (1316/2013 & 1315/2013); they have been created as a coordination instrument to facilitate the completion of major parts of the core network of strategic importance.
Source: European Commission, Directorate-General for Mobility and Transport, TENtec Information System

Figure 3: Proposed Adriatic-Ionian Highway¹⁰¹



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