

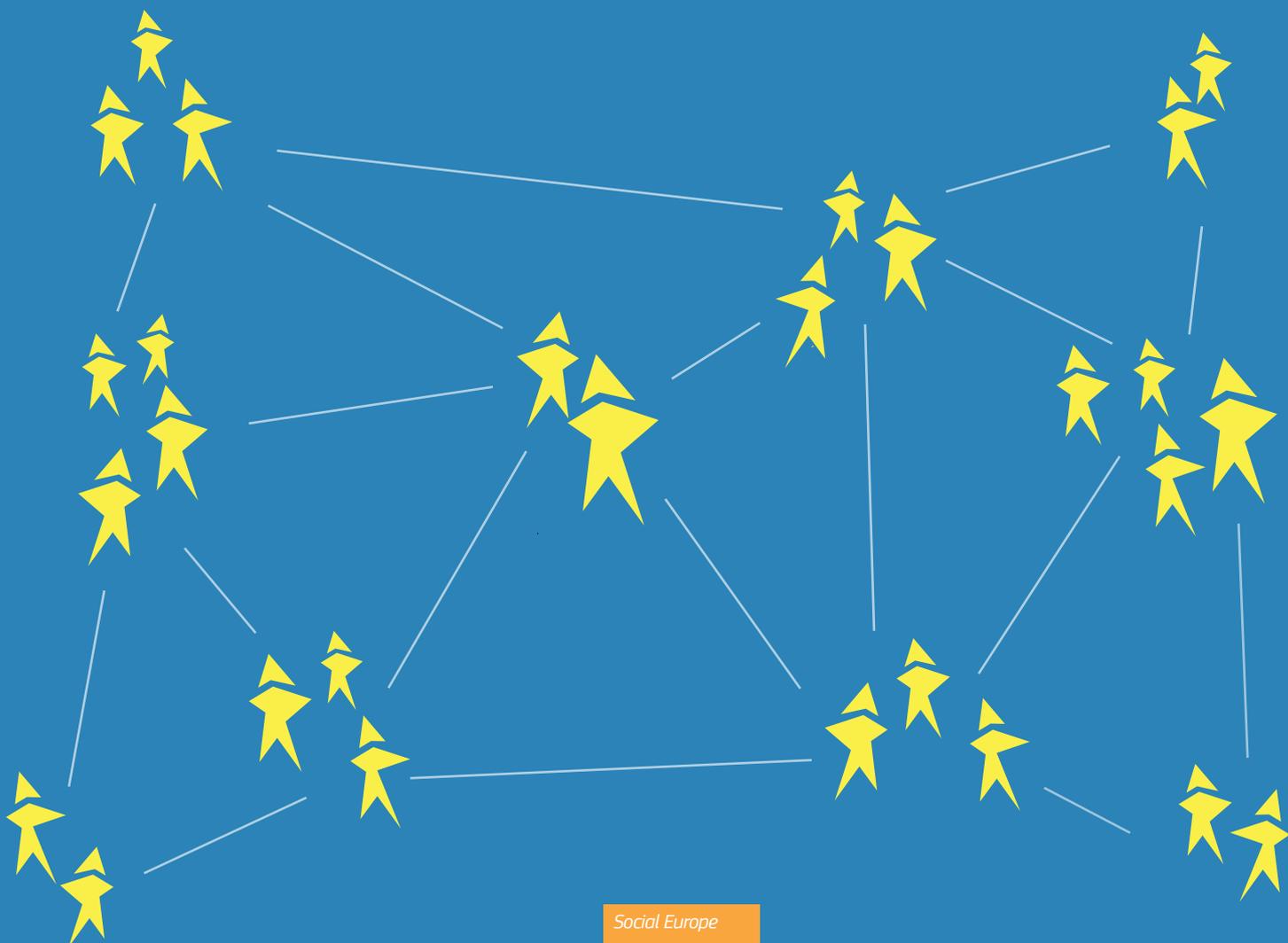


EUROPEAN SOCIAL POLICY NETWORK (ESPN)

Financing social protection

Montenegro

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European Social Policy Network (ESPN)

**ESPN Thematic Report on
Financing social protection**

Montenegro

2019

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Summary

This analysis of current levels and past trends of social protection expenditure in Montenegro is based on the national data collected from the ministries and implementing agencies, since neither any other public data on Montenegro nor the European System of Integrated Social Protection Statistics (ESSPROS) database is available. Due to the limited scope of the data, the figures for pension expenditure include aggregated expenditure on old-age pensions, survivor and disability pensions. Data on other expenditure include three categories: social protection, unemployment and disability expenditure. The social protection category includes family support, child allowance, care of other persons, disability benefits, etc. Disability benefits refer only to expenditure from the fund for the professional rehabilitation of persons with disabilities.

Social protection expenditure in Montenegro was 16.6% of GDP in 2017; from 2005 it has had a stable average level of 17.9%. An increase of 78.8% in real terms between 2005 and 2017 followed economic growth in the country that was additionally accelerated by the country's independence in 2006.

Most social protection expenditure goes on pensions (57% in 2017), followed by health (28.3%). Some 14.7% of total expenditure involves spending on other social protection functions (unemployment, family, housing and social exclusion). There have been no significant shifts in the structure of financing social protection by function since 2005. However, there was a slight increase in other expenditure in 2016, due to the introduction of the life-long benefits for mothers with three or more children (abandoned in 2017).

Most of the social protection system is financed from social contributions (65% in 2017), although a shift towards government revenues can be observed, especially after the crisis. The highest share of social contributions – an average level of 83% in 2017 – is in healthcare. Of all receipts for pension spending, in 2017 74% came from social contributions. The share of social contributions is lowest for other social functions, on average 18%.

During the last decade, social contributions have undergone several changes, resulting in a decline in the overall social contribution rate, which is currently at the level of 34.3%. However, not all the changes implemented have sought to reduce the contribution rate. The most important changes have been related to reducing contributions for pension and disability insurance, as well as health insurance (in 2005 and 2007), and to increasing the overall contribution rate for health insurance in 2009 and 2015. Despite the rise in the overall contribution rate for health insurance, revenue from this source has not increased.

The Montenegrin system of social protection financing is very centralised in all segments, even in the area of other social protection functions. In addition, the share of private financing is very low. However, during the past few years, there has been a development in social services provided by state and non-state actors (such as non-governmental organisations – NGOs); but the financial sustainability of those initiatives is questionable, as they are implemented as projects with limited funds and time for implementation.

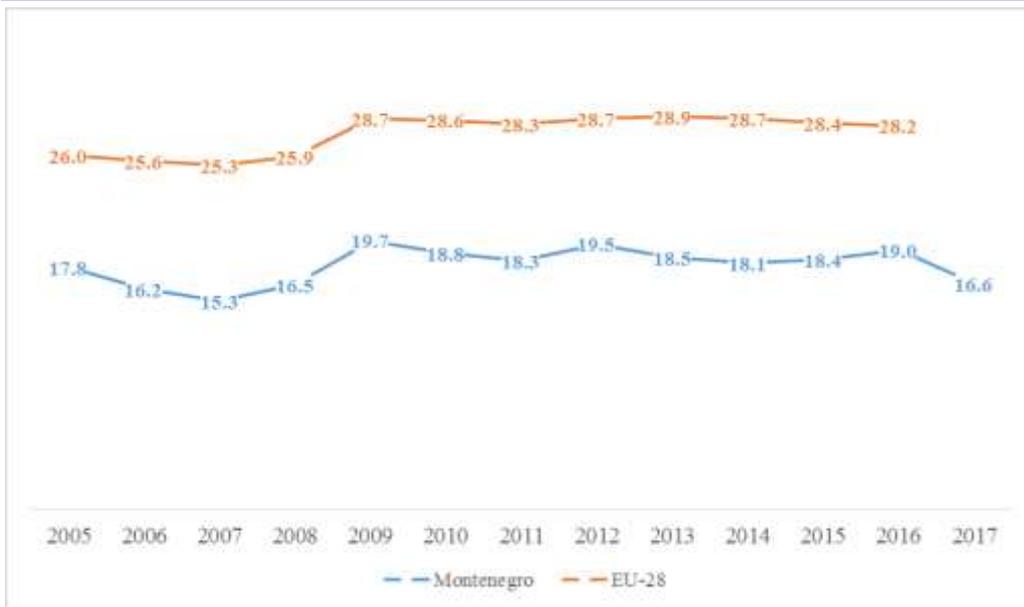
Demographic trends and a high level of the grey economy present the most important risks for the financing of the social protection system in Montenegro, as it is highly dependent on social contributions. In addition, the already high tax wedge limits the scope for increasing contribution rates. Thus, future reforms should focus on increasing aggregate income through education, pension and other structural reforms.

1 Current levels and past changes in financing social protection

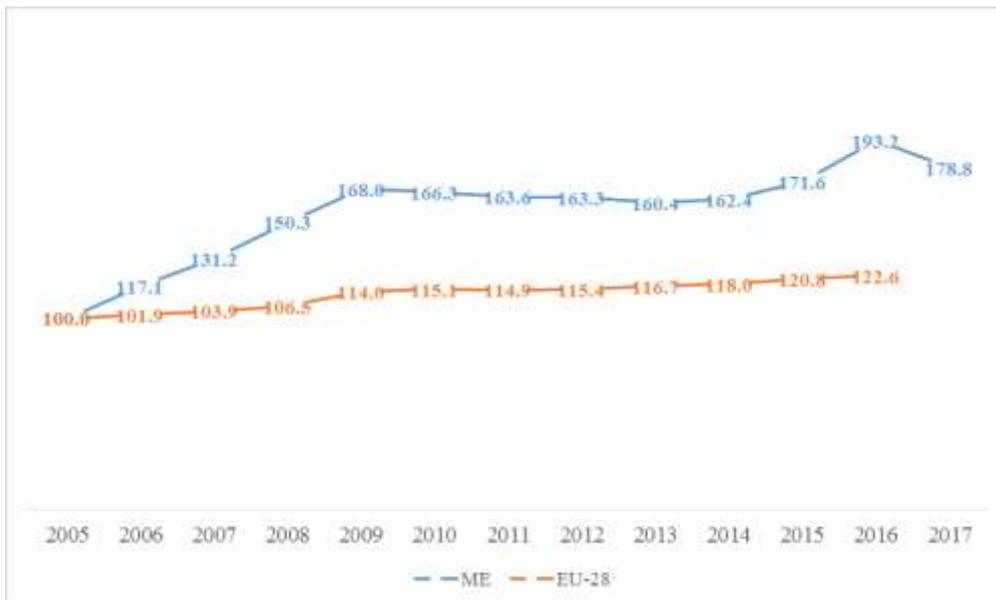
In 2017, social protection expenditure in Montenegro amounted to EUR 714 million, or 16.6% of GDP – significantly below the EU-28 level (28.2% in 2016). From 2005 until 2017 social protection expenditure increased in real terms by 78.8%. However, during the same period, expenditure accounted for an average of 17.9% of GDP, without significant fluctuations, indicating that the increase in expenditure followed economic growth.

In addition, the significant growth observed is a consequence of the low level of social protection expenditure before 2006, when Montenegro became independent and started the fully independent management of its social protection system.

Figure 1: Social protection expenditure in Montenegro and EU-28, 2005-2017, as % of GDP



in real terms (at constant 2005 prices)

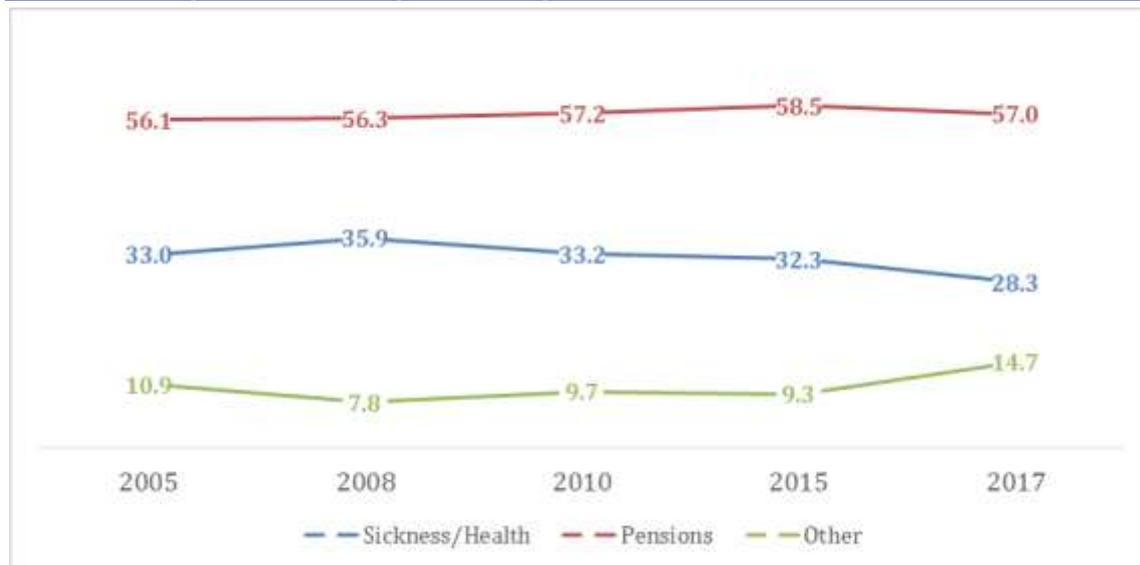


Source: Authors' calculations based on data collected from the Ministry of Labour and Social Welfare, Ministry of Health, Ministry of Finance, Employment Agency of Montenegro, MONSTAT.

Most social protection expenditure (57% of total expenditure in 2017) goes on pensions. In absolute terms, expenditure on pensions doubled between 2005 and 2017, as a result of economic growth and an increase in the number of beneficiaries. In terms of share of total expenditure, pension expenditure was stable between 2005 and 2017.

Between 2005 and 2017, health expenditure recorded a slight decrease of 4.7 percentage points in its share of total expenditure. The share of other social protection expenditure was stable until 2016, at which time it increased, due to newly defined rights for mothers with three or more children to life-long benefits.

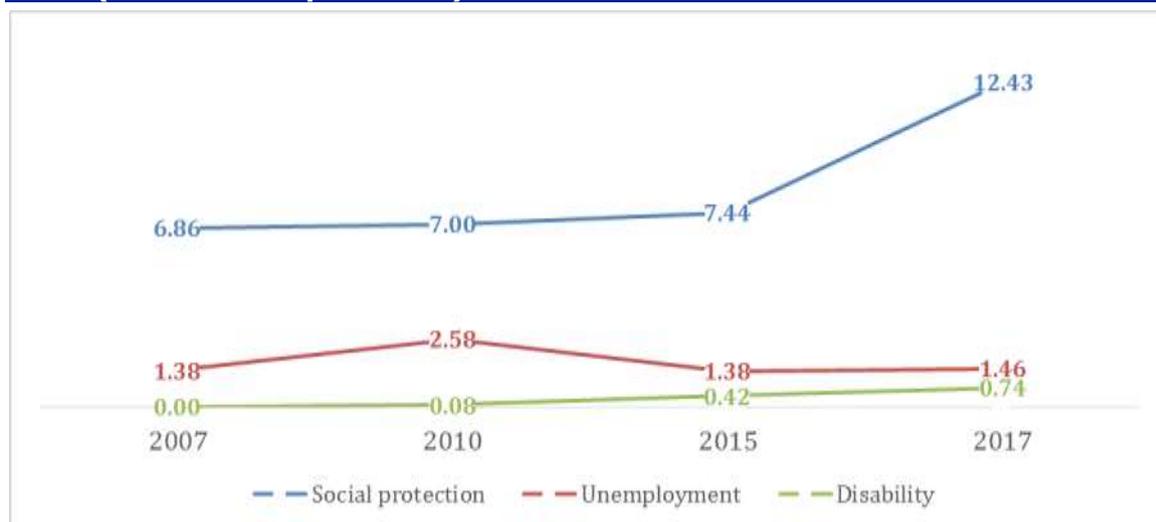
Figure 2: Breakdown of gross expenditure on social protection by function, 2005-2016 (% of total expenditure)



Source: Authors' calculations based on data collected from the Ministry of Labour and Social Welfare, Ministry of Health, Ministry of Finance and Employment Agency of Montenegro

The bulk of 'other' expenditure is related to the social protection of families and children (on average 80% of other expenditure). In 2016, there was a significant increase in this category following adoption of the law on benefits for mothers with three or more children. Cash compensation for the unemployed made up around 1.4% of total expenditures in 2017, while benefits for people with disabilities were at the level of 0.7%. Spending on unemployment peaked after the financial crisis (especially 2010), following an increase in the unemployment rate. Disability expenditure has increased, especially since 2015, as a result of the public debate on transparency in spending funds related to the professional rehabilitation of persons with disabilities.

Figure 3: Breakdown of gross expenditure by function in 'other' category, 2005-2016 (% of total expenditure)



Source: Authors' calculations based on data collected from the Ministry of Labour and Social Welfare, Ministry of Health, Ministry of Finance, Employment Agency of Montenegro, MONSTAT.

2 Current mix and past changes in the sources of financing social protection

The main sources for financing social protection in Montenegro are contributions for compulsory social insurance and government revenues. Also, in some areas of social protection there are other receipts. However, the two major sources are the above-mentioned social contributions and government revenues.

Mandatory social contributions are defined under Montenegrin law. The obligation to pay contributions for compulsory social security is regulated by special laws: the Law on Pension and Disability Insurance, the Law on Health Insurance and the Law on Contributions for Compulsory Social Insurance. Obligatory forms of social insurance that imply contributions are:

- pension and disability insurance,
- health insurance, and
- unemployment insurance.

The contributions for pension and disability insurance are calculated on the gross salary of the employee. The gross salary cannot be lower than the salary defined by general collective agreement, which takes into account various criteria such as the level of expertise, education, working years, etc. But the additional level of protection is determined on the basis of the minimum wage (EUR 222). The highest annual contribution base is EUR 50,000 as defined by the law.

Regarding coverage, aside from employees with an employer, entrepreneurs who earn income from self-employment pay contributions for mandatory social insurance: for pension and disability insurance at a rate of 20.5%, for health insurance at a rate of 12.3% and for unemployment insurance at a rate of 1%. The basis for payment of those contributions for compulsory social security is taxable income (profit) from self-employment.

For entrepreneurs who pay tax in an annual lump sum (this is option for those who have annual turnover less than EUR 18,000), the basis for paying contributions is determined by the state based on the type of activity; amount of realised or planned turnover and share of operating costs. For those entrepreneurs who do not pay tax in an annual lump

sum, the base is determined according to the amount of realised or planned annual turnover, as follows:

- up to EUR 9,000, the basis is 60% of the average monthly salary in Montenegro,
- up to EUR 15,000, the basis is 100% of the average monthly salary in Montenegro,
- over EUR 15,000, the basis is 150% of the average monthly salary in Montenegro.

Also, farmers – i.e. persons engaged in agricultural activity as their sole or main occupation – pay contributions for compulsory social insurance: for pension and disability insurance at a rate of 20.5% and for health insurance at a rate of 12.3%. The basis for payment of these contributions is 50% of the average monthly salary in Montenegro in the month for which contributions are paid. Exceptionally, in line with the Decree on Fees for Paying Agricultural Insurance Contributions¹ for insured farmers who are on the Register of Farmers (which is kept at the Ministry of Agriculture), the compulsory base for the calculation of contributions is 12% of the average salary in the country (from the previous year).

Table 1: Current levels of social security contributions in Montenegro

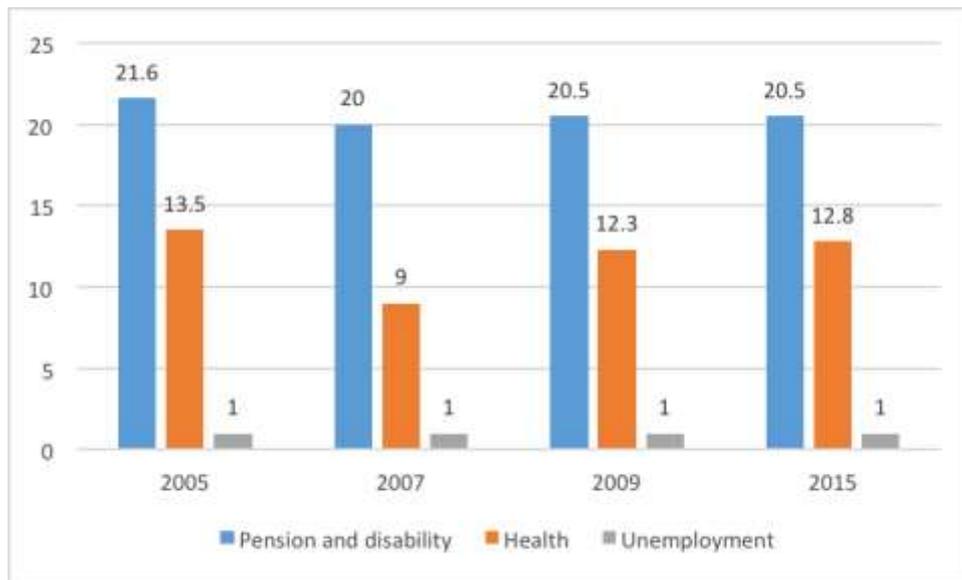
Type of Contribution	% of gross wage
Taxes and contributions paid by the employee	
Contributions for pension and disability insurance	15
Contributions for health insurance	8.5
Contributions for unemployment	0.5
Taxes and contributions paid by the employer	
Contributions for pension and disability insurance	5.5
Contributions for health insurance	4.3
Contributions for unemployment	0.5
Contributions cumulatively	
Contributions for pension and disability insurance	20.5
Contributions for health insurance	12.8
Contributions for unemployment	1
Contributions TOTAL	34.3

Source: Law on Contributions for Compulsory Social Insurance (Official Gazette of Montenegro, Nos. 13/07, 79/08, 86/09, 78/10, 14/12, 62/13, 08/15, 22/17).

Social security contributions have undergone some changes in the past three decades. From the beginning of 1994 until 2005, the cumulative contribution rate was 40% (pension insurance 24%, health insurance 15% and unemployment insurance 1%) and was evenly distributed between the employer and the employee. In the period 2005-2007, compulsory social security contributions accounted for 36.1% (20% for employees and 16.1% for employers). In 2008, the cumulative rate was reduced to 34%, and to 32% in 2009 (17.5% for employees and 14.5% for employers). From 2010, the cumulative amount of the contribution was 33.8% (24% for employees and 9.8% for employers), slightly up on 2009. Today, the situation is almost the same as in 2010, with one change – a slight increase of 0.5% in health insurance paid by the employer (from 3.8% to 4.3%). Today, total cumulative contributions for social insurance amount to 34.3%.

¹ Official Gazette of the Republic of Montenegro, No. 2/06.

Figure 4: Main changes in overall contribution rates for different types of compulsory social insurance

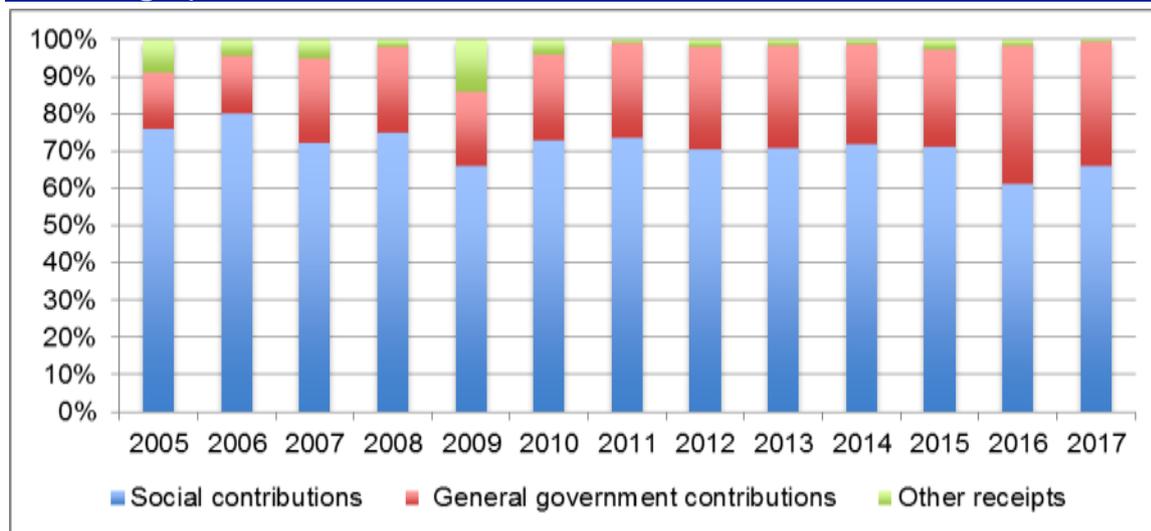


Source: Law on Contributions for Compulsory Social Insurance.

2.1. Financing social protection

The analysis of the financing of the social protection system in Montenegro shows that the system is financed mainly from social contributions (on average 71%). The second source is general government contributions, with an average share of 25% over the observed period.

Figure 5: The structure of social protection financing by type of receipt in Montenegro, 2005-2017



Source: Authors' calculations based on data collected from the Ministry of Labour and Social Welfare, Ministry of Health, Ministry of Finance, Employment Agency of Montenegro, MONSTAT.

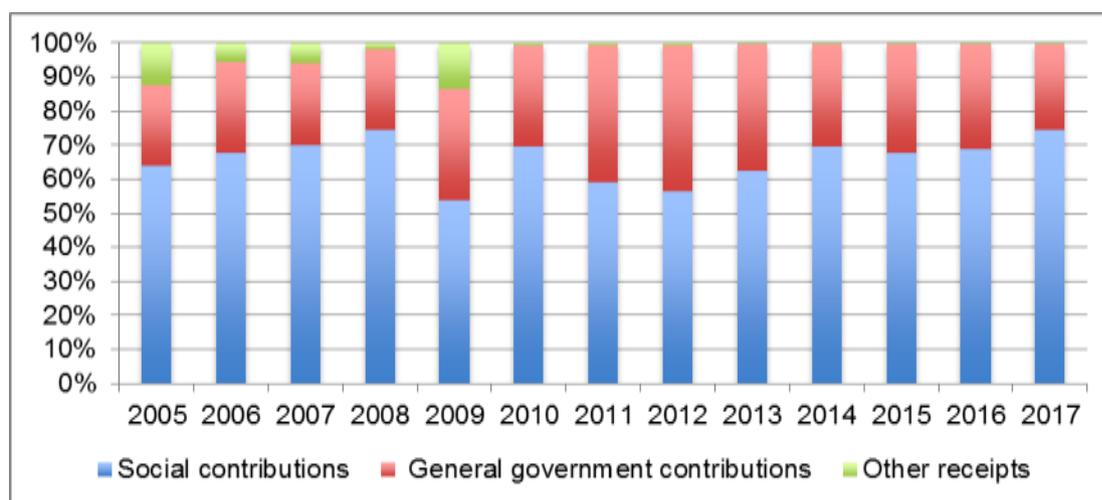
Trend analysis shows a slight shift from social contributions towards government contributions, especially after the financial crisis. The share of social contributions decreased by 11 percentage points from 2005 to 2017. Moreover, just in the period from

2015 to 2017, the share of social contributions fell by 6 percentage points, which indicates that this trend may continue into the future.

2.1.1 Pension expenditure

On average, 66% of all receipts for pensions came from social contributions. The lowest share of receipts from social contributions was recorded in 2009 (54%), while the highest was in 2008 and again in 2017 (74%). On average, general government contributions represented 30% of total receipts for pensions. Other receipts account for only 3% on average, but if we compare the periods 2005-2009 and 2009-2017, we find a significant decrease of 7.5 percentage points. These were mainly revenues from the sale of financial assets or loans (in 2009).

Figure 6: The structure of pensions financing by type of receipt (2005-2017)

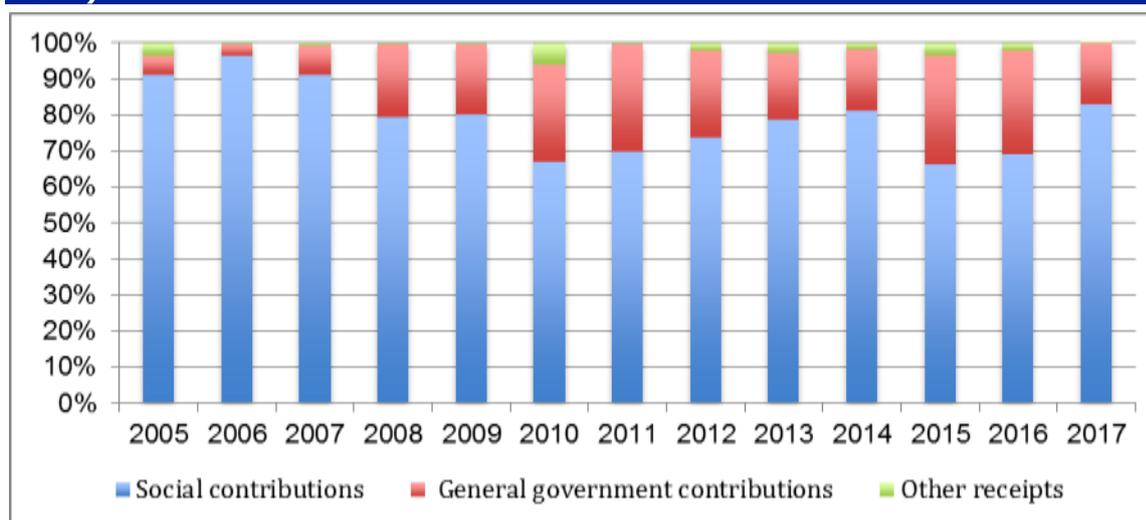


Source: Authors' calculations based on data collected from the Ministry of Labour and Social Welfare, Ministry of Health, Ministry of Finance, Employment Agency of Montenegro, MONSTAT.

The structure of the basic sources of financing of the pension system has not changed significantly over the past 15 years, but there have been changes in the participation of certain sources in the total financing of the system. Contributions for pension and disability insurance are vital to the sustainability of this part of social protection. However, apart from economic factors (such as the economic crisis), the unfavourable situation regarding the participation of these revenues in the overall financing of pensions was influenced both by demographic factors and by inconsistency in the reform (too many amendments to the Law on Pension and Disability Insurance since 2005). Despite the many reform attempts (redefining pensionable age, the pension formula, conditions for retirement, etc.), government transfers to the Pension and Disability Fund (PIO Fund) remain high, amounting to 25-40% of total pension system expenditure in the period 2005-2018.

2.1.2 Healthcare expenditure

The financing patterns for the healthcare function are even more oriented towards public contributions than the financing structure of pensions. On average over the observed period, social contributions accounted for 79% and general government contributions for 19% of the total receipts used to finance healthcare. The remaining 2% are from other receipts. Also, a fluctuating but declining trend in the share of social contributions may be observed. Social contributions have decreased from 91% in 2005 to 83% in 2017.

Figure 7: The structure of health protection financing by type of receipt (2005-2017)

Source: Authors' calculations based on data collected from the Ministry of Labour and Social Welfare, Ministry of Health, Ministry of Finance, Employment Agency of Montenegro, MONSTAT.

The changes in contributions for health insurance are designed to stimulate employers to take on and register employees: employer contributions have decreased over time (except from 2015). Also, the reduction in the overall contribution rate for health insurance from 13.5% to 9% resulted in an increase in revenue from these contributions of more than 15% in the first year. However, new changes were introduced during the crisis year (2009), when the overall contribution rate for health insurance was increased to 12.3% of the gross wage. However, this measure did not prevent a reduction in the total amount of revenue collected through this contribution. In fact, it took until 2015 for the amount of money collected through health contributions to regain the 2008 level (EUR 144 million). Hence, the reform measures to reduce the contribution rate paid by the employer may have had a positive effect, but the increase in the overall contribution rate neutralised it.

Table 2: Allocation of the contribution rates to the employee and the employer (in %)

Year of change	Contribution type	Employer	Employee	Total
2005	Pension and disability insurance	9.6	12.0	21.6
	Health	6.0	7.5	13.5
	Unemployment	0.5	0.5	1.0
2007	Pension and disability insurance	8.0	12.0	20.0
	Health	5.0	4.0	9.0
	Unemployment	0.5	0.5	1.0
2009	Pension and disability insurance	5.5	15.0	20.5
	Health	3.8	8.5	12.3
	Unemployment	0.5	0.5	1.0
2015	Pension and disability insurance	5.5	15.0	20.5
	Health	4.3	8.5	12.8
	Unemployment	0.5	0.5	1.0

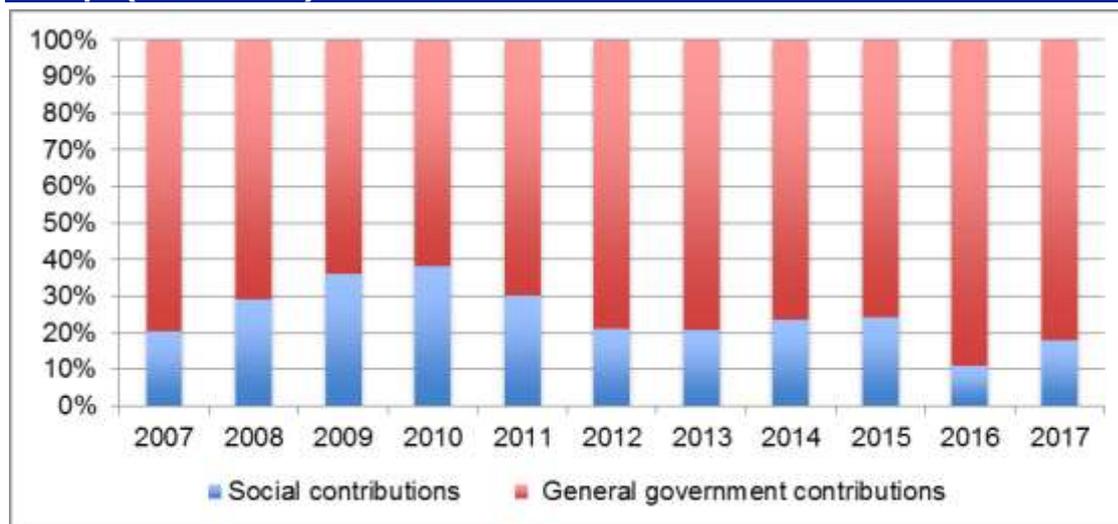
Source: Law on Contributions for Compulsory Social Insurance.

This situation at the same time required a change in the mix of the main sources of funding for health protection: the share of government (state budget) revenues to finance health protection increased from a level of 3-5% during 2005-2006 to 29-30% in 2015-2016. Other sources for financing health protection are minor and insignificant.

2.1.3 Other expenditure

Other social protection schemes are mostly financed through general government contributions, on average at the level of 75%. The remaining 25% comes from social contributions.

Figure 8: The structure of other social protection functions financing by type of receipt (2005-2017)



Source: Authors' calculations based on data collected from the Ministry of Labour and Social Welfare, Ministry of Health, Ministry of Finance, Employment Agency of Montenegro, MONSTAT.

The source of financing for other social protection rights (family and child protection, unemployment and disability) is predominantly government revenue: over recent years, its share in the financing of these rights has amounted to over 80%. However, analysis of the categories within the 'other' social protection expenditure shows that each is fully financed from one source: social protection rights related to the family and child support are 100% financed by government revenues; meanwhile unemployment rights are fully financed from contributions. A look at the Montenegrin budget laws in recent years reveals that more money has been collected through contributions for unemployment insurance than has been paid out in cash benefits to the unemployed. However, this surplus remains in the state budget for other purposes. Disability benefits are totally financed by the central budget, from the fund for the professional rehabilitation of persons with disabilities.

3 Strengths and weaknesses of the existing mix of financing options and potential future sources of financing - national debate on the topic

Sustainability of the social protection system is of crucial importance for each country, and that largely depends on financial sustainability, i.e. the provision of financial sources. Hence, the precondition must be the establishment of a permanent and sustainable source of financing.

The social protection system in Montenegro is highly dependent on social contributions, which means that there are certain risks related to its suitability. The main risk is demographic and is related to the ageing population (during the last 40 years, the average age of the population has increased by 10 years for both men and women) and migration trends (the outflow of young people). A second risk is related to the high level of the grey economy (around 30% of GDP, according to UNDP (2015)), which indicates that there is considerable evasion of social insurance. This limits the possible effects of measures aimed at increasing the contribution rate, and puts the emphasis on policies aimed at widening the base. Also, a tax wedge of over 40% of the gross wage further limits the possibility of increasing contributions.

In Montenegro, the state is the main financier and provider of social welfare services. The legislative framework allows local self-governments to provide additional forms of protection, if they have necessary funds. Since this is only a possibility, rather than an obligation, there is inadequate participation by local government in the development and financing of social protection (which is mainly offered as one-off financial assistance) (Kaluđerović and Radević 2011). In this context, the need for systematic improvements in terms of fiscal decentralisation must be emphasised, which would enable municipalities to increase their capacity to allocate and manage the funds.

In accordance with the Law on Social and Child Protection, various regulations are adopted to regulate the organisation and work of institutions, professional activities in the field of social and child care, standards of social and child care services, the quality-control system in social and child care, and other issues involving the functioning of the social and child care system. One of these is the Rulebook on the amount of funds for the development, i.e. financing of social and child care services and the criteria for their distribution.² Also, debate on the expansion of the social protection services has resulted in a visible trend of development of social and child care services in Montenegro. However, the majority of new services are not financially sustainable in the long run, as they are established as initiatives funded on a project basis (mainly through EU-funded projects or projects funded by other international organisations). For instance, during 2016 and 2017, a new and innovative service (family associates) was introduced, but only as a pilot project, with a limited budget and implementation period.

Greater reliance on social contributions implies the importance of increasing aggregate income. A current pension initiative is aimed at increasing the sustainability of the pension system through measures such as planned new retirement age limits (an increase in the pensionable age), conditionality for retirement, as well as a new pension formula. These measures may in turn increase aggregate income, especially among the elderly population. In addition, an education policy that includes a life-long learning policy should result in higher productivity, and consequently higher income. However, further efforts in this area are necessary at the policy and implementation level.

² Official Gazette of Montenegro, No. 42/15.

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