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**Economic reforms and strategic development
vision of Montenegro**

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Economic reforms and strategic development vision of Montenegro

This paper presents basic information on the economic reforms in Montenegro and its strategic vision. The idea of the paper is exposed through the five following sections.

1. Current economic situation in Montenegro
2. Development potential of Montenegro
3. Concept and the realization of the economic reforms in Montenegro
4. Development of the SME sector
5. Strategic development vision

I Current Economic Situation in Montenegro

Here are several general pieces of information on Montenegro.

The territory of Montenegro covers area of 13,812 km². The population is estimated to be about 715,000 citizens including about 75,000 refugees. This means that in the recent period the population has increased for more than 12%, which represents a real demographic shock for this space. The average life expectance is at the level of 76 years.

In the last ten years the economic situation in Montenegro has been influenced by the disappearance of the ex-Yugoslavia, the wars in the neighborhood and the sanctions imposed by the international community.

The following data testify these changes:

GDP of Montenegro is estimated at the level of 700 million US\$, whereas in 1989 it was 1,6 billion US\$, which implies that the current level of the GDP is at the level of 45% of the 1989 GDP.

There has been the fall of the GDP per capita from 2,300 US\$ to the level of about 920 US\$.

Industrial production index is at the level of 56% compared to 1990, whereas the level of employment is 62% compared to 1990, which suggests a huge increase of unemployment. In fact, the number of the unemployed was 77,800 last year, while the number of employed was 115,615.

The number of pensioners was about 80,000, compared with 68,694 in 1989 suggests the increase.

The current account deficit is about 140 million US\$, which is at the level of 20% of the GDP. The situation in Montenegro defines the abrupt decrease of the tourism revenues: from about 250 million \$ in 1989 to less than 20 million \$ in 2000.

Those are some aggregate indicators, which suggest the grave state of our economy. This situation is particularly oppressed by the relations with Serbia as well as the border blockade, which was active until several months ago.

Still, the dependence of the Montenegrin companies decreases. Three years ago it reached 65%, last year it was at the level of 35% (of the selling and buying market of the Montenegrin companies in Serbia in relation to the whole amount of the buyings and sellings). The dependence is even less today as our enterprises are forced to seek new markets.

The indicators of the current economic situation are the following:

- There was the rise of the industrial production of 7% in Montenegro during the previous year, 2000.
- The average salary is about 190 (net) and about 370 (brut)
- Minimum wage rose from 60 to 80 DM
- There has been slight increase of the employment rate followed by further parallel rise of the unemployment.
- The inflation fell from 21.7% (November 1999, when DM was introduced as a legal tender) to -0.1% in June 2000 and 2.9% in November 2000.
- Informal economy represents 35% of total GDP (before DM introduction it was 70%)

If it is the main economy problems of Montenegro to be highlighted than it is:

1. **Unemployment.** All too small number of people works productively so that the higher level of the GDP may be secured.
2. **Structural economy problems.** The existence of the several enterprises, which lost their markets by the fall-apart of the former Yugoslavia, i.e. Steel factory.

II The Basic Potentials of Montenegro and How to Resolve the Budget Deficit

Some estimates indicate that the potential GDP in the frame of the current structure of the economy with its rehabilitation may reach the level of 2 billion US\$. There are possibilities of the increase in the following:

- Montenegro is a Mediterranean country
- Agricultural production (fruits, vegetables, food, wine, grape whiskey, fish)
- As for tourism there are 150,000 beds (20,000 used now). The estimate is that Montenegro might have by 2015 the hard currency revenue from tourism of 1,6 billion US\$.
- 293 km long Adriatic coast
- Possibility of the production of 100,000 tones of aluminum
- Potential electricity production of 10 million KWH (3,000,000 now)

- Capacity for 400,000 tones of raw iron production
- Capacity for 1,000,000 tons of bauxite production
- Capacity for 75,000 tons of sea salt production
- Capacity for 75,000 tones of coal production
- The Port of Bar
- Sector of services (Shipyard “Bijela” – the potential capacity is 2,800,000 working hours, or 30 million US\$; transport)
- Highly educated population should be counted as Montenegrin potential
- SME sector development

Montenegro has to import a lot of different products:

- Montenegro needs about 310,000 tones of oil per year
- Montenegro needs about 120,000 tones of wheat per year
- Montenegro needs about 26,000 tones of sugar per year

In effect, Montenegro possesses certain resources, whose specific value must be seen in the light of the fact that Montenegro is a Mediterranean country. However, the society based on information is characterized by the ever greater importance of the non-material factors, primarily new knowledge and management at all the levels.

When it comes to the question whether Montenegro is able to finance itself independently at this moment, the answer is: No! Total deficit (budgetary and quasi budgetary) is about 110 million of US\$. Budgetary deficit is or was the characteristic of every country in transition because of so called Transitional crisis, plus the fact of being long in a warring surroundings, undergoing hyperinflation and having extremely unfavorable political conditions for the development in Yugoslavia, being finally on the edge of the conflict with the federal forces, explains a lot.

However, when it comes to the question whether Montenegro has resources and human capital to finance itself independently, the answer is: Yes! The most important prerequisite is that Montenegro stays on the course of the economic reforms, building new economic system of the market economy as well as an open and transparent system integrating region and Europe, and expressing itself as a challenge for the foreign investors and tourists.

These are the basis for the state status to be resolved, as an additional accelerator of the democratic and economic reforms in Montenegro. Montenegro must take responsibility for its own development, avoiding any transfer of the responsibility in the future, i.e. at the federal level. In effect, we put the emphasis of our future development on the continuation of the already begun reforms and the creation of the preconditions for their implementation and quickening, seeing one of the preconditions in the independence of Montenegro.

The above suggest that the resolution of the **budgetary deficit problem depends primarily on the continuation of the economic and political reforms**, nonetheless

legal status of Montenegro. Budgetary problem is a real problem, which is not going to be wiped away or disappear at the moment Montenegro becomes an independent state or remains a part of the federation. Budgetary problem remains a huge problem of Montenegro, its citizen, nonetheless the legal status.

We estimate that the problem of the budgetary deficit as well as the other problems will be resolved more efficiently in the independent state, having in mind immense differences in relation to Serbia, such as the size difference (Serbia is 15 times bigger), the economy structure (Montenegro is oriented towards tourism and services, Serbia towards agriculture and industry), the character of reforms (Montenegro claims private property and capitalism, whereas in Serbia the role of state and own currency have been selected as a precondition to the development), as well as the extent of the already implemented reforms (Montenegro has already been exercising this process for the last three years, whereas Serbia is only preparing itself to enter it)

In case the political turbulences in the region are avoided, Montenegro may in the net 5-7 years join the period of the budgetary balance, along with the simultaneous reduction of the deficit, especially after the third year, from 2004.

Our assessment is that should this opportunity to establish new economic market-oriented and transparent system is missed, **Montenegro will remain politically unstable country and a source of the potential conflicts in the region over the long haul.**

III How to benefit from the material and human resources in Montenegro?

Our standpoint is, as already said, that without a new economic system and new market institutions, there is no way leading to economic recovery. This suggests that the key assumption is the build-up of the new institutions, and through the new institutions the change of the behavior of the people. Institutions should be seen as rules of the game in the society or formal procedures that people have developed to facilitate their interaction.

Postulates of the new institutional framework. It is about:

1. Free market and private property
2. Open economy (internationalized one) with the national treatment of the foreigners
3. National tolerance and democracy
4. Protection of the property rights following international standards
5. Freedom of contracting and the protection of contracting following the international standards

These are the postulates of the economic reforms we promote, which has especially been focused in the recent years.

What is the essence of the reforms being implemented?

The goal is to achieve the better living conditions for all the citizens of Montenegro. The standard of living should be the criterion to show how successful the reforms are.

Basic economic reforms stem from the concept of the economic sovereignty of Montenegro. What does it mean?

This implies that the parliament of Montenegro is entitled to pass all the acts covering the economic system guaranteeing its implementation. Put differently, the Government and the parliament should provide the institutional and legal frame of the new system. Further, Montenegro should build its economic system independently from the character of the system at the federal level or in the other federal unit.

This concept began to be implemented in 1997-98.

Our economic reforms have been concentrated on:

1. Full and transparent of the privatization of the state ownership
2. Monetary and the financial sector reforms
3. New business environment development

1. Full and transparent privatization of the state ownership

Our stand is that everything can be privatized. There must not remain single area to be fully under ownership control of the state. Transparency is the fundamental principle of our process of the privatization. Without transparency there is no opening of Montenegro to the world, no American, German and European businesses and businessmen, no tourists from Europe.

The total amount of capital is estimated to be at the level of 9 billion DM

In so far, 25% of the total state owned capital has been privatized. The remainder of the 75% will be privatized through two basic methods:

1. Massive voucher privatization (MVP) 26%
2. International tender sales to the strategic investors (about 50 biggest companies from Montenegro)

The realization of the MVP program has been undertaken with the support of the USAID and Barents Group, that is PriceWaterHouseCoopers, and it is to be finished by the end of June 2001. The idea of the program is that the citizens will be provided free-of-charge vouchers to be substituted with the shares of the companies currently being owned by the state but planned to be encompassed by the MVP.

At the same time, we see the privatization as an ideal instrument for the opening towards the international community. We have begun the process of the selling of our enterprises

to the strategic investors from all around the world. Our goal is to attract the most important international companies to invest their capital in Montenegro. The Brewery, for example, was sold to the Belgian company InterBrew. The management contract for 7 hotels has been signed with renowned French company ACCOR. The foreign bank called EuroMarket bank has been founded. Slovenian insurance company has invested 6,000,000 DM in a domestic insurance company. A great deal of small companies that have been privatized have in its structure foreign capital, including Montenegrin citizens, which work abroad. The growing number of joint ventures is present in the SME sector (the production of fish, wood and furniture, textile, food production, services, urban transport, dairy plants,...)

Tender for selling tobacco industry is under procedure. Transaction is going to be finished at the end of March / beginning of April 2001.

We prepare tender for Telecom, it will be announced in March 2001.

Tender for selling next three hotels is also announced:

1. "Avala", Budva
2. "Mogren", Budva
3. "As", Perazica do

We prepare tenders for:

1. Electricity Power System of Montenegro (by the end of 2001.)
2. »Plantaže« (vine and grape whisky) – beginning of 2002.
3. »Jugopetrol« (oil) – September 2001.
4. »Gornji Ibar« (wood processing) – September 2001.

Also, we prepare tender for selling packages of shares of 25 medium sized firms (tender will be announced in march 2001.)

All hotels at Montenegrin seaside will be privatized.

We adopted basic Acts and procedures, which provide transparency. Each tender sale in Montenegro must be done with involvement of international financial and legal adviser and under public and clear rules.

Our motto is:” **We don’t sell companies, we buy good owners**”. It means we encourage new investments, new technology, new management,...

Privatization process has been conducted with assistance from US and other international consultant firms. Beside USAID, PriceWaterHouseCoopers and CIPE (Center for International Private Enterprises (from Washington, D.C, we cooperate with Know How Fund, Hong Kong Shangaj Bank, Credit Ainstalt Investment Bank, Raiffeisen Investment

Bank, Deloitte&Touch, legal adviser Linclaters and Denton Hall, Fond for Open Society, European Union and others.

2. Monetary reform and financial system reform

Montenegro introduced German DM as official parallel payment currency in November 1999, beside YU dinar. At the beginning of two-currency system, structure of money mass was: 85% - YU dinars and 15% DM. Eight months latter (Jun 2000.) structure was: 96% of total money mass was DM and 4% YU dinars.

With introduction of Law on Central bank of Montenegro (November 2000.), DM has become the only payment currency in Montenegro.

Preparations of replacement DM with EURO are under procedure.

Citizens completely accepted DM as a payment currency, and they do not have a willingness to accept again local currency and inflation.

Introduction of DM as a legal payment currency is key reforms measure in Montenegro, which, with all others, has made Montenegrin Economic system different than economic system in Yugoslavia.²

3. Building of new business environment

Reform of tax system has started and main goals are lower tax rates and wider tax base, based on standards from European Union. VAT will be introduced.

Foreign investment Law is adopted and, according to it, foreigners have national treatment, all boundaries and foreign investment licenses are revoked (except for military industry), foreigners can buy real estate, land, companies, shares under the same conditions as domestic people. Also, they can establish banks, insurance companies, and brokerage houses under the same conditions as domestic people. There is no any limitations for property share in any company or financial institutions for foreigners. State guaranties to foreigners that, if Laws are changed, their investment will be ruled according to the Laws in period of their investment in Montenegro, unless new Laws are better for them.

New Companies Law and Bankruptcy Law are preparing.

Also, guaranties in several areas are provided: taxes repatriation, currency convertibility, protection from expropriation, non-discriminatory treatment and equal treatment of foreign investors, access to all legal and judiciary decisions, economic autonomy, access

² Central bank of Yugoslavia exists, but it covers only territory of Serbia and doesn't have any ingerentions at territory of Montenegro. In Yugoslavia (Serbia) official curenecy is dinar.

to international organizations and, in case of litigation, international court competence. Regime will provide:

1. Retroactive and constant guaranties, as proscribed with international practice and international trade agreements
2. Guaranties related with insurance, registration, taxation and labor force.

4. Tax system reform

We have already started with pension system reform two years ago. Main principles are lower tax rates and wider tax base.

VAT (Value Added Tax) will be introduced.

Also, reform in terms of higher budget transparency and budget expenditures are also part of Tax system reforms and are in procedure.

Montenegro is one of rare countries where budget revenues and budget expenditures are public and under analyze. They are published in magazine MONET (web-site: www.monetonline.com).

Now, Treasury implementation is under procedure.

Our international consultants declared Montenegro made big results in reform of Budget and it's transparency, which is great contribution to all reforms and theirs speed.

5. Foreign trade reform

Reform goes to next directions:

- ❖ Equal and non-discriminatory national treatment of goods and services
- ❖ Elimination of all non-custom tariffs barriers (quotas for example) except those which are proscribed by international standards
- ❖ Elimination of all import-export formalities
- ❖ Rules related with safety, anti-damping and measurement system, according to the rules of WTO (World Trade Organization)

6. Custom Tariffs System reform

- a. Application for membership in WTO custom tariffs agreement
- b. Application for membership in General Agreement of WTO
- c. Implementation of procedures according to the international practice, as, for example, inter alia, urgent housing, cross-borders controlling schemes,

procedures of rules appliance, intellectual property rights and customers complaints.

Custom tariffs in Montenegro are in range from 0 to 12%, and twice and more lower than in Yugoslavia (Serbia)

7. Economic regulation

In cooperation from Know How Fund from London and consultancy firm “London Economics” project of “Strategy of infrastructure regulation in Montenegro” has been prepared.

Based on that strategy, new Telecommunication Act is adopted, and Act on regulation of energetic sector, Act on Communal services, Act on Water Supply industry and establishment of Independent Regulatory Agency are under procedure.

8. Capital Market Building

Capital Market represents heart of new economic system. We build new institutions in this area. CDA (Central Depository Agency) was founded; we have Stock Exchange, eight brokerage firms.

Montenegrin Parliament adopted new Securities Act.

Three Management companies were established for privatization funds management.

Twenty young people were educated for work in capital market institutions.

Our concept is to involve Montenegrin Capital market into regional capital market (capital markets from former Yugoslavia states: Bosnia, Serbia, Croatia, FYR of Macedonia, Slovenia).

So, we have started with building of completely new institutional system. It is difficult task. We know this needs a time, new knowledge, but also technical support from international community, because we cannot conduct our reform without it. Also, importance of new people is significant, because new system needs new knowledge, new behavior and new way of thinking.

IV Development of SME sector

According to economic policy in Montenegro, SME sector has been encouraged, thought liberalization of company establishment procedure and accessibility of loans for business establishment.

Number of companies increased from 1990. (1900 firms) on 15.227 firms in 2000. 14.089 firms are private owned, 638 state owned and 500 with mixed ownership structure.

Small enterprises (with less than 50 employees) dominate in total structure.

Montenegrin Government, through Employment Fund approved 3.000 micro-loans for self-employments (amounts over than 6.000 DM): Development Fund (which dispose with privatization revenues) approved 210 loans for new private owned enterprises or almost 10 million DM. Conditions for Development Fund loans are:

1. Fund finances no more than 60% of total investment
2. Grace period – at least 3 years
3. Interest rate in range from 5-7% (depends from type of economic activity)

Either domestic citizens or foreigners can apply for the loan.

Several foreign organizations established micro-loans schemes. For example, Micro-credit Montenegro (capital from USA) approved almost 2.000 loans: than several German funds through Montenegrin Commercial bank; humanitarian aid programs also.

More and more people from Bosnia, Croatia and Slovenia become interested to establish firms in Montenegro.

Government of Montenegro established Agency for SME development.

Several private owned consultants firm have been established.

With coordination of Center for Entrepreneurship, CIPE from Washington, D.C realize program “Development of Entrepreneurship in Montenegro”.

University of Montenegro organizes a lot of courses on SME topics.

According to policy of Government of Montenegro, almost all privatization revenues were and will be invested in private owned firms and SME sector.

Analyses show hundred non-realized SME projects are caused with loan non-availability.

V Strategic vision of development

This is my personal opinion and attitude.

I see Montenegro as independent state, as a part of wider integrations and state, which share part of its sovereignty with those integrations.

We (experts from ISSP) are in favor of concept of Montenegro as a microstate.

Montenegro is microstate, not small state. Small state is, for example, Slovenia (2 million citizens). Small country, according to the rules, has all functions are big one. Microstate mustn't have all functions. Microstate should be more efficient and less expensive (lower costs). In such state, economy must dominate under politics, huge corporations under political parties!

Concept of Montenegro as a microstate means state and state's administration should have only those functions which provide **integration with region and Europe.**
Montenegro is too small to have big state administration.

Also, there are a numerous situations that, in case of development of big state administration, the biggest part of labor force work in state and quasi-state institutions, in political parties bureaucracy.

If great number of workers work for the state, then, who will make an income and from where budget revenues will be financed. Concept of microstate resolves this economic problem.

On the other side this concept provides lower influence from political parties on economy.

Montenegro, as microstate, should have, among the others:

1. Small and professional state administration, much lower than it has today
2. Mixed Presidential-Parliamentary political system, and smaller and reduced Government with reductions of its role in economy of Montenegro and reduction of number of state's and quasi state's institutions.
3. Revocation of the Army and reduction of Police forces
4. Representative offices and embassies only in the most important countries
5. Total privatization of public sector
6. Development of transparent system of entrepreneurial economy (based on entrepreneurship, innovations, encouragement of the most incapable individuals and firms, transparency)
7. Completely open economic system (without or will low custom tariffs rates and without any licenses)
8. Arrival of foreigners in Montenegro without visa (as it is now)

9. National treatment of foreigners
10. International guaranties of property and signed contracts

Connection among vision and reality we can make:

1. Thought privatization we can provide strategic partners for, for us important sectors as: tourism, energy, aluminum, and services. It means we should understand privatization as inflow of new knowledge, investments and economy openness.
2. As parallel activity, we should, and we do, **develop domestic entrepreneurial category and increase employment**. Employment increase is the most difficult and the most important task we have in conduction of reform. It is hard to believe unemployed person can understand our reforms and visions, and support them. *That's why I believe development of SME sector and loans supplement are urgent and crucial. Problem of unemployment is our major problem.*
3. Montenegro should be more **smaller and more near**. It means it has **excellent road**, traffic infrastructure that will provide to drive from south to north for less than three hours, not for a seven.
4. Realization of Projects proposed for Stability Pact (“Verige” bridge, regional water supply infrastructure, Highway beside coast, Tunnel Sozina, Highway Sarajevo - Podgorica - Tirana, Detour around Podgorica, reconstruction of the railroad - Podgorica - Niksic, Reconstruction of the airports in Podgorica and Tivat, Hydro electric power plant at rivers Moraca and Tara, Ecological investments)

Our opinion is Montenegro has **critical mass of young people** who understand entrepreneurial philosophy, who have computer literacy, speak fluently foreign languages and truly want a reform. Those people are the key potential for development of Montenegro!

Appendix

Institute for strategic studies and prognoses³

Macroeconomic indicators in Montenegro

Economic indicator	1989.	1990.	1991.	1992.	1993.	1994.	1995.	1996.	1997.	1998.	1999.	2000.
Nominal GDP (mil. US \$)	1.407,0	1.167,33	1.041,2	796,48	505,52	549,3	560,3	723,0	795,0	790,0	670,0	700,0
DP per capita (in \$)	2.309,5	1.812,62	1.692,91	1.295,02	821,94	885,97	882,36	1.131,46	1.236,39	1.221,02	917,81	1.069
DP (% change)	-	-17%	-11%	-24%	-37%	9%	2%	29%	10%	-1%	-15%	4,4%
Industrial Production (% change)	-	-17,0	-13,0	-20,0	-42,0	-8,0	-1,0	48,0	0,0	na	na	7%
Labor productivity (% change)	-	-1,25	8,82	-10,62	-8,28	6,11	5,09	3,37	9,59	na	-4,9%	+0,5%
Unemployment (%)	22,0	23,0	21,6	23,6	22,4	21,8	21,8	22,2	21,9	23,5	27,3	29,7
Number of employee /Number of pensioners	2,45	2,21	1,89	2,05	2,01	1,94	1,84	1,75	1,66	1,44	1,39	1,34
Real wages (% change from previous year)	24,0	-20,0	0,0	-53,0		269,0	17,0	17,0	30,0	6,0	na	na
Average monthly wage (in DEM)	na	na	na	na	29,40	108,49	126,94	148,52	193,08	204,66	165,2	203
Inflation (%)	na	na	na	na	na	67.295.290.516	179,8	182,4	120,0	143,0	130,0	7,0
Export (mil. \$)	na	na	na	na	na	na	na	78,04	109,11	110,57	216,929	137
Import (u mil. \$)	na	na	na	na	na	na	na	211,76	232,51	293,71	359,7	281
Trade balance (mil. \$)	na	na	na	na	na	na	na	-133,72	-123,40	-183,14	-142,771	-144
Population (000)	na	644,0	615,035	na	na	na	635,0	639,0	643,0	647,0	730,0	658
Exchange rate (DEM)-end of the year	na	na	na	na	na	1,62	3,4	3,78	4,74	8,01	20,0	25,9
Money mass - M ₁ - end of the year (mil. DM)	na	na	na	na	na	121,755	162,805	274,765	457,4	540,365	759,83 ⁴	95 ml DM

³ Researcher: Veselin Vukotić, Maja Baćović

Attention: ISSP experts estimate several indicators, so source must be written whenever they are publicly used.

Strategic projects aplyied througft Stability Pact

1. **Bridge Verige**, bridge over Boka Kotorska Bay; value: 50.000.000 \$.
2. **Highway beside coast**, connecting Trieste -Athens - Instabull.
3. **Tunnel Sozina**, connecting the Adriatic coast with middle Europe - Hungary; value 85.000.000\$.
4. **Highway Sarajevo - Podgorica - Tirana**, value 100 million US \$
5. **Detour around Podgorica**, value 84.000.000 \$.
6. **Motor Podgorica - Pristina**, value: 480.000.000 \$.
7. **Reconstruction of the railroad - Podgorica - Niksic**, value 56.000.000 \$.
8. **Reconstruction of the airports in Podgorica and Tivat**, value 15.000.000 \$.
9. **Hydroelectric power plant at rivers Moraca and Tara**, value 450.000.000 \$.
10. **Regional water supply system "Montenegro coast"**, value 94.000.000 \$.
11. **Ecological investments**, value 100.000 \$.