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## **Macroeconomic trends and Economic Reforms in Montenegro**

### **Objectives of the paper**

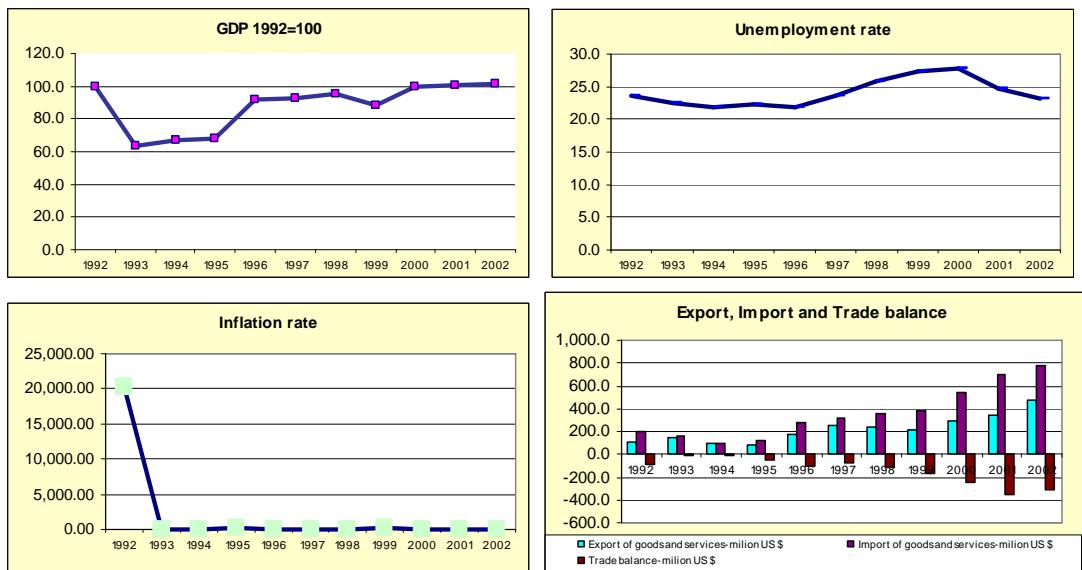
In the paper, macroeconomic issues and new economic and institutional system in Montenegro were presented. In first part, major macroeconomic changes happened during the last decade were presented. This is followed by overview of current situation, and then with key principles of economic reforms and building of new institutional system in Montenegro.

#### **1. Macroeconomic trends**

During last decade, significant number of problems and situations influenced quality and quantity of economy. During that period, Former Yugoslavia was split; hyperinflation; sanctions from international community, non-democratic regime.

Compared with 1992, when Former Yugoslavia was broken, real growth rate of GDP in 2002 was 1,3%; inflation rate from 20.293,0 % decreased to 9,4 % u 2002; unemployment rate from 23,6% was reduced to 23,25%; export increased for 318%, import for 298%, while foreign trade deficit increased for 271%.

Next graphs presents key economic trends during period after Former Yugoslavia split. Detailed statistics are presented in Annex of this paper (Annex, table 3).



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## **2. Macroeconomic disequilibria**

Macroeconomic situation in Montenegro reflects three essential disequilibria's:

1. **Internal disequilibria**, reflected through high unemployment rate
2. **Fiscal disequilibria** – reflected through consolidated budget deficit
3. **External disequilibria** – Balance of payment deficit and foreign debt

### **2.1. Real sector**

**Gross Domestic Product (GDP)** in Montenegro in 2002 was € 1.221 million, or €1.82 per capita. Compared with previous year, real growth rate was 0,84%, while GDP deflator 16,4%. Since 1996 GDP in Montenegro has recorded positive real growth rates.

Montenegrin economy is dominantly services oriented. Services represent more than 60% of GDP. Transportation and trade are the major services, while in tourism 10% of GDP was produced.

**Industrial production** in 2002 increased by 0,7% compared with 2001.

**Number of tourists** visited Montenegro in 2002 was lower by 4% than in year before. **Structure of tourists** has been changed in favor of foreign visitors, from 20,8% in 2001 to 24,8% of total number of tourists in 2002, which influenced increase in revenues from tourism.

**Unemployment rate** in 2002 was 23,25%<sup>2</sup>. Total number of unemployed persons was 57.688.

**Inflation rate** was 9,4%.

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<sup>2</sup> Source: Households Income and Expenditure Survey, ISSP

## **2.2. Fiscal sector**

**Budget deficit<sup>3</sup>** in 2002 amounted € 24,3 million or 2% GDP. After grants were included, budget amounted surplus of € 2,6 million(0,2% GDP).

### **2.2.1 Budget revenues and grants**

Total budget revenues (excluding grants) in 2002 were equal to € 226.4 million, which represents 17.4% of the estimated GDP<sup>4</sup>. Compared to the central budget revenues executed in 2001, central budget revenues in 2002 were almost at the same level.

Composition of budget revenues. Turnover tax (including excises) and personal income tax represented more than 70% of total budget revenues in 2002. These categories together with revenues from taxes on international trade and transactions represented 82% of total revenues. Other taxes (corporate income tax as well as property and real estate tax) represented almost 6% of total revenues (€13.3 million). Non-tax revenue (fees, fines and other revenue) represented 9.3% of total revenue.

**Grants.** At the end of 2002 total foreign aid (grants) was close to €27 million. Foreign aid represented almost 12% of total revenues.

### **2.2.2 Budget expenditures and net lending**

Total budget expenditures including net lending, in 2002, were close to €250 million (19.3% of GDP). Expenditures with net lending were €8.6 million smaller in comparison with 2001.

**Composition of budget expenditures.** The largest expenditure category in 2002, wages and salaries, represented almost 44% of total expenditures and amounted to €105.9 million, or 21.4% below the planned level. The second largest expenditure category was expenditures for goods and services. This category amounted to close to €42 million, and represented 17.3% of total expenditures. Social Insurance and Social Security transfers represented 14.8% of total expenditures. Subsidies to enterprises represented 7.5% of total expenditures (€18.2 million). Other non-interest expenditure (rents of government buildings and other expenditures), reached €3 million in 2002. This category represented 1.25% of total expenditures. In 2002 the Montenegrin Government started to pay interest on the old foreign debt (debt accrued before 1990) to non-residents. At the end of 2002, expenditures for interest to non-residents reached €12.5 million.

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<sup>3</sup> Revenues and expenditures of Pension fund, Health fund and Employment fund are excluded from this statistics. After it is included, fiscal deficit in 2002 was € 40,5 million or 3,3% GDP. After foreign grants were added, deficit amounted € 13,6 million (1,1% GDP)

<sup>4</sup> GDP at current prices, ISSP estimation.

**Capital expenditures** (mainly investment and maintenance of existing objects) represented 4.6% of total expenditures and amounted to €16.8 million.

**Net lending.** In 2002, net lending (net credits given by the government) was €9.1 million.

### **2.2.3 Budget balance and financing**

Overall budget balance excluding grants in 2002, calculated as the difference between total revenues and total expenditures and net lending, was - €24.3 million on a cash basis, which represented close to 2% of GDP. If grants are included the budget balance turns positive and amounts to €2.6 million on a cash basis.

Generally, the **budget policy** in 2002 can be considered restrictive. Revenues and grants were below the planned level. The budgetary expenditures were roughly in line with the total revenues (including grants) and lower revenues forced the Government to reduce some expenditure categories or postpone its obligations. This cash-based discipline along with the larger privatization receipts allowed the Government to reduce its liabilities and deposit<sup>5</sup> some additional funds for 2003 year.

## **2.3. External sector / Balance of payments**

### **2.3.1. Current Account**

The current account deficit in Montenegro in 2002 amounted to €166 million or 14% of GDP<sup>6</sup>, which is less than in 2001 when the deficit amounted to €199 million (or 19% of GDP). Total revenues were equal to €704 million, or 12% more than in 2001, while expenditures were equal to €871 million or 5% more than in the previous year.

#### *Goods Trade*

In 2002 total trade of goods (imports plus exports) was greater than €1 billion, an increase of 11% over the previous year. Exports rose by 36%, while imports increased by 2%. Overall, the ratio of exports to imports rose from 32% in 2001 to 43% in 2002. The resulting trade deficit was €422 million or 35% of GDP and represented a considerable improvement over 2001, when it was €491 million (47% of GDP).

The increase of imports and exports is primarily due to the increase of trade with Serbia and Kosovo. This is particularly true of exports. In 2002, Montenegrin exports to Serbia and Kosovo accounted for 65% of total non-aluminum exports and in US\$ terms, they were 297% higher than in 2001. Exports directed to other countries grew at an average level of about 5%.

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<sup>5</sup> These deposits were mostly thanks to Jugopetrol privatization receipts.

<sup>6</sup> GDP for 2002 is estimated at €1.221 billion according to ISSP estimation

Imports grew in 2002 primarily due to an increase of electricity import as well as increased import from Serbia and Kosovo (albeit the growth rate was much lower than in case of exports). Fewer imports of oil and oil derivatives (38% lower in 2002 than in 2001) coupled with the restrained growth in other imports resulted in a moderate growth of total imports of goods. This, together with a high growth in total exports (43%), yielded a lower trade deficit in 2002.

#### *Balance of services*

In 2002, Montenegro's surplus on services was €102 million or 5% greater than in 2001. This improvement is primarily due to the better balance of transportation and tourism services with countries other than Serbia. Revenues from foreign tourists and from transportation services grew in 2002 much more than the respective expenditures, resulting in a higher surplus and enabling the improved services account (for details see also section on tourism in chapter 1).

#### *Income*

The net balance of income rose 44% in 2002, going from €47 million in 2001 to €67 million in 2002. This increase is due to a 35% increase of total compensation of Montenegrin workers abroad and a 21% increase of transfers from Serbia for Montenegrin persons. The net income balance accounted for 5.5% of GDP in 2002.

#### *Transfers*

Current transfers to Montenegro decreased during 2002 by 41%. They fell from €148 million in 2001 to €87 million in 2002 as a result of lower foreign assistance and other transfers from abroad. The balance of transfers in 2002 remained positive and amounted to €92 million or 7% of GDP.

### **2.3.2. Capital and Financial Account**

In the financial account, foreign direct investment constitutes the most significant position. The inflows related to FDI are mostly result of the privatization of the oil company: *Jugopetrol*. Consequently, the per capita foreign investment inflow grew from €16 in 2001 to €128 in 2002.

Net portfolio investments remained at a negligible, negative level while other investments (net loans) turned positive in 2002 and amounted to €4.4 million.

### **3. Potentials of Montenegro**

Montenegro is small Mediterranean state: population of 660.000 living in area of 13.628 km<sup>2</sup>.

**Potentials of Montenegro are:**

- Montenegro is part of Europe
- Montenegro is Mediterranean state
- Agricultural potentials
- 293 km of sea cost
- Capacities for production of 100,000 tones of aluminum
- Capacities for production of 400,000 tones of raw Ferro
- Capacities for production of 1,000,000 tones of bauxite
- Capacities for production of 2.500.000 tones of coal
- Capacities for production of 75,000 tones of salt
- Services (Port of Bar, Ship yard Bijela)
- High-educated people represents 20% of labor force
- 85% of total number of enterprises are private-owned

Tourism is especially important for Montenegro!

Table 1: Tourism Revenues in Montenegro

Year	Revenues
1990	€ 150 million (€ 60 million from foreign tourists)
2000	€ 35 million (€ 5 million from foreign tourists)
2001	€ 110 million (€ 40 million from foreign tourists)
2005	€ 150 million
2020	€ 800 million

Source: DEG (Master Plan for tourism development in Montenegro)

How these potentials may be used? Answer is in creation of new economic system.

#### **4. New Economic System**

Building of new economic system in Montenegro has started in 1998<sup>7</sup>. Despite the fact that in 2000, Montenegro and Serbia, was still part of Federal Republic of Yugoslavia, Montenegro had its own sovereign economic system.

Key principles of economic reforms in Montenegro originate from the fact that Montenegro is:

- a) Very small market
- b) Mediterranean country
- c) Need to be included in global development mega-trends

Key principles on which new economic system is built are listed below:

1. Private property in all areas and protection of property rights
2. Open economy
3. National treatment of foreigners
4. Transparency

These principles can be applicable only if institutions, which create and protect these principles, are created. That's why institution development is keystone of economic reforms in Montenegro.

On these basis following activities are carried out:

1. **Liberalization** – above 98% of all prices are liberalized and formed on the market; average tariff rate is 3%; more than 90% of goods are on free import regime.
2. **Deregulation** – administrative barriers are reduced in order to reduce transaction costs and liberate entrepreneurial initiative. For example, foundation of company is simplified; bankruptcy procedures are much faster now...
3. **Monetary Reform** – in 1999 DEM is introduced as legal currency, and from 2002, EURO is only legal mean of payment.
4. **Tax Reform** – Value Added Tax is introduced (flat tax rate is 17%); personal income tax is introduced too (progressive tax rate in range 17-25%); corporate income tax – 20%.
5. **Privatization** – more than 60% of state owned capital has been privatized and above 90% of all companies. Key privatization models were: internal privatization, coupons (vouchers) privatization, and international tenders. Strategic investors that have come in Montenegro are from Belgium, Greece, Norway, USA, Japan, Germany, Italy, Slovenia,..

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<sup>7</sup> Break up with Milosevic's politics in Serbia

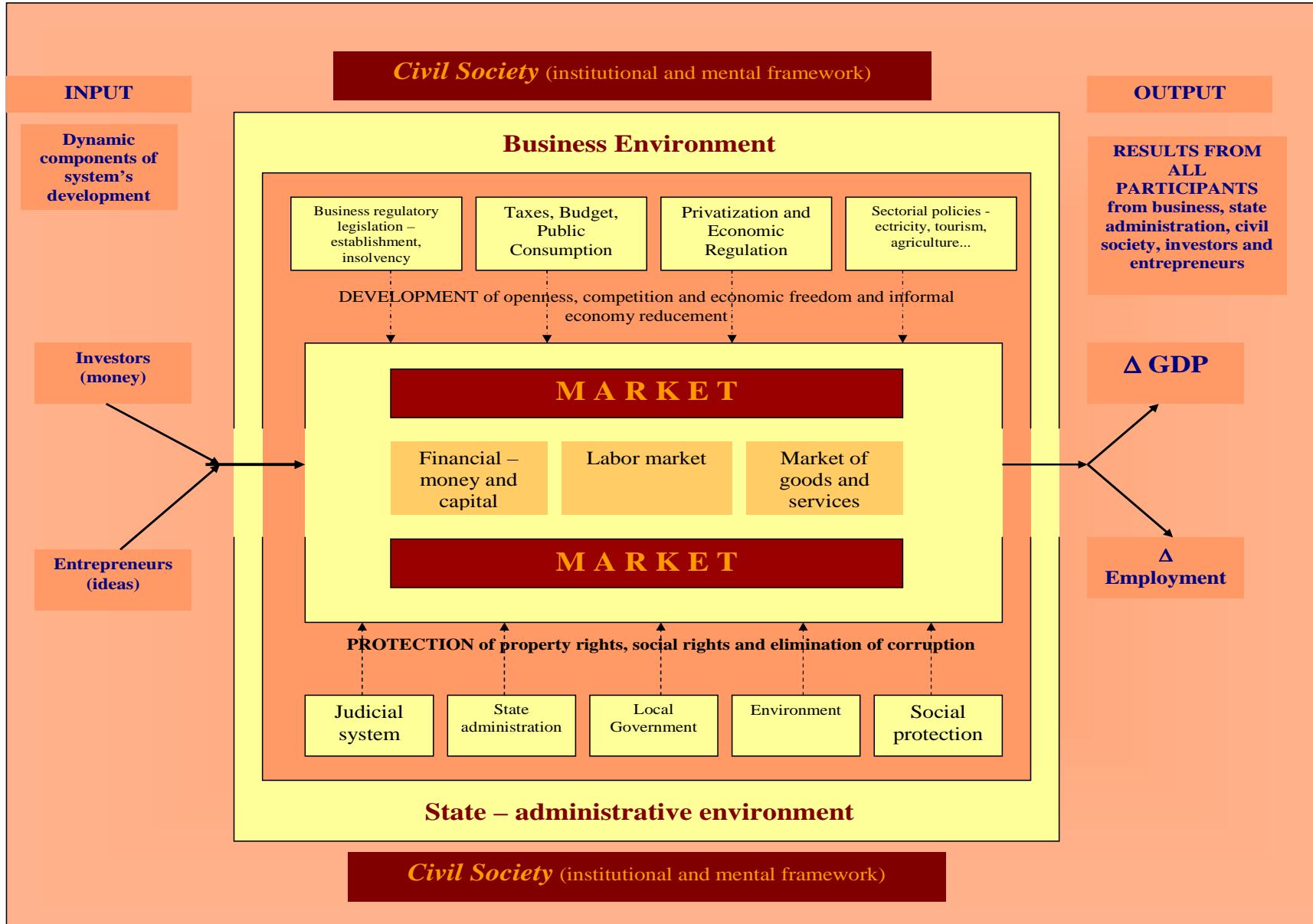
6. **Economic regulation** – Along with the privatization much work have been done in area of economic regulation. Keystones in this area are independent regulatory bodies for telecommunications, energy, radio-diffuse frequencies, and regulation within other fields is being established (water-supply, utilities...)
7. **Banking sector** – Nine banks operate in Montenegro, from which 3 are foreign banks (Nova Lubljanska Bank, Euromarket Bank and Opportunity Bank). Only one bank is state owned, while the biggest state bank »Montenegrobanka« has been privatized. Until the end of this year, all shares of state ownership in banking sector will be sold. Banking sector is regulated and supervised by the Central Bank of Montenegro, which is authorized for giving working licenses to the banks.
8. **Capital Market** – Capital market in Montenegro operates. All capital market institutions exist. Shares are registered in the Central register. Securities Commission regulates activities in this area. There are two stock exchanges, five brokerage houses, and six privatization funds in Montenegro. As every small capital market, Montenegrin capital market suffers from children's diseases (see graph in annex).
9. **Business environment** – Company in Montenegro can be founded for € 1; bankruptcy procedures have been speed up; private sector can participate in providing public services; Public Procurements Law is adopted and implemented.
10. **Pension System Reform** – New Pension Law and New Labor Law are in procedure of adoption in Parliament.
11. **Corruption** – In order to regulate this field the Anti-corruption Agency is founded and all necessary laws for its functioning are established.
12. **Other areas** – changes and reforms have started in, more or less, each area (education, health care, state administration...)

Reforms in Montenegro continue according to the **Economic Reforms Agenda** 2002-2006.

It is comprehensive economic reforms document, whose main goal is modernization of economic life in Montenegro. Main goals stressed in this document are listed below:

1. Increase economic freedom
2. Protect property rights
3. Promote transparency principle and reduce corruption
4. Administrative reform

Simultaneously, all measures necessary to encourage investors and entrepreneurs are being undertaken. Graph below shows anatomy and physiognomy of Economic Reform Agenda.



Indicative parameters in Agenda are listed below:

**Table 2.** Parameters of Economic Reform Agenda in period 2002. - 2006.

<i>Macroeconomic indicators</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>
<i>GDP (mil euro)</i>	1.221	1.328	1.421	1.516	1.618
<i>GDP per capita - €</i>	1.832	1.982	2.111	2.241	2.379
<i>Inflation Rate</i>	9,4%	8,5%	4,5%	2,8%	2,1%
<i>Unemployment Rate</i>	23,25%	22,00%	21,00%	20,00%	19,00%
<i>Balance of Payment (mil \$)</i>	-60	-33	33	34	35
<i>Foreign Direct Investments (mil \$)</i>	75	90	120	150	180
<i>Informal Economy</i>	30%	20%	15%	13%	11%

As part of consistent socio-economic reforms, beside Economic Reform Agenda, Government implements reforms programs in other areas, such as: Administrative Reform, Education Reform, Entrepreneurship Development, and Anti-drugs Program.

### Instead of Conclusion

Montenegro is on the way to understand elementary logic of economic facts: ***you must live from your own work, from money you earn.*** This fact causes big debates in Montenegro, which sometimes take on political character and cause real divisions.

Main goal of reforms, which are implemented, is creation of solid base for sustainable development of Montenegrin economy on regional and global market.

## **ANNEX –Graphs and Tables**

**Table 3:** Macroeconomic Indicators in Montenegro - 1989-2002

	Gross Domestic Product (GDP)-million US \$-constant prices	GDP 1992=100	Population (000)	GDP per capita - US \$-constant prices	Industrial production-1992=100	Agriculture - 1992=100	Number of tourists (000)	Unemployment rate	Number of employed	Number of unemployed	Inflation rate	Export of goods and services-million US \$	Import of goods and services -million US \$	Foreign trade balance - million US \$
1992	1,027.4	100.0	624.0	1,646.5	100.0	100.0	413	23.6			20,293.2	112.6	195.1	-82.5
1993	655.3	63.8	631.9	1,037.0	66.0	91.8	423	22.4			n.a	146.8	159.4	-12.6
1994	686.6	66.8	635.3	1,080.7	60.6	97.4	603	21.8			n.a	94.3	101.1	-6.8
1995	701.8	68.3	638.6	1,099.0	59.0	102.4	625	22.2	178,868	55,436	111.80	79.1	126.0	-46.9
1996	939.6	91.5	643.0	1,461.3	89.6	105.8	658	21.9	183,483	56,477	47.20	177.2	272.9	-95.7
1997	953.8	92.8	647.4	1,473.3	90.8	116.0	663	23.5	178,562	57,342	16.20	249.5	322.0	-72.5
1998	982.5	95.6	651.3	1,508.5	90.5	116.8	622	25.7	180,365	50,693	42.00	239.9	360.2	-120.3
1999	908.9	88.5	655.2	1,387.2	83.3	122.0	298	27.3	184,832	53,340	128.40	211.5	383.8	-172.3
2000	1,022.1	99.5	658.3	1,552.6	86.2	115.9	448	27.8	181,762	54,949	24.80	293.6	545.4	-251.8
2001	1,032.0	100.4	661.6	1,559.9	85.0	124.0	555	24.8	175,242	57,536	28.00	345.3	695.2	-349.9
2002	1,041.2	101.3	663.0	1,570.4	86.1		541	23.3	177,617	57,688	9.40	471.4	777.7	-306.3

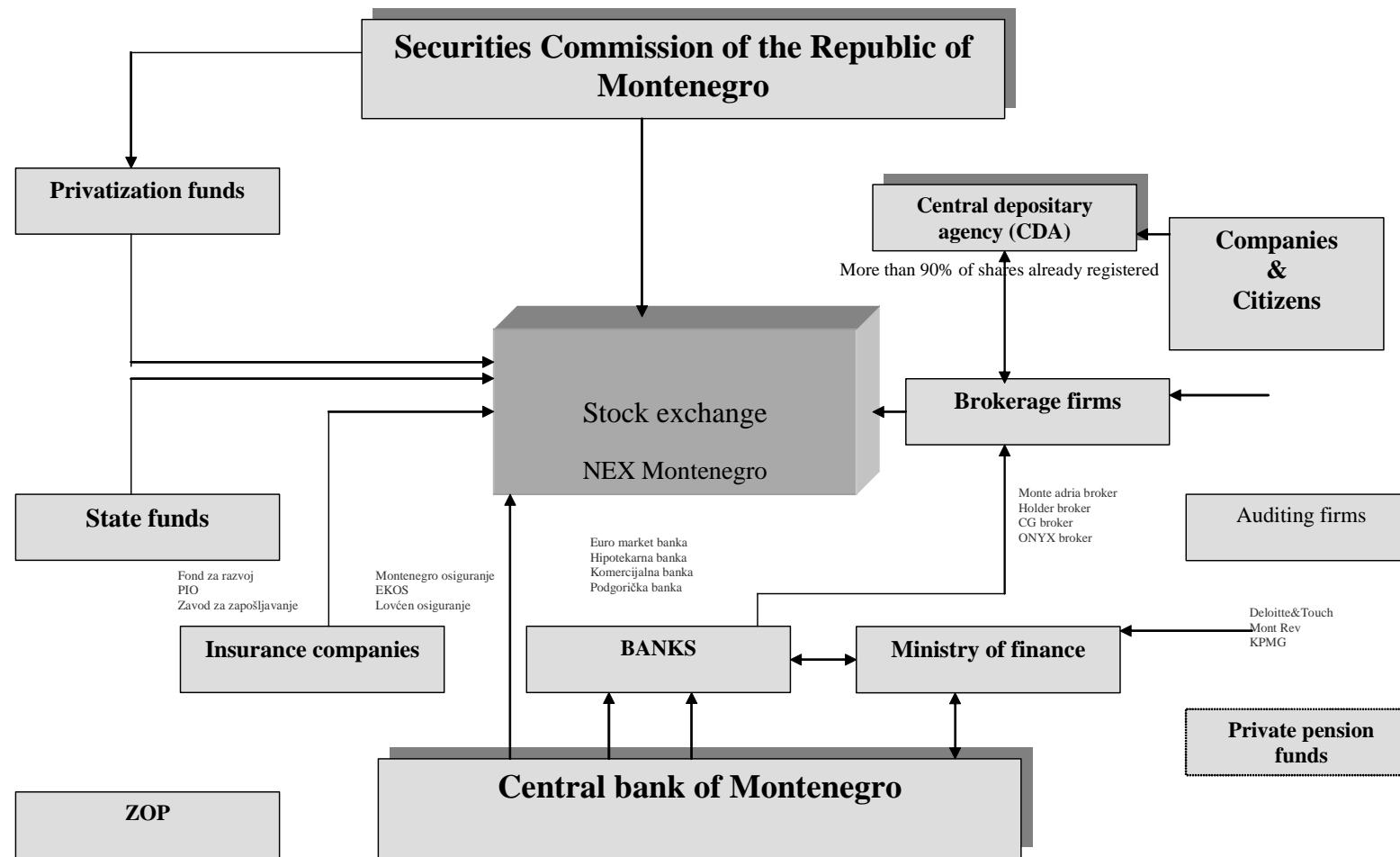
**Table 4.** Balance of Payments in 2002 - summary (000 €)

	Jan-Dec 2002	% Of GDP
<b>CURRENT ACCOUNT</b>	<b>-166,157</b>	<b>-13,60%</b>
Total CA revenues	704,354	57,67%
Total CA expenditures	870,511	71,28%
	1574,865	
<b>GOODS AND SERVICES TRADE BALANCE</b>	<b>-320,154</b>	<b>-26,21%</b>
<b>GOODS TRADE BALANCE</b>	<b>-421,950</b>	<b>-34,55%</b>
Total export of goods	320,823	26,27%
Total import of goods	742,773	60,82%
BALANCE OF SERVICES	101,796	8,34%
Total revenues from services	176,094	14,42%
Total expenditures from services	74,298	6,08%
<b>BALANCE OF NET FACTOR INCOME</b>	<b>67,126</b>	<b>5,50%</b>
Revenues	110,331	9,03%
Expenditures	43,205	3,54%
<b>BALANCE OF CURRENT TRANSFERS</b>	<b>86,871</b>	<b>7,11%</b>
Transfers to Montenegro	97,106	7,95%
Transfers from Montenegro	10,235	0,84%
<b>CAPITAL AND FINANCIAL ACCOUNT</b>	<b>105,537</b>	<b>8,64%</b>
<b>CAPITAL ACCOUNT</b>	<b>0,000</b>	
<b>FINANCIAL ACCOUNT</b>	<b>105,537</b>	<b>8,64%</b>
Foreign Direct investment	87,327	7,15%
Portfolio investment-net	-0,174	-0,01%
Other investment	4,411	0,36%
Change in net foreign assets	10,007	0,82%
Change in reserves of CBM (term deposits in banks abroad)	3,966	0,32%
<b>BALANCE OF CAPITAL AND FINANCIAL ACCOUNT</b>	<b>-60,620</b>	<b>-4,96%</b>
<b>NET ERRORS AND OMISSIONS</b>	<b>-60,620</b>	<b>-4,96%</b>
<b>GDP</b>	<b>1221,300</b>	
Source: Central bank of Montenegro		

**Table 5.** Revenues and Expenditures of Central Budget in 2002 (000 €)

		<b>2002</b>
<b>A</b>	<b>Total revenues and grants (1+2)</b>	<b>253,324</b>
1	Total revenues (1.1+1.2)	226,436
1,1	Current revenues (1.1.1+1.1.2)	226,436
1.1.1	Tax revenues (1.1.1.1+1.1.1.2+1.1.1.3+1.1.1.4+1.1.1.5)	205,476
1.1.1.1	Personal Income Tax	57,908
1.1.1.2	Sales tax	52,324
1.1.1.3	Akcise	50,786
1.1.1.4	International trade and transactions tax revenues	27,111
1.1.1.4.1	Custom	13,307
1.1.1.4.2	Transit	13,805
1.1.1.5	Other tax revenues	17,346
1.1.2	Non-tax revenues	20,960
1,2	Capital revenues	0,000
2	Grants (from international community)	26,888
<b>B</b>	<b>Total expenditures and net loans (1+2)</b>	<b>250,748</b>
1	Total expenditures (1.1+1.2)	241,662
1,1	Current expenditures (1.1.1+1.1.2)	230,475
1.1.1	Interest	13,108
1.1.2	Non-interest expenditures (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4+1.1.2.5+1.1.2.6)	217,367
1.1.2.1	W3ages and other payments to employees	105,921
1.1.2.2	Material and services	41,756
1.1.2.3	Transfers and social benefits	35,727
1.1.2.4	Subsidies	18,170
1.1.2.5	Reserves	12,784
1.1.2.6	Other	3,009
1,2	Capital expenditures	11,187
2	Net loans	9,086
	Loans	9,086
	Repayment of loans	0,000
	<b>Budget balance excluding grants from international community (on cash basis) (A-B-C-2)</b>	<b>-24,312</b>
	<b>Budget balance (cash) (A-B-C)</b>	<b>2,576</b>
	<b>Financing (1+2)</b>	<b>33,822</b>
1	Domestic and Foreign financing (net)	-3,864
	Loans	45,055
	Repayment of loans	48,919
2	Revenues from privatization	37,686
A	Total revenues and grants (1+2) as % of GDP	0,207
B	Total expenditures and net loans (1+2) as % of GDP	0,205
	Budget balance (cash) (A-B-C) as % of GDP	0,002

## Capital market in Montenegro



*Shema: Capital market in Montenegro (institutional approach)*