



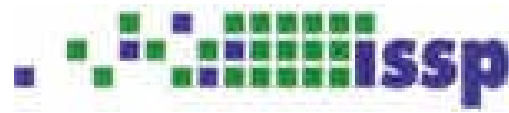
# MONTENEGRO ECONOMIC TRENDS MONET



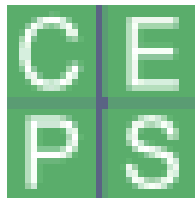
Montenegro economic trends (MONET)

An EU-funded project managed by the European Agency for Reconstruction

**MONET**



# **MONTENEGRO ECONOMIC TRENDS**



**July 2005**

## ABOUT ISSP

The Institute for Strategic Studies and Prognoses (ISSP), established by Professor Vukotic in 1999, is the first independent economic institute in Montenegro. USAID assisted in this process and continues to support the work of the Institute. ISSP has a wide network of associates both in Montenegro (about 150) and abroad. ISSP is a member of the Balkan Network, the Global Development Network established by the World Bank and the European Integration Network. ISSP cooperates with ICER (Torino), WIIW (Vienna), CEPS (Brussels) and Chesapeake Associates (Washington).

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- a) Privatization
- b) Monetary Reform
- c) Capital Markets Development
- d) Fiscal Reform
- e) Reform of the Pension System
- f) Introduction of the SNA system
- o Macroeconomic indicators in Montenegro
- o Economic education

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## ABOUT MONET

MONET ([www.isspm.org](http://www.isspm.org)) is the result of the joint work of ISSP in Podgorica and CEPS in Belgium. It is financed by the grant from the European Agency for Reconstruction.

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## Table of contents

<b>Events</b>	<b>3</b>
<b>Executive Summary</b>	<b>5</b>
<b>Part 1</b>	
<b>Chapter 1. Output</b>	<b>8</b>
<b>Chapter 2. Employment</b>	<b>18</b>
<b>Chapter 3. Wages</b>	<b>26</b>
<b>Chapter 4. Prices</b>	<b>32</b>
<b>Chapter 5. Budget</b>	<b>42</b>
<b>Chapter 6. Money</b>	<b>54</b>
<b>Chapter 7. Capital Market</b>	<b>64</b>
<b>Chapter 8. External Sector</b>	<b>72</b>
<b>Chapter 9. Regional Comparison</b>	<b>80</b>
<b>Part 2</b>	
<b>Comment 1. Study review: trends of economic development in Montenegro</b>	<b>87</b>
<b>Comment 2. Restructuring of the electricity sector</b>	<b>92</b>
<b>Comment 3. Institutional framework for new statistical system in Montenegro</b>	<b>101</b>
<b>Comment 4. How the potential increase in minimum wage will influence the Montenegrin economy?</b>	<b>106</b>
<b>Comment 5. World Trade Organization and Agriculture</b>	<b>114</b>

## Events

### January 2005

- 06. **Christmas Proceedings for Economic Faculty.** Held traditional Christmas Proceedings with the subject "State and Person;" there were approximately 500 participants.
- 07. **Started new payment system in Montenegro.** Commercial banks in Montenegro officially took over payment operations. The provision for payments, after abolishment of the Fund PIO fee, was decreased by one-third and banks were allowed to determine their own level of provision.
- 12. **Treasury bills issue.** Government of Montenegro issues 56-day-treasury bills in the amount of € 5.6 million.
- 13. **Increased the number of Internet users in Montenegro.** According to an announcement by the Agency for Telecommunication of Montenegro, over € 170 million was realized on the Montenegrin telecommunication market, which is 3.3% higher than 2003. Total revenues from Internet services increased by 50% compared to 2003.
- 13. **Treasury bills issue.** Government of Montenegro issues 182-day-treasury bills in the amount of € 3.6 million.
- 20. **Treasury bills issue.** Government of Montenegro issues 28-day-treasury bills in the amount of € 8.7 million.
- 20. **Treasury bills issue.** Government of Montenegro issues 91-day-treasury bills in the amount of € 2 million.
- 25. **New petrol increase.** The price of petrol at Montenegrin gas stations increased by about 3-4%. The price for diesel increased 4%, amounting to € 0.78, while the prices for Unleaded and Super petrol increased by 3-4%, with their new prices hitting €0.91 and € 0.9, respectively. The retail sale price for eco diesel increased 4% and is now priced at € 0.79.
- 28. **Privatization revenues amount to € 25.8 million.** According to an announcement by the Privatization Council, Montenegro realized € 25.8 million in 2004 through the privatization of the shares and assets of Montenegrin companies; this amount is 2% lower than in 2003.

### February 2005.

- 03. **Bosnia and Herzegovina introduced customs on flour and beer.** After Montenegro introduced a custom rate of 30% on flour import, Bosnia and Herzegovina reacted with the Decree on Introduction of Custom on Flour and Beer Import. This decision abolishes a zero custom rate from the Free Trade Contract with Montenegro.
- 04. **Treasury bills issue.** Government of Montenegro issues 56-day-treasury bills in the amount of € 5 million.
- 14. **Electronic banking services were begun.** Montenegrin banks introduced electronic banking services that enable their clients to perform financial transactions, print abstracts of their accounts and conduct other banking operations all without going to the bank.
- 17. **Treasury bills issue.** Government of Montenegro issues 28-day-treasury bills in the amount of € 8.5 million.

### March 2005.

- 02. **Realized \$ 15.5 million in exports.** According to an announcement by the Aluminum Mill, this company produced 9,366 tons of aluminum in February and realized revenue in the amount of \$ 18.5 million. The company received \$ 15.5 million from export. In the first two months of 2005, production was higher than planned, amounting to 19,662 tons, and revenue was \$ 37.2 million.
- 08. **New petrol increase.** Retail prices for one liter of diesel and eco diesel increased by € 0.05, bringing their prices to € 0.83 and € 0.84. The price for Super petrol and Unleaded petrol didn't change.
- 09. **Treasury bills issue.** Government of Montenegro issues 56-day-treasury bills in the amount of € 6 million.
- 11. **Realized the highest turnover on the Stock exchange.** Through the sale of shares, investment units, and old foreign exchange currency saving bonds, and above all due to trade of Telekom shares, the NEX Montenegro stock exchange realized turnover of € 10.5 million.

11. **Treasury bills issue.** Government of Montenegro issues 182-day-treasury bills in the amount of € 1 million.
12. **Abolished custom on flour import.** The Government of Montenegro adopted the Decision on Abolishment of Decree on Protection from Excessive Wheat Flour Import, thereby abolishing the 30% custom rate.
15. **Signed contract on Telekom sale.** Hungarian company "Matav" became owner of 51.2% of Telekom shares. Telekom was sold for € 114 million.
17. **Treasury bills issue.** Government of Montenegro issues 28-day-treasury bills in the amount of € 9 million.
24. **Treasury bills issue.** Government of Montenegro issues 92-day-treasury bills in the amount of € 5 million.
31. **Treasury bills issue.** Government of Montenegro issues 56-day-treasury bills in the amount of € 2.5 million.

### April 2005.

04. **Award for the Center for Entrepreneurship and Economic Development (CEED).** American foundation "Atlas," within the Program Templeton Anjards, awarded CEED, from Podgorica, for the great scores in their support of the private sector's development in Montenegro.
07. **Treasury bills issue.** Government of Montenegro issues 182-day-treasury bills in the amount of € 2 million.
14. **Abolished customs on flour and beer from SCG.** The Council of Ministers of Bosnia and Herzegovina abolished the customs on beer and flour that had been introduced in February. This Decision is in reaction to the abolishment of the 30% flour custom in SCG.
14. **Treasury bills issue.** Government of Montenegro issues 28-day-treasury bills in the amount of € 5 million.
20. **Founded Montenegrin Investment Promotion Agency – MIPA.**
28. **Announced Tender for five Hotels.** Tender for five Hotels of "Ulcinjaska Rivijera" – "Mediteran," "Galeb," "Olimpik," "Belvi," and "Grand lido," with apartments. Domestic and foreign investors were called to convey their offers to the Ministry of Tourism of Montenegro through July 26, and for "Mediteran" and "Galeb" until June 10<sup>th</sup>.
29. **Tourist Stock exchange.** At the Adriatic Fair in Budva, the Tourist Stock exchange began, where over 70 domestic and foreign companies participated and presented their offers for the next tourist season.

### May 2005.

05. **Collected € 220 thousand from penal.** In the first quarter of 2005, market inspection of 5,200 controls found over 3,500 anomalies. The Market inspection penalized over 1,400 subjects, and based on that, collected over € 220 thousand.
05. **Treasury bills issue.** Government of Montenegro issues 56-day-treasury bills in the amount of € 4 million.
09. **For Montenegro - € 45.5 million.** The European Union would, through the CARDS program, provide € 23.5 million to Montenegro in 2005 and € 22 million in 2006. According to that, support for Montenegro, over a two-year period, would be € 45.5 million.
18. **Tender for sale Podgoricka bank.** The Agency for Restructuring and Foreign Investments of Montenegro announced Tender for sale of 64.25% of the shares of Podgoricka bank. According to the Agency announcement, total assets of the bank amount to € 59 million and the bank has over € 16.7 million of equity capital.
18. **Two new Brokers received license for work.** The Security Exchange Commission of Montenegro handed two Broker houses licenses for work - MB broker from Podgorica and Monte broker from Berane.
30. **Tender for Coal Mine.** Tender Commission of Montenegro announced Tender for sale of 31.11% of the Coal Mine from Pljevlja, as well as the Thermal Plant from Pljevlja, for one buyer as a part ownership of the Electric company.

## Executive summary

### First part

Review of the Montenegrin macro-economy, in the first five months of 2005, is presented in this issue of MONET.

*Industrial production* in the first five months of 2005 was 1.6% lower than in the corresponding period of 2004, while its annual growth rate in May of 2005 was -5.7%. Average electricity production in the period January-May 2005 was 17% higher than in the same period of 2004. Average aluminum production in the first five months of 2005 declined by 0.6% compared to the corresponding period of 2004. Compared to the corresponding period of 2004, the first quarter of 2005 found transport of goods decreased by 15.7% and transport of passengers decreased by 13.6%.

The *average wage* and salary after taxes and contributions in the first five months of 2005 was 6.4% higher as compared to the same period last year. The highest average wages and salaries after taxes and contributions in the first quarter of 2005 were achieved in the Central region. The average effective tax rate in the first five months amounted to 13.3%, while in the corresponding period last year, it was 14.1%.

*Employment* in the first quarter of 2005 was slightly lower as compared to the previous quarter, while as compared to the same period last year, there are no significant changes. The average number of registered unemployed persons is 18.1% lower in the first five months of 2005 as compared to same period in 2004.

Projected *inflation* in the next 12 months will range from 1.8% to 2.7%. According to the optimistic scenario, the inflation rate in the four quarters is projected to be: 4.3% in Q3 of 2005, 2% in Q4 of 2005, 1.9% in Q1 of 2006, and 1.8% in Q2 of 2006. According to the pessimistic scenario, the inflation rate in the four quarters is projected to be: 6.2% in Q3 of 2005, 2.8% in Q4 of 2005, 2.7% in Q1 of 2006, and 2.7% in Q2 of 2006.

In the first five months of 2005, the Republic *budget* had a surplus of €8.64 million; total revenues were about 9% higher in comparison to the same period of last year and amounted to €147.1 million, while total expenditures were at €138.5 million. VAT revenue had the greatest share of 43%, or €67.4 million, in total revenues, and the biggest expenditures category is related to the salaries in the public sector (€57 million).

In the first four months of 2005, monetary aggregates recorded positive annual growth rates. Monetary aggregate MO, in April 2005, recorded an annual growth rate of 6.37%, M1 (which do not include Government deposits) of 13.97%, and monetary aggregate M11 16.94%, compared to the same month of the previous year. Total deposits continued their increasing trend during the observed period and at the end of April 2005, they reached 299.8 million €, which is 35.15% higher than the same month last year. Data on loans provided by Montenegrin banks show that the total amount of loans increased by 38.57% in April 2005 compared to the same month of 2004.

The situation on the *capital market* in the first 5 months of 2005 implies that the capital market of Montenegro is growing fast and that it is becoming a significant part of the whole Montenegrin economy. Namely, turnover realized on the stock exchanges in the analyzed period amounted to more than € 90 million, which is two times as high as turnover during the entire 2004 year. On the other side, 40,674 realized transactions, or 140% more than in the same period of 2004, indicate that more and more citizens are look to the capital market as a financial resource and as a possibility to earn money.

### Second part

#### ***Review of the study: Trends of economic development in Montenegro***

This study was done for the needs of the Environment Plan of Montenegro. What is the goal of this study? A relationship between the economy and the environment in the long term! In other words, spatial allocation of resources. How can we know how a certain environment (map of Montenegro) influenced development and how development influenced the environment, or devastation of the environment (economy)?

#### ***Reconstruction of the Electricity sector – a way to open the electricity market***

World trend in electricity companies' development means fast reconstruction of conventional, centralized, completely regulated, market open electricity structures. In this way, the market game came into the first plan. In a modern, reconstructed electricity company, transfer and distribution are completely changed and have become independent subjects.

#### ***Institutional framework for new statistical system in Montenegro – Proposed Law on Statistics and Statistical System in Montenegro***

The transition process from a planned economy to a market oriented economy in Montenegro has initiated many changes in the economic system. Such a process has also influenced the statistical system in Montenegro. All participants in economic and social transactions have become more aware of the importance of accurate statistics and information.

#### ***How the potential increase in minimum wage will influence the Montenegrin economy?***

It is the custom in Montenegro to demand that the Government solve a variety of problems. Employment, wages, pensions, competition, investment, inequality, poverty, education, etc. are issues that are often put on the Government's agenda. The question is whether the government can or **should** solve all these problems. By minimizing the government's role in the economy, except for setting the rules of the game, the market forces will solve some of these problems.

#### ***World trade organization and agriculture***

The World Trade Organization is an international organization, which was established in 1995 when it replaced the General Agreement on Tariffs and Trade (GATT). The objective of WTO is to oversee the negotiations (rounds) for open door trade, and with that objective in mind, to assure countries that import tariffs and other barriers will be annihilated. The largest negotiations that are guided by the WTO are in regards to the sector of agriculture.



# PART 1

## Chapter 1. Output

**Table 1.1 Major developments in the Real sector**

	GDP		Industrial production					Tourism			Transport				
	1989=100	Annual change in %	1989=100	Annual change in %	Processing industry **		Aluminum production (ton)	Electricity generation (in MWh)	persons	Annual change in %	Share of foreign tourists in total in %	Transport of passengers		Transport of goods	
					1989=100	Annual change in %						1989=100	Annual change in %	1989=100	Annual change in %
2000	84.1	3.1	100.0	3.3	100.0		95,526	2,698,019	448,187		17.8	99.3	18.7	66.2	-18.2
2001	83.2	-0.2	98.0	-2.0	101.6	1.6	108,123	2,492,993	555,040	23.8	20.8	82.0	-17.4	69.1	4.5
2002	83.9	0.8	98.7	0.7	103.9	2.3	116,482	2,194,516	541,699	-2.4	25.1	65.2	-20.6	83.1	20.2
2003	85.1	1.4	100.9	2.2	104.6	0.6	120,212	2,586,420	598,539	10.5	23.6	67.3	3.3	81.2	-2.4
2004	87.7	3.1	114.6	13.8	120.8	15.6	120,796	3,246,608	699,604	16.9	27.3	64.4	-4.4	76.8	-5.4
2002-Q1			88.0	-15.1			26,619	507,743	33,292	-5.1	20.9	50.9	-14.7	84.5	80.3
2002-Q2			89.0	-5.8			29,513	265,271	118,958	21.7	25.5	61.4	-14.0	67.1	-18.1
2002-Q3			101.0	16.1			30,105	501,282	352,718	-8.9	26.9	88.4	-27.5	72.1	14.6
2002-Q4			116.7	9.4			30,245	920,220	36,731	4.3	25.6	59.9	-20.0	108.8	28.3
2003-Q1			108.5	23.3	104.4		29,744	1,010,097	26,913	-19.2	21.7	45.7	-10.2	63.8	-24.5
2003-Q2			87.9	-1.2	105.9		29,988	377,521	123,180	3.5	27.5	62.3	1.4	81.8	21.9
2003-Q3			98.1	-2.9	99.2		30,176	458,240	420,910	19.3	25.0	104.5	18.2	85.5	18.6
2003-Q4			106.8	-8.5	108.7		30,304	740,562	27,536	-25.0	29.5	56.8	-5.1	93.5	-14.0
2004-Q1			106.6	-1.7	111.3	6.6	30,168	840,947	26,265	-2.4	42.1	47.4	3.8	72.5	13.7
2004-Q2			117.5	33.6	121.0	14.3	29,783	981,060	121,790	-1.1	34.0	60.3	-3.3	70.7	-13.7
2004-Q3			104.7	6.7	113.8	14.7	30,335	518,626	512,740	21.8	26.0	98.3	-5.9	83.3	-2.6
2004-Q4			129.4	21.2	139.0	27.9	30,510	905,975	38,809	40.9	38.2	51.4	-9.6	80.7	-13.7
2005-Q1			110.94	4.0	115.5	3.8	29,951	1,388,921	29,154	11.0	34.4	41.0	-13.6	61.1	-15.7
Jan-04			99.67	-0.1	80.2		10,274	275,727	6,578	-30.9	23.7				
Feb-04			109.04	-3.5	115.5	-1.8	9,588	340,680	14,318	50.4	47.6				
Mar-04			111.55	-1.1	131.0	14.9	10,305	224,540	5,369	-31.8	55.0				
Apr-04			119.35	44.6	113.3	22.4	9,846	327,487	14,198	2.9	33.5				
May-05			116.73	46.0	123.4	15.2	10,091	382,956	43,697	16.7	36.1				
Jun-04			116.38	16.5	124.3	5.30	9,846	270,617	63,895	-11.2	32.5				
Jul-04			105.56	6.1	108.8	13.00	10,291	158,113	177,957	-2.7	22.7				
Aug-05			99.01	0.2	112.2	16.50	10,174	209,536	241,916	42.3	21.4				
Sep-04			109.51	14.6	128.6	14.6	9,870	150,977	92,867	36.3	33.9				
Oct-05			111.04	7.3	129.8	9.0	10,321	188,282	21,242	54.8	40.7				
Nov-04			122.25	19.4	143.0	49.1	9,934	296,330	8,074	8.6	39.1				
Dec-04			154.77	28.3	139.7	25.7	10,256	421,363	9,493	48.9	34.7				
Jan-05			112.98	13.3	95.4	19.0	10,296	350,921	7,999	21.6	30.3				
Feb-05			103.16	-5.5	126.1	9.2	9,384	766,800	9,840	-31.3	30.4				
Mar-05			116.67	4.5	125	-4.6	10,271	271,200	11,315	110.7	42.6				
Apr-05			104.65	-12.4	99.5	-12.2	9,856	205,200							
May-05			110.30	-5.7	129.8	5.2	10,009	222,500							

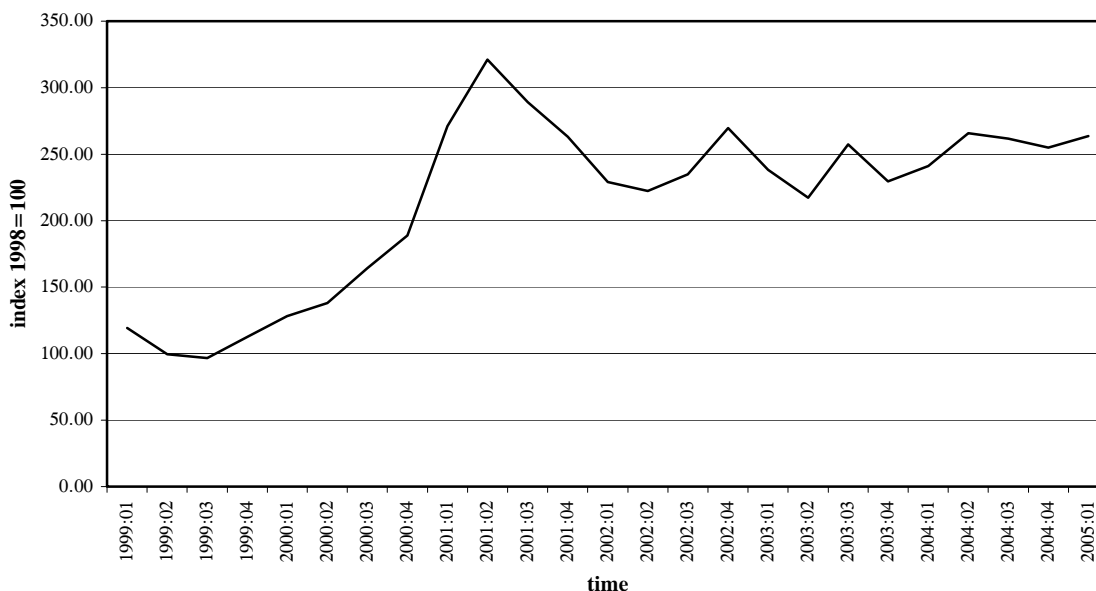
Sources: Monstat, ISSP, KAP, EPCG

## 1. REAL SECTOR

- *Industrial production in the first five months of 2005 was 1.6% lower than in the corresponding period of 2004, while its annual growth rate in May 2005 was -5.7%.*
- *Average electricity production on the treashold of the Power plant, from January - May 2005 was 17% higher than in the same period of 2004;*
- *Average aluminum production in the first five months of 2005 declined by 0.6% compared to the corresponding period of 2004.*
- *Transport of goods decreased by 15.7%, while transport of passengers decreased by 13.6% in the first quarter of 2005 compared to the corresponding period of 2004;*
- *In the tourism sector, the registered number of tourists increased by 11% in the first three months of 2005 compared to the same period of the previous year.*
- *The sector of forestry and the sector of construction (measured by effective working hours) decreased their production in the period January - May 2005 compared to the first quarter of 2004.*

The situation in the real economy at the beginning of 2005 is described through analysis of different sectors, especially industrial production, construction, transport, tourism, forestry, and retail trade. The general trend was positive within the sectors of industrial production, tourism and retail trade, while it was negative within the sectors of forestry, transportation and construction<sup>1</sup> due to the bad weather conditions and problems with roads.

**Graph 1.1. Situation in the real economy (seasonal adjusted-1998=100)<sup>2</sup>**



Source: Monstat; Index of the activity within the real sector was calculated by ISSP

<sup>1</sup> Measured by effective working hours

<sup>2</sup> Graph 1.1 presents seasonal adjusted data about activities in the real sector. Aggregated index, which presents activities in the real economy, is consisted of weighted indices of industrial production, transport of goods, transport of passengers, retail trade, forestry, tourism, catering and construction. This is due to the fact that these sectors within the real economy participate on average around 50-55% in GDP since 2000.

## Chapter 1. Output

*Table 1.2. Industrial production: disaggregated indices of major industries*

	Sahre in total industry 2004	1-5.2005 1-5. 2004	01.2005 01.2004	02.2005 02.2004	03.2005 03.2004	04.2005 04.2004	05.2005 05.2004
<b>INDUSTRY TOTAL</b>	100.0	98.4	113.3	94.5	<b>104.5</b>	87.6	94.3
<b>MINING AND STONE EXTRACTING PROCESSING UNDRUSTY</b>	6.0	111.7	109.3	59.6	181.7	105.7	130.8
<b>ELECTRICITY, GAS AND WATER PRODUCTION</b>	67.6	104.2	119	109.2	95.4	97.8	105.2
<b>MINING AND STONE EXTRACTING RAW MATERIALS EXTRACTION</b>	26.4	84.9	105.1	75.3	124.4	63.4	67.9
<b>OTHER RAW MATERIALS EXTRACTION</b>	6.0	117.7	109.3	59.6	181.7	105.7	130.8
Metal ores mining	2.3	85	78.2	59.4	343.8	15.8	127.2
Other ores and stone extraction	3.7	135	339.8	59.8	149.4	144.1	132.0
	2.9	127.8	461.2	50	146.2	132.5	
	0.8	200.00	121.2	153.3	183	258.0	237.7
<b>PROCESSING UNDRUSTY MANUFACTURE OF FOOD PRODUCTS, BAVERAGES AND TOBACCO</b>	67.6	104.2	119	109.2	95.4	97.8	105.2
Manufacture of food products and baverages	9.1	100	85.8	118.5	108.5	89.3	99.7
Manufacture of tobacco products	6.3	87	84.1	74.3	98.7	80.2	93.9
<b>MANUFACTURE OF TEXTILE AND TEXTILE PRODUCTS</b>	2.8	140.7	93.4	226.4	132.5	119.9	119.6
Manufacture of yarn and fabrics	1.5	108	132.6	104.6	48.8	220.7	158.8
Manufacture of wearing apparel and fur	0.2	26	-	-	-	48.2	
<b>MANUFACTURE OF LEATHER AND LEATHER PRODUCTS</b>	1.3	113	144.2	117.1	50.1	235.6	163.3
<b>WOOD PROCESSING AND WOOD PRODUCTS</b>	0.1	212.8	-	-	-	-	212.7
<b>MANUFACTURE OF PAPER; ISSUING AND PRINTING</b>	1.6	62	82.6	3	13.8	57.5	126.7
Manufacture of cellose, paper and paper processing	0.8	99.4	82.5	82	95.7	86.9	150.3
Issuing, printing and reproduction	0.2	131.8	91.7	91.8	102	69.5	272.9
<b>MANUFACTURE OF COKE AND OIL DERIVATES</b>	0.6	90.6	80.7	79.6	94	92.2	108.8
<b>MANUFACTURE OF CHEMICAL PRODUCTS AND FIBERS</b>	-	-	-	-	-	-	-
<b>MANUFACTURE OF RUBBER AND PLASTIC PRODUCTS</b>	2.1	556.4	566.6	787.4	659.6	579	302.3
<b>MANUFACTURE OF PRODUCTS OF OTHER NONMETAL MINERALS</b>	0.1	64.1	-	37.8	84.6	119	94.0
<b>MANUFACTURE OF BASE METALS AND METAL PRODUCTS</b>	6.0	98.6	99.9	95.9	97.1	100.1	101.3
Manufacture of basic metals	44.8	98.8	115.3	93.6	83.8	87.1	98.1
Manufacture of metal products, except machines	43.1	94.2	115.7	95.3	83.6	83.4	95.9
<b>MANUFACTURE OF MACHINERY AND DEVICES, OTHER</b>	1.7	93.4	96.9	40.4	88.7	194.2	158.4
<b>MANUFACTURE OF MACHINERY, DEVICES AND HOUSEHOLD EQUIPMENT</b>	0.6	121.5	170.5	192.1	104	105	89.3
<b>MANUFACTURE OF TRANSPORT EQUIPMENT</b>	0.1	72.9	-	-	45	40.7	142.9
<b>PROCESSING INDUSTRY, OTHER</b>	0.7	65.8	-	-	65.9	57	47.6
<b>ELECTRICITY, GAS AND WATER PRODUCTION</b>	0.1	71.9	96.8	116.8	104.8	23.1	34.8
	26.4	84.9	105.1	75.3	124.5	63.4	67.9

### 1.1. PRODUCTION

Total production in Montenegro, which is consisted of industrial production, forestry, and construction, was 1% higher in the first quarter of 2005 as compared to the same period of 2004. This production in 2004 accounted for around 28% of GDP.

#### 1.1.1. Industrial production

Industrial production in the first five months of 2005 was 1.6% lower than in the corresponding period of 2004. Annual growth rates of industrial production in March, April and May 2005 were 4.5%, -12.4%, and -5.7%, respectively. The main reasons for the decline in industrial production in the first five months of 2005 were seasonal factors, old

technology, the inappropriate use of production capacities, as well as the process of ownership changes within some companies. This especially influenced lower production within several sub-sectors of the processing industry such as the food processing industry and beverages production, wood processing industry, and especially basic metals production.

In the first quarter of 2005, industrial production increased by 3.9% compared to the same period of 2004.

### *Three major industrial sectors*

The average level of production within the *processing industry* sector, which represents 67.6%<sup>3</sup> of total industrial production, was 4.2% higher in the first quarter of 2005 compared to the corresponding period of the previous year. The annual growth rate of processing industry production was 4.2% in May 2005. The main contributors to the growth in the processing industry production within the period January - May 2005 were the sub-sectors of tobacco manufacturing, textile and textile products manufacturing, as well as the manufacture of chemical products and fibers.

The sub-sector of the *industry of tobacco* represents 2.8% of total industrial production and increased its production by 40.7% in the first five months of 2005. The sub-sector "*Manufacture of textile and textile products,*" which accounts for 1.5% of total industrial production increased its production by 8% in the first five months of 2005 and by 58.8% in May 2005 compared to May 2004. Furthermore, the sub-sector "*Manufacture of chemical products and fibers*" (2.1% of total industrial production) increased its production by 456.4% in the first five months of 2005. In May 2005, this production increased by 202.3% compared to the same month of 2004.

The industry *food products and beverages* (6.3% of total industrial production) decreased its production by 13% in the first five months of 2005 compared to the same period of the previous year. This production decreased by 6.1% in May 2005 compared to the same month of 2004. In addition, one of the major sub-sectors of the processing industry, "*basic metals and metal products manufacturing*" (44.8 % of total industrial production), decreased its production by 5.8% in the first five months of 2005 compared to the corresponding period of the previous year and 1.9% in May 2005 compared to the same month in 2004. The sub-sector "*Wood processing and wood products,*" which accounts for 1.6% of total industrial production, decreased its production by 37.9% in the period January - May 2005 compared to the same period of 2004. However, this production increased in May 2005 by 26.7% compared to the same month of the previous year. The average production of the sub-sector "*Manufacturing of products of other non-metal minerals*" (6.0% of total industrial production) declined in the period January - May 2005 by 1.2% compared to the same period of 2004, and increased by 1.3% in May 2005 compared to the same month of 2004. Production within the sector of "*Manufacturing of paper; issuing and printing*" (0.8% of total industrial production) declined by 0.6% in the first five months of 2005, but increased 26.7% in May 2005 as compared to the corresponding period of the previous year.

The second major industrial sector, *electricity, gas and water*, which accounts for 26.4% of total industrial production, saw its production decrease by 15.1% in the first five months of 2005 compared to the same period of the previous year. The annual growth rate of its production was -32.1% in May 2005.

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<sup>3</sup> Data based on the share of sales in 2004, used in official statistics in 2005.

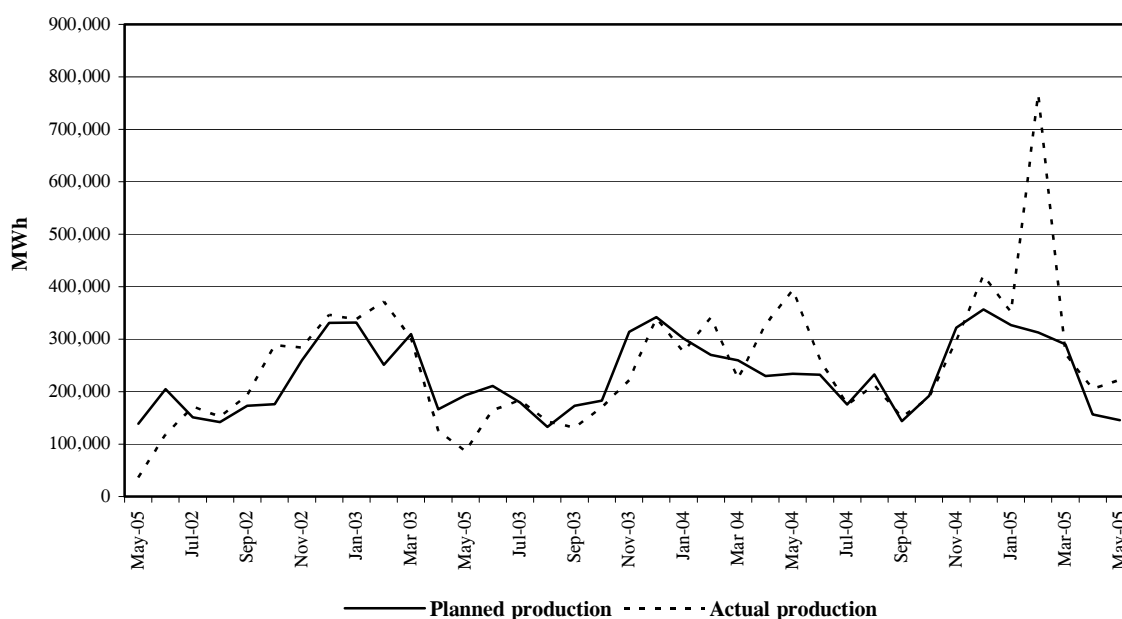
The mining and quarrying industry, which accounts for about 6.0% of total industrial production, increased by 11.7% in 2005 compared to the same period of 2004. The annual growth rate of its production in May 2005 was 30.8%.

### *Leading industrial producers*

One of the most important industrial producers- *The Power Company of Montenegro (Elektroprivreda Crne Gore)* produces electricity, which accounted for 26% of total industrial production in Montenegro. This company increased its production on the threshold of the Power plant, by 17% in the period January - May 2005, compared to the same period of 2004. The annual growth rate of its production was 65% in the first quarter of 2005, while it was -41.2% in May 2005.

Graph 1.2 presents the aggregate planned and actual electricity production of the three power plants existing in Montenegro: *Perucica Hydro Plant, Piva Hydro Plant, and Pljevlja Thermal Plant.*

**Graph 1.2. Total electricity production**



Source: *The Power Plant of Montenegro (EPCG)*

Total actual production of the three plants in the first five months of 2005 was 47.3% above the planned level. The actual production in May 2005 was 41.2% lower than in the same month of 2004, and it was 52.4% above the planned level.

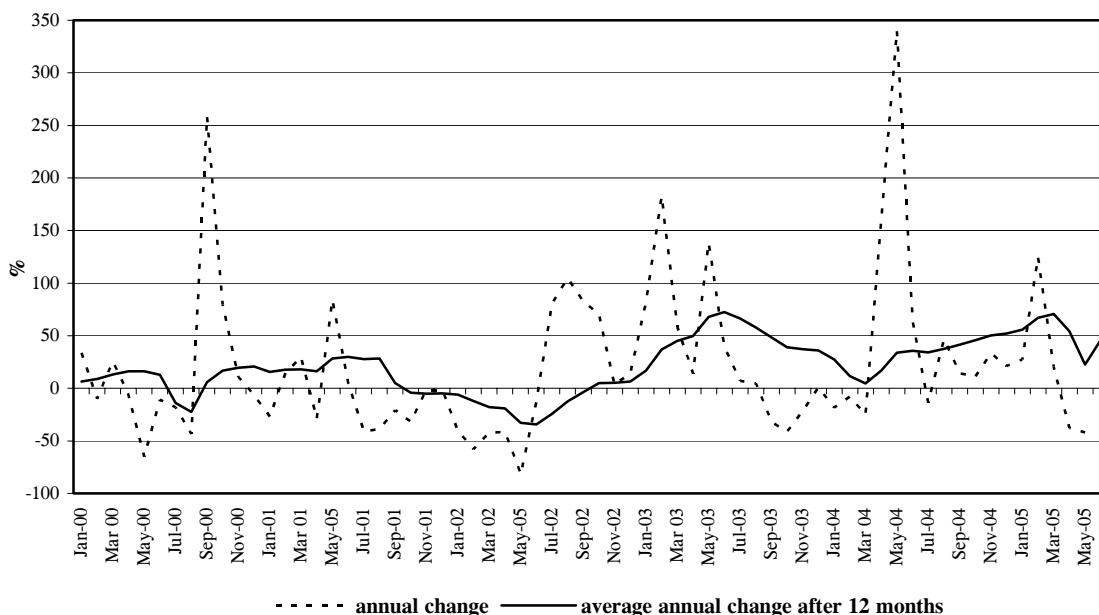
Total actual production of two hydro plants in 2004 was 1,048,188 MWh, or 57.7% of total executed electricity production. The rest of production came from the thermal plant Pljevlja.

Total actual production of the *Perucica Hydro Plant* was 20.6% above the planned level in the period January - May 2005 and 18% above the planned level in May 2005. Actual production of the *Piva Hydro Plant* also exceeded the planned level by 20% in the first five

months of 2005 and was 505% above the planned level in May 2005. The reason of this was good hydrology and accumulation.

Actual production of the *Thermal Plant Pjevlja* in the period January - May 2005 was 112.3% above the planned level due to its production above the plan in February 2005. Generally, appropriate delivery of coal to this plant is the main reason for realizing production of the Thermal Plant. In May 2005, there was no production of energy within the Thermal Plant Pljevlja due to a longer than planned remount, as well as the late delivery of coal, which is important to realize production.

Graph 1.3. Dynamics of electricity production



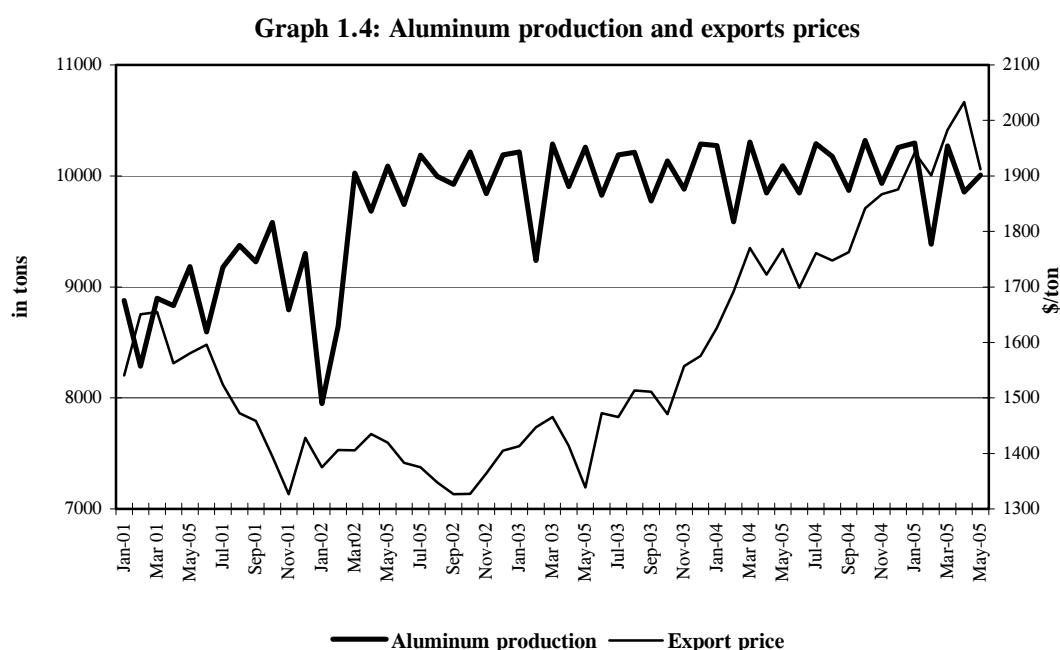
Source: EPCG

Note: 12-month averages of annual changes are moving averages of annual changes during the past 12 months

Aluminum production in the first five months of 2005 declined by 0.6% compared to the corresponding period of 2004. In addition, the exported quantity of this aluminum produced by Aluminum Combine Podgorica (**KAP**) decreased by 20% in the above-mentioned period of 2005 compared to the first five months of 2004. The export value of aluminum decreased by 9.3% in the first five months of 2005 compared to the corresponding period of 2004.

Total aluminum production in May 2005 was 0.8% lower compared to the corresponding period of 2004.

Generally, one of the reasons for the decreased aluminum production and export at the beginning of 2005 is the ongoing privatization process of KAP.



Source: KAP

Aluminum production, as graph 1.4 presents, increased in 2004. At the beginning of 2005, this production slowly declined in February and March compared to the same months of 2004. The average monthly aluminum price has been going up particularly quickly in recent months and has reached 2,033 \$/ton in April and 1,912 \$/ton in May 2005.

### 1.1.2. Forestry and Construction

#### Forestry

Production in the forestry sector increased in January 2005 by 19.3% compared to the same month of the previous year. However, due to the very bad weather conditions, which left much snow and created problems using the roads, the level of production in this sector declined by 81% in the first quarter of 2005 compared to the corresponding period of 2004. In general, production within the forestry sector is lower in the first quarter of each year than it is during the other three quarters.

#### Construction

Average production in the sector of construction, measured by the value of the constructor's activities, was 10% higher in the first quarter of 2005 compared to the same period of 2004. However, activities within the construction sector, measured by the effective working hours, decreased by 17% in the first quarter of 2005 compared to the corresponding period of the previous year. Here, it is important to note that data on construction activities are based on a rather limited *Monstat* sample of firms that are active in construction. This means that output of the construction sector in Montenegro is underestimated and there are other firms in addition to the above-mentioned sample that are active in this sector and contribute to higher production and GDP in Montenegro.

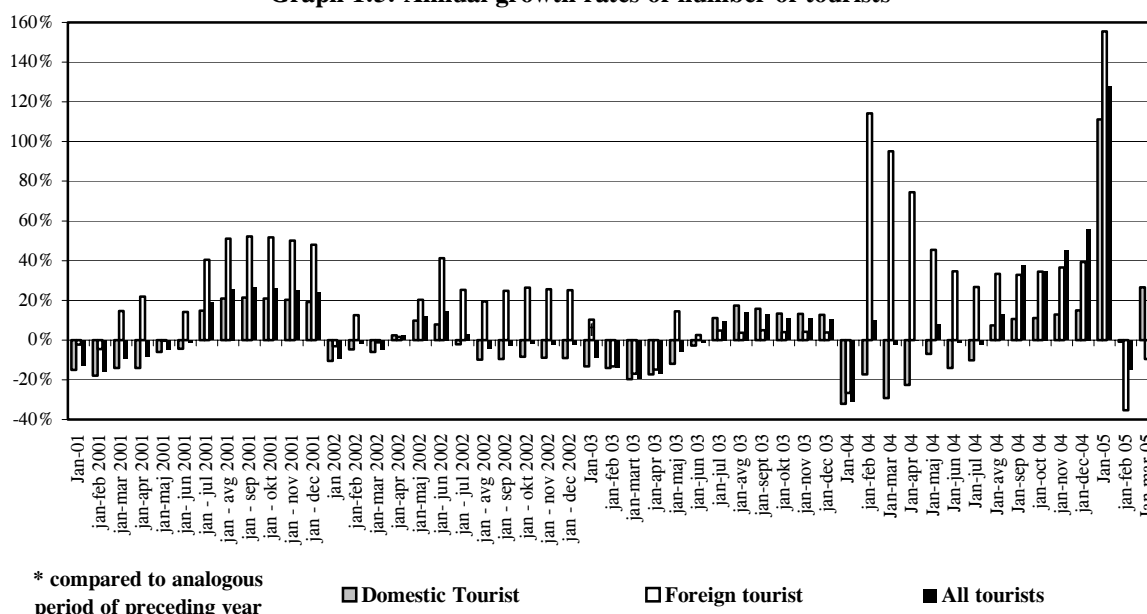


## 1.2. TOURISM

In the first quarter of 2005, the total number of tourists increased by 11% compared to the same period of the previous year. The number of domestic tourists increased by 26.6%, while that of foreign guests declined by 9.6% compared to the first quarter of 2004. In the first quarter of 2005, the share of foreign tourists was 35.1%, which is 8.0 percentage points less than in the corresponding period of 2004 (see graph 1.5).

Tourism revenues from non-resident tourists amounted to € 3.6 million and increased by 34.5% compared to the corresponding period of the previous year; they increased mostly due to the increase of revenues from abroad (outside Montenegro and Serbia), despite the fact that the number of foreign tourists was lower in Q1-2005 compared to Q1-2004.

Graph 1.5. Annual growth rates of number of tourists\*



Source: Monstat

In March 2005, the total number of tourists increased by 110.8% compared to the same month of the previous year. The number of domestic tourists increased by 168.9%, while the number of foreign tourists increased by 63.2% compared to the same month of 2004.

Tourism revenues from non-resident tourists amounted to €3.6 million and increased by 34% in the first quarter of 2005 compared to the corresponding period of the previous year.

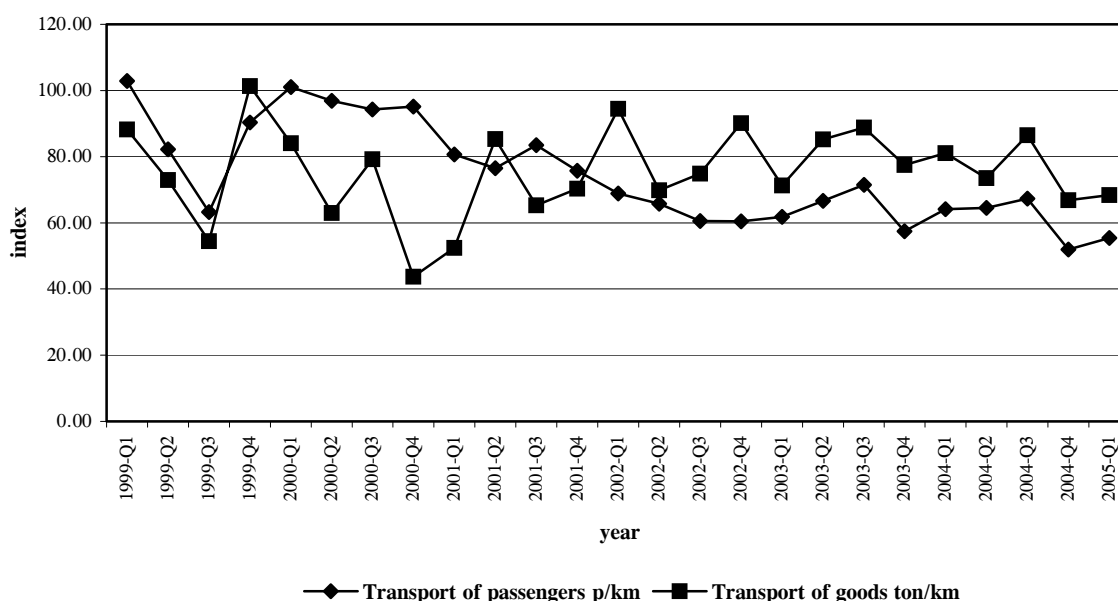
## 1.3. OTHER SECTORS OF SERVICES

### Transport

Due to the fact that Monstat publishes only the disaggregated monthly index of transport, and it includes the following indices: road transport of goods, road transport of passengers, railway transport of goods, railway transport of passengers, sea transport of goods and air transport of passengers, the ISSP estimates the index of total transportation of goods and the index of total transportation of passengers. In order to create an index of goods transport, we used ton/km as a weight, and for calculation of the passengers' transport index, the passengers/km were used as a weight.

Estimated transport of goods in the first quarter of 2005 declined by 15.7% compared to the corresponding period of 2004. Estimated transport of passengers in the first quarter of 2005 decreased by 13.6% compared to same period of the previous year (see graph 1.6). Reasons behind the deterioration in the transport sector were bad weather conditions and the lack of possible transport due to snow on the roads and other barriers on the roads making transportation activities difficult. As a result, railway transport of goods was the only mode of transportation whose activities rose by 39% in the first quarter of 2005 compared to the same period of 2004. Other sub-sectors within the transport sector had negative annual growth in the first quarter of 2005.

**Graph 1.6: Transport of passengers and goods (seasonal adjusted), 1998=100**



Revenues from the export of transportation services, as evidenced in the Balance of Payments statistics, amounted to € 10.5 million and nominally increased by 12.7% in the first quarter of 2005 compared to the same period of the previous year.

### *Retail trade*

The ISSP estimated retail trade turnover for 2004 and the first quarter of 2005 based on monthly data obtained from *Monstat's* limited sample from 2003. The average retail trade turnover nominally increased by 10% in the first quarter of 2005 compared to the corresponding period of 2004. In real<sup>4</sup> terms, retail trade turnover increased by 7.8% in the first quarter of 2005 compared to the same period of 2004. In March 2005, real retail trade turnover increased by 9.6% compared to March 2004.

### *Catering*

The average real level of catering in the first quarter of 2005 was 6.7% higher than in the same period of 2004, while in nominal terms, it was 8% higher. On an annual basis, the real growth of catering in March 2005 amounted to 5.3%.

<sup>4</sup> Deflated by CPI

Table 1.3 Indices of development in the various sectors of the economy

	index	Jan-Mar 2005	01/2005	02/2005	03/2005
	base period	Jan-Mar 2004	01/2004=100	02/2004=100	03/2004=100
<b>Production</b>	<b>Total</b>	101.0	124.8	115.7	97.6
	<b>Industrial production</b>	104.0	113.3	94.5	104.5
	<b>Forestry</b>	19.0	69.9	-	-
	<b>Construction (value of construction works)</b>	110.0	107.5	124.7	122.3
	<b>Construction (effective working hours)</b>	86.0	84	87	88
	<b>road (goods)</b>	75.0	82.5	68.5	66.5
<b>Transport</b>	<b>road(persons)</b>	58.0	90.8	70.8	42.6
	<b>sea (goods)</b>	50.0	108.3	108.7	64.3
	<b>railway (goods)</b>	139.0	174.4	173.0	146.7
	<b>railway (persons)</b>	86.0	88.3	100.7	87.0
<b>Retail trade</b>	<b>current prices</b>	110.0	110	109	111
	<b>deflated by CPI</b>	108.7	106.1	107.7	109.6
<b>Catering</b>	<b>current prices</b>	108.0	100.0	95.8	114.8
	<b>deflated by CPI</b>	106.7	106.7	106.7	106.7
<b>CPI</b>		101.2	103.7	101.2	101.3

Source: Monstat

## Chapter 2. Employment

**Table 2.1. Labor force and unemployment**

	Population mid -year <sup>1</sup>	Total number of employed persons <sup>2</sup>	Number of registered unemployed (2)	Unemployment rate %	Unemployment rate % (estimate)
	Official data			ISSP estimate based on official data	ISSP
1991	591,843	153,667	58,144	27.5	13.4
1992	594,137	145,653	64,632	30.7	17.1
1993	596,432	143,657	62,818	30.4	17.6
1994	598,727	140,684	58,210	29.3	18.6
1995	601,022	137,232	59,045	30.1	19.9
1996	603,317	137,743	60,225	30.4	19.2
1997	605,611	147,083	63,995	30.3	17.5
1998	607,906	147,233	68,373	31.7	16.7
1999	610,201	145,571	75,303	34.1	20.1
2000	612,496	140,762	83,583	37.4	20.1
2001	614,791	141,112	81,561	36.6	19.5
2002	617,085	140,778	80,865	36.5	21.6
2003	618,233	142,679	71,679	33.4	22.9
2004	620,706	143,479	65,185	31.2	22.3
2003-Q1		143,616	76,275	34.7	24.2
2003-Q2		143,088	72,744	33.7	23.4
2003-Q3		143,298	66,964	31.8	21.9
2003-Q4		140,714	70,732	33.4	23.2
2004-Q1		141,850	71,123	33.4	24.5
2004-Q2		143,847	68,589	32.3	23.6
2004-Q3		145,163	61,602	29.8	21.5
2004-Q4		143,056	59,422	29.3	21.2
Jan-03		143,726	76,584	34.8	24.2
Feb-03		143,851	76,077	34.6	24.1
Mar-03		143,272	76,165	34.7	24.2
Apr-03		143,036	74,896	34.4	23.9
May-03		142,533	73,250	34.0	23.7
June-03		143,694	69,735	32.7	22.6
July-03		144,022	66,951	31.7	21.8
Aug-03		143,693	66,277	31.6	21.7
Sep-03		142,180	67,664	32.2	22.2
Oct-03		141,478	71,023	33.4	23.2
Nov-03		140,810	72,547	34.0	23.6
Dec-03		139,856	68,625	32.9	22.8
Jan-04		142,343	69,573	32.8	24.0
Feb-04		140,765	71,419	33.7	24.7
Mar-04		142,442	72,378	33.7	24.7
Apr-04		143,734	72,202	33.4	24.5
May-04		143,759	68,993	32.4	23.7
June-04		144,049	64,572	31.0	22.5
July-04		145,390	62,143	29.9	21.7
Aug-04		145,747	62,159	29.9	21.6
Sep-04		144,351	60,503	29.5	21.3
Oct-04		143,830	59,930	29.4	21.2
Nov-04		143,434	59,387	29.3	21.1
Dec-04		141,905	58,950	29.3	21.2
Jan-05		142,145	59,115	29.4	20.9
Feb-05		142,072	58,774	29.3	20.8
Mar-05		141,298	58,075	29.4	20.7
Apr-05			57,557		20.4
Maj-05			56,772		20.0

Source: Monstat, Employment Office of Montenegro and ISSP

**Methodological note:**

**Official unemployment rate** was calculated from official data on number of employed and unemployed with the use of the formula:

$$UR = \frac{n}{n+z} \cdot 100$$

where UR-unemployment rate, n-number of unemployed and z-number of employed persons.

**An ISSP estimate of the unemployment rate** is a revised estimate obtained by combining data from Monstat, Federal Labor Force Survey and ISSP Household Survey.

<sup>1</sup> Data for the period 1991-2003 are Monstat data, 2004 data are ISSP estimates.

<sup>2</sup> Annual data are Monstat numbers, while monthly and quarterly data for 2003 and 2004 are estimated by ISSP

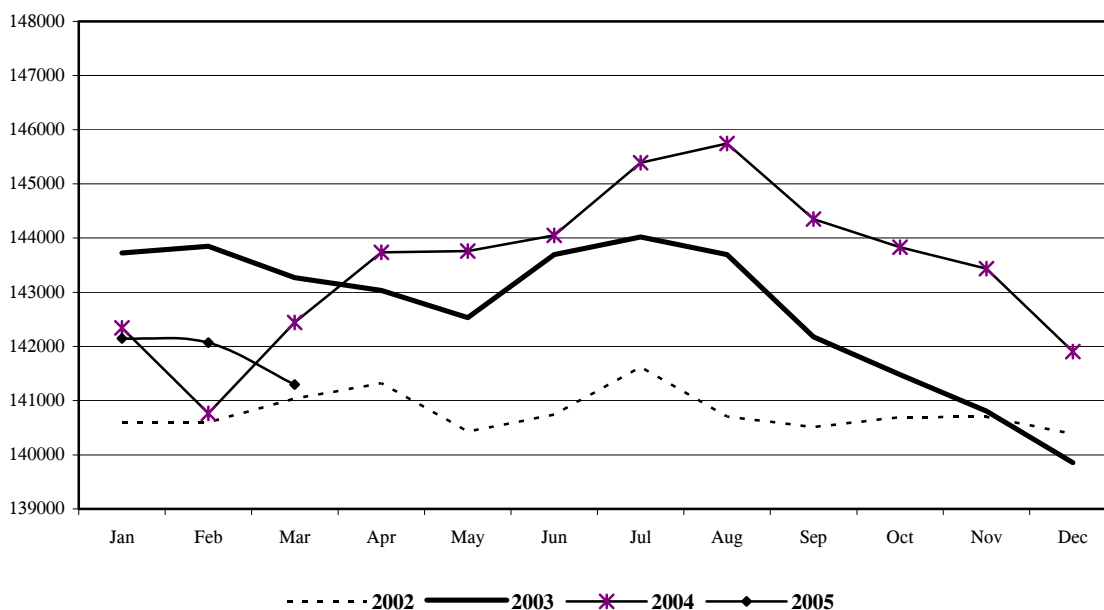
## CHAPTER 2. EMPLOYMENT

- According to the Monstat Labor Force Survey, in October 2004 the unemployment rate in Montenegro was 27.7%.
- Employment in the first quarter of 2005, according to MONSTAT data, was slightly lower as compared to the previous quarter, while as compared to same period last year there are no significant changes.
- The average number of registered unemployed persons is 18.1% lower in the first five months of 2005 as compared to the same period in 2004.

### 2.1 EMPLOYMENT AND UNEMPLOYMENT

In the first quarter of 2005, employment has decreased by 0.9% as compared to the previous quarter. However, in annual terms employment has remained at the same level as it was in the first quarter of 2004. The number of employed persons increased over January and February, while it decreased in March to a total of 141,298 persons.

Graph 2.1: Number of employed persons (2001-2004)



Source: Monstat

The decrease in employment over the first couple of months is a typical phenomenon, while in later months the increase in employment is expected, especially in the summer season.

If we observe annual changes, employment in January and March is below the level in comparative months of 2004, by 0.1% and 0.8%, respectively. In February of 2005, employment is 0.9% higher than in February of 2004.

On the other hand, registered unemployment has exhibited constant declines. In the first five months of 2005, unemployment is 18.1% lower as compared to the same period in 2004. Each month experienced lower unemployment than their respective months in 2004; in January, registered unemployment was 15% lower, in February - 17.7%, in March - 19.8%, in April - 20.3%, and in May - 17.7%. According to the Employment Office, this

## Chapter 2. Employment

decrease in registered unemployment is due to new jobs openings, rather than the removal of the long-term-unemployed from the register. However, official employment figures, which are now more reliable and based on the PIO Fund base of contributors, do not support this statement.

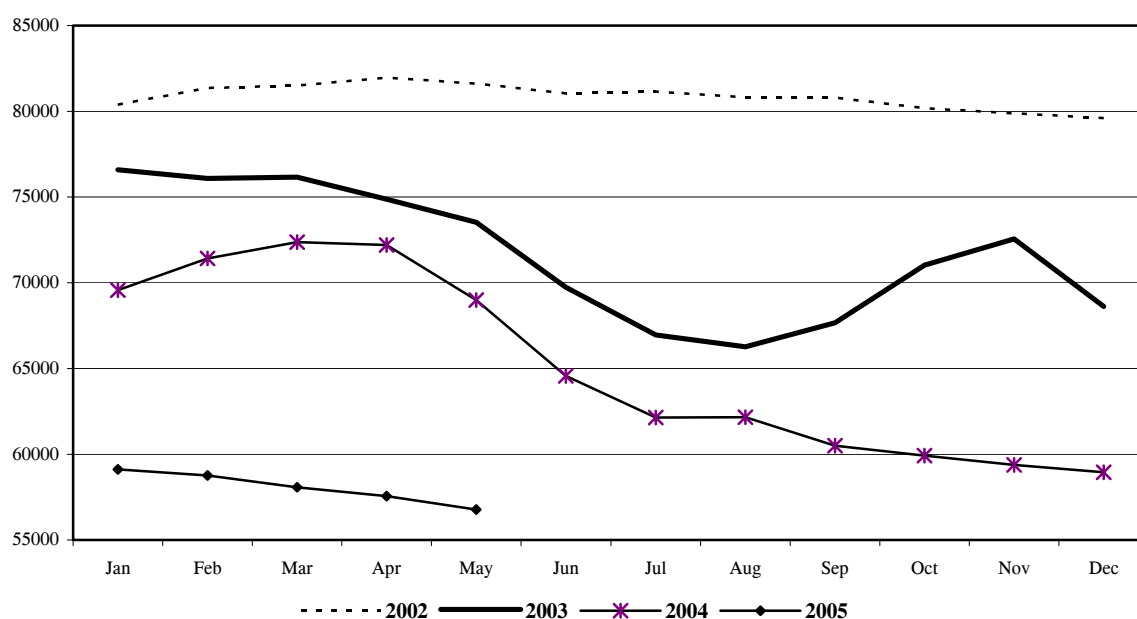
*Table 2.2: Changes in the number of employed and unemployed persons*

	Annual changes in the number of employed persons	Monthly changes in the number of unemployed persons	Annual changes in the number of unemployed persons	Monthly changes in the number of unemployed persons
	%			
Jan-04	-0.1	0.2	-15.0	0.3
Feb-04	0.9	-0.1	-17.7	-0.6
Mar-04	-0.8	-0.5	-19.8	-1.2
Apr-04			-20.3	-0.9
May-04			-17.7	-1.4

*Source: Monstat, Employment Office, ISSP calculations*

If one observes the dynamics in the number of unemployed persons over previous years, it is clear that registered unemployment will decrease further, but what has caused such remarkable success? That remains to be seen.

**Graph 2.2: Number of unemployed persons (2000-2005)**

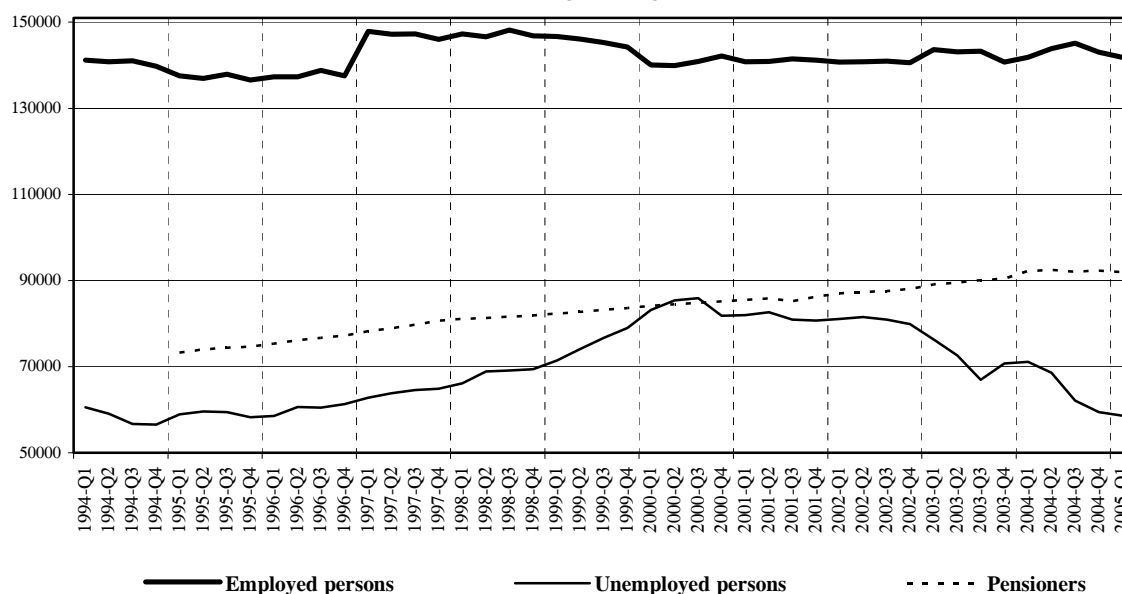


*Source: Employment Office of Montenegro*

If we assume that the number of unemployed persons has reduced due to new employment, this would mean that from 2001 to 2005 almost 30,000 persons have been employed. If that were the case, the number of employed should increase by the same amount, but there is no clear evidence of that. On the other hand the Decree on Tax Relief for Newly Employed Persons has resulted in close to 60,000 newly registered employees, of which, according to the Employment Office, 30,000 are true new jobs. However, the issue is whether these jobs have simply been shifted from the shadow economy or if they are new jobs. The most likely answer is that the vast majority of these registered employees are those who were formerly working in the shadow economy and whose status is now legalized, rather than that new jobs have been created.

While the number of employed persons varies by about 140,000, the number of unemployed is decreasing and the number of pensioners is constantly increasing as observed in graph 2.3.

Graph 2.3: The official number of employed, unemployed persons and pensioners (1994Q1-2005Q1)



Source: Monstat, Employment Office of Montenegro and ISSP

Note: data are quarterly averages

In the first quarter of 2005, the number of pensioners is 0.2% lower than in the corresponding period in 2004, while the average number of pensioners in the first five months of 2005, as compared to the same period in 2004, is 0.2% higher.

## 2.1 LABOR FORCE SURVEY

In October 2004, Monstat has, for the first time, independently conducted a Labor Force Survey(LFS)<sup>3</sup>. The sample included 900 households from Montenegro.

The survey provides information on the population's activity by age and gender. The main concepts used in the survey are:

- **employed** persons are those, that for at least one hour during the previous week, were engaged in some activities for which they received compensation (in kind or money), as well as persons who hold a job but were absent in the referenced week.
- **unemployed** persons are those who, in the referenced week, were not engaged in paid work and did not have a job from which they were absent; additionally, they need to satisfy the following conditions:
  - In the last week, they were actively looking for a job and if they are offered a job, they are able to begin working in a two week period.
  - In the last two weeks they have not looked for a job because they have found a job that they will begin working after the referenced week but no later than three months after the referenced week.
- **Active population** is composed of employed and unemployed persons.

<sup>3</sup> All previous Labor force surveys were conducted by the Statistical Office of Serbia and Montenegro.

## Chapter 2. Employment

- **Inactive population** is all persons over 15 years of age that are not listed as active.
- **Activity rate** is the percentage of the active population in total population aged above 15 years.
- **Employment rate** is the percentage of employed in total population aged 15 and above.
- **Unemployment rate** is the share of unemployed in the total active population.

### 2.1.1. Overview of the Montenegrin labor market

According to LFS results, the Montenegrin population seems to be rather inactive. From among the total population, 61.1% are within the working age, out of which 51.7% are economically active (working or looking for a job), or in other words, out of the 423,290 persons that are of working age, 259,092 persons are actually economically active. Out of the total population, 41.1% are economically active, which would indicate that 187,333 employed persons support 630,584 persons, including themselves, or in other words, one employed person supports, on average, 3.36 persons.

*Table 2.3: Population by activity (October 2004)*

	Montenegro	Southern region	Central region	Northern region
Total population	630,548	148,290	286,869	195,389
Population aged 15 and above	501,358	122,452	138,865	152,908
Economically active population	259,092	60,826	114,930	83,336
▪ <i>Employed</i>	187,333	48,189	80,727	58,417
▪ <i>Unemployed</i>	71,759	12,637	34,203	24,919
Inactive population	242,266	61,626	111,068	69,572
Population below 15 years of age	129,190	13,184	60,871	42,481

*Source: Monstat, Labor Force Survey*

However, it appears that the population in the Northern region is more active than those living in the remaining two regions, with an activity rate of 54.5%. The lowest activity is in the Southern region (49.7% activity rate).

*Table 2.4: Population by activity (October 2004)*

	Montenegro	Southern region	Central region	Northern region
Activity rate (%)	51.7	49.7	50.9	54.5
Employment rate (%)	37.4	39.4	35.7	38.2
Unemployment rate (%)	27.7	20.8	29.8	29.9

*Source: Monstat, Labor Force Survey*

The unemployment rate in Montenegro, according to survey results, is 27.7%, while the employment rate (defined as the share of employed in the working age population) is 37.4%. The unemployment rate in the Northern and Central region is almost the same – 29.9% and 29.8%, respectively, while in the Southern region, it is 20.8%. These higher unemployment rates in the Central and Southern regions could be partly explained by higher activity rates of the population.



### 2.1.1. Overview of the Montenegrin labor market by gender

LFS data breakdown by gender shows that females are less active than males. Females represent 50.5% of the total working age population, while their share in the active population is 43.1%.

The employment rate is nearly 10 percentage points higher for females than for males, 33.0% as opposed to 23.6%, respectively. Among all males in the working age population, 46.5% are employed, while from among the female working age population, only 28.8% are employed.

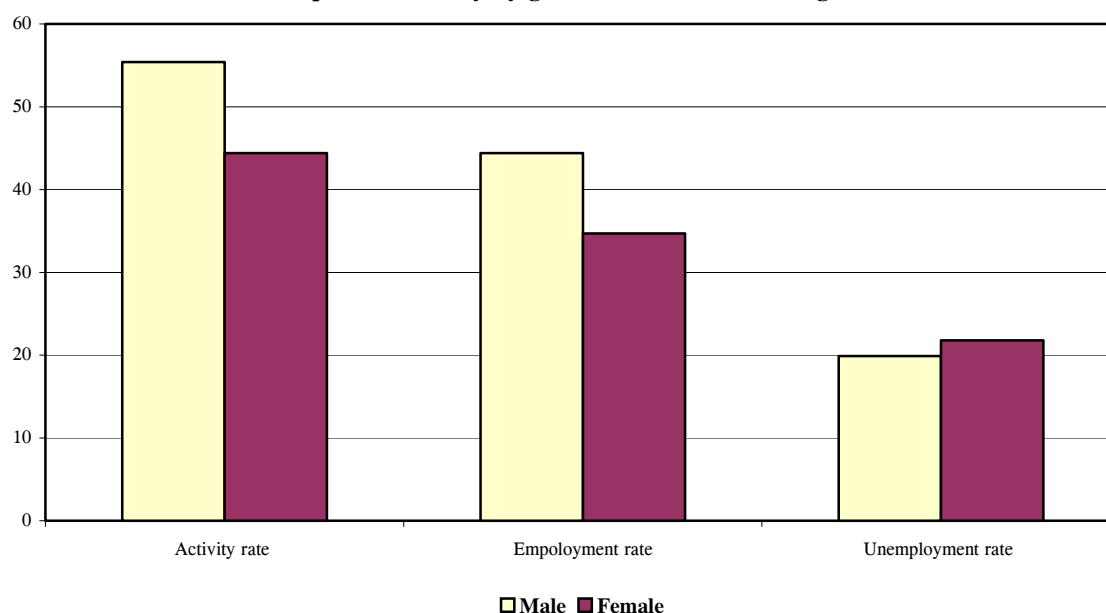
**Table 2.5: Activity of population by gender (October 2004)**

	Male	Female
Activity rate (%)	60.9	43.1
Employment rate (%)	46.5	28.8
Unemployment rate (%)	23.6	33

Source: Monstat, Labor Force Survey

If we observe regions, the highest activity rate among females is recorded in the Southern region (44.4%), while the lowest is in the Central region (41.9%). Among males, the highest activity rate is recorded in the Northern region (65.4%), while the lowest is in the Southern region (55.4%). The activity rate of males in the central region is 60.7%.

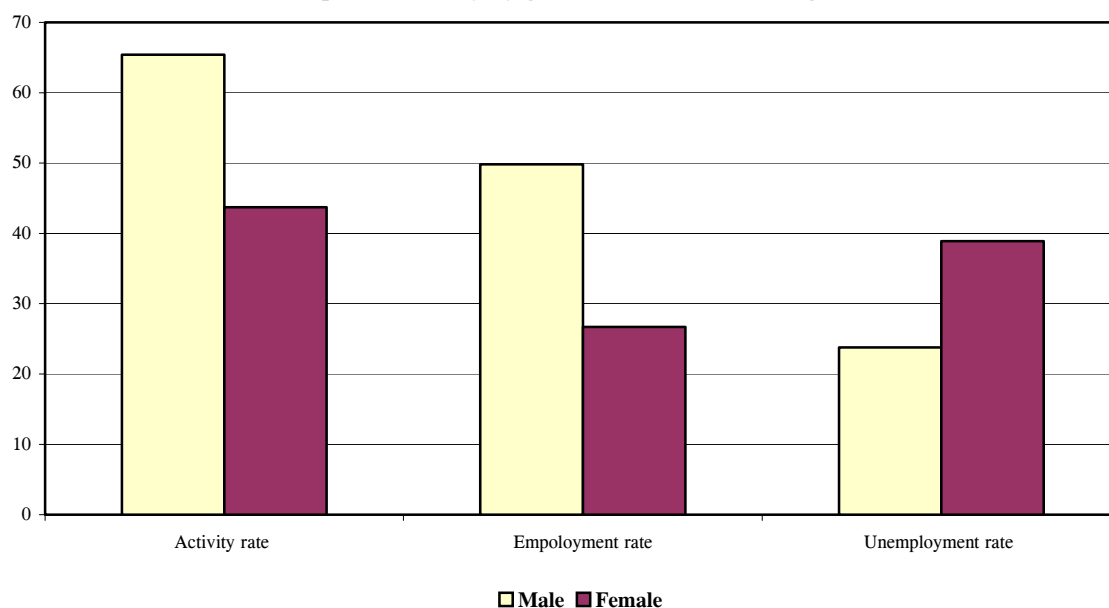
**Graph 2.4: Activity by gender in the Southern region**



Source: Monstat, Labor Force Survey

The unemployment rate among males is highest in the Central region (25.4%), while it is lowest in the Southern region (19.9%). The unemployment rate among males in the Northern region is 23.8%. One explanation for the higher unemployment rate in these regions could be the higher activity rates among the population.

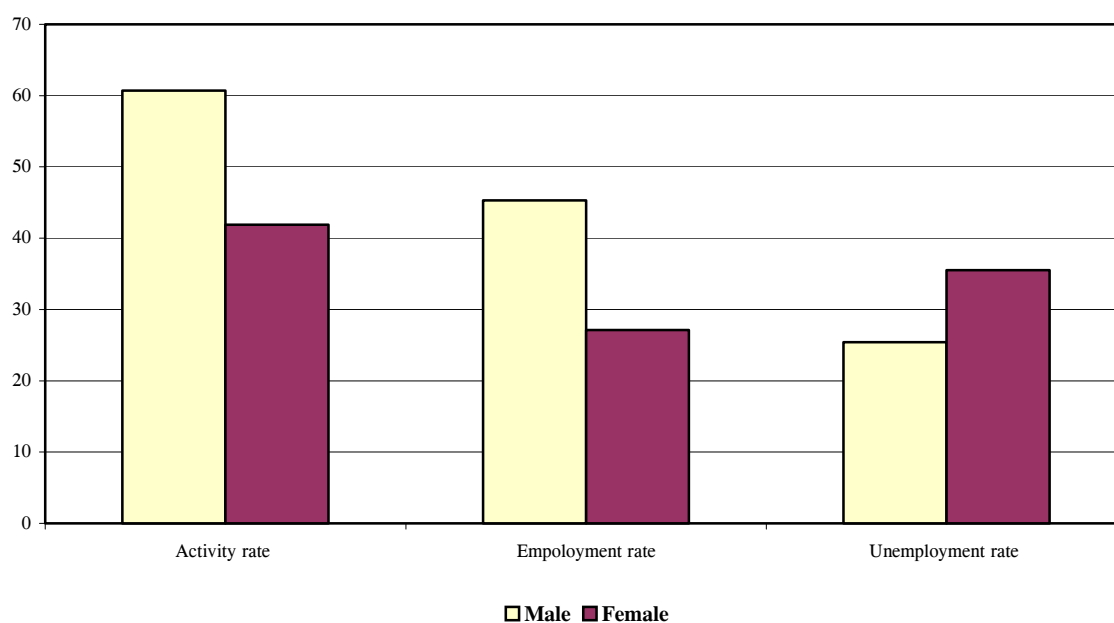
**Graph 2.5: Activity by gender in the Northern region**



*Source: Monstat, Labor Force Survey*

Unemployment among females is highest in the Northern region with an unemployment rate of 38.9%, while it is lowest in the Southern region (21.8%). The female unemployment rate in the Central region is 35.5%.

**Graph 2.6: Activity by gender in the Central region**



*Source: Monstat, Labor Force Survey*

Employment rates among females are highest in the Southern region (34.7%), while in the Central and Northern regions the employment rates are 27.1% and 26.7%, respectively. Employment rates among males are 44.4% in the Southern region, 49.8% in the Northern region and 45.3% in the Central region.

### 2.1.2. Overview of activity on the Montenegrin labor market by age

The LFS also provides data on activity by age groups. The highest share of the economically active population is between the ages of 25 and 44, also the activity rate of these population groups is the highest – above roughly 80.0%.

**Table 2.6: Activity by age groups and gender (October 2004)**

Age groups	Activity rate (%)	Female activity rate (%)	Male activity rate (%)
15-19	15.6	13.5	17.3
20-24	54.1	47.5	59.9
25-29	73.6	63.6	85.2
30-34	80.1	69.4	91.1
35-39	88.0	77.6	96.7
40-44	81.7	74.2	90.0
45-49	72.6	65.8	80.2
50-54	68.2	57.0	80.2
55-59	46.0	23.2	65.7
60-64	19.7	15.6	26.6
65-69	6.9	3.7	10.7
70-74	5.0	5.1	4.8
75-more	4.0	1.1	8.2

Source: Monstat, Labor Force Survey

The survey results have shown that there is a share of population above the working age (65 years) that is still economically active; for both genders, the share of economically active population older than 65 is about 5%.

In all age groups the activity rate of males is higher than for females. Activity rates above 50% are recorded in age groups from 20 to 54 years of age. For females, activity rates exceed 50% among those between the ages of 25 to 54, while for males, the activity rate exceeds 50% for those aged 20 to 54.

The most active population within both genders is those between the ages of 35-39 (88.0%); this is true for males (96.7%) and females (77.6%).

**Table 2.7: Unemployment rate by age groups and gender (October 2004)**

Age groups	Unemployment rate (%)	Male unemployment Rate (%)	Female unemployment Rate (%)
15-19	68.3	62.4	77.0
20-24	58.7	58.1	59.6
25-29	40.1	30.2	51.6
30-34	28.9	22.0	37.6
35-39	25.3	19.8	33.4
40-44	18.3	14.1	22.9
45-49	17.3	14.2	20.7
50-54	11.8	12.4	11.1
55-59	15.4	13.4	22.2
60-64	10.5	7.8	13.3

Source: Monstat, Labor Force Survey

Unemployment is highest for both males and females in the population aged between 15 and 25 years of age. On the other hand, unemployment for both genders is lowest on the other end of the age scale.

The LFS results have shown that youth unemployment seems to be a very important issue in Montenegro.

## Chapter 3. Wages

**Table 3.1: Wages and salaries**

Minimum wage	Average gross wage (official)	Total contributions on gross wage	Average disposable wage	Average pension (paid)	Ratio min. wage/ average disposable wage (%)	Average disposable wage*	Total labor cost**	Average tax rate (% gross wage)
<b>Official data IN DINARS</b>						<b>ISSP estimates IN DINARS</b>		
1994	65.0	292.7	154.1	139.0	47.0	406.0	33.0	
1995	128.0	637.8	330.8	307.0	280.0	873.0	32.0	
1996	243.0	1349.0	689.7	659.0	600.0	1826.0	31.0	
1997	332.0	1801.4	922.5	879.0	738.0	2445.0	31.0	
1998	453.0	2503.8	1276.1	1228.0	1073.0	3391.0	31.0	
1999	663.0	3159.3	1227.3	1932.0	1581.0	4356.0	19.0	
<b>IN EURO</b>						<b>IN EURO</b>		
2000	37.0	150.9	55.5	96.4	83.5	218.0	19.0	
2001	42.0	176.2	68.5	108.0	97.0	174.0	249.0	19.0
1-6/2002	42.0	185.8	72.9	112.9	106.0	262.5	19.0	
2002-Q1	46.0	178.5	69.7	108.9	103.0	254.2	19.0	
2002-Q2	46.0	193.1	76.2	116.9	108.0	270.9	19.0	
Jan-02	46.0	166.5	65.0	101.7	101.0	239.7	19.0	
Feb-02	46.0	181.3	70.7	110.6	104.0	257.5	19.0	
Mar-02	46.0	187.8	73.3	114.5	104.0	186.0	266.2	19.0
Apr-02	46.0	194.0	78.3	115.7	104.0	270.1	19.0	
May-02	46.0	191.0	74.5	116.4	110.0	274.4	19.0	
Jun-02	46.0	194.5	75.8	118.7	110.0	273.4	19.0	
<b>New personal income tax system</b>								
Minimum wage	Average wages and salaries of employee	Total contributions and taxes	Average wages and salaries without taxes and contri.	Average pension (paid)	Ratio min. wage/ average w&s without taxes and contributions (%)	Average disposable wage *	Total labor cost**	Average tax rate (% wages and salaries)
7-12/2002	50.0	272.6	101.2	171.4	112.0	29.0	365.6	15.4
2003	50.0	271.2	97.2	174.0	113.0	29.0	364.2	14.1
2004	50.0	304.1	107.8	195.4	122.0	25.6	405.2	14.0
2003-Q1	50.0	233.5	83.9	149.6	112.0	33.9	316.8	13.0
2003-Q2	50.0	274.3	99.4	174.8	112.0	28.6	366.9	14.3
2003-Q3	50.0	281.9	100.7	181.3	112.0	27.6	378.1	14.5
2003-Q4	50.0	295.0	104.7	190.3	112.0	26.4	395.1	14.8
2004-Q1	50.0	283.9	101.7	182.1	120.0	27.5	378.6	14.0
2004-Q2	50.0	301.1	108.9	192.1	122.0	26.0	399.2	14.4
2004-Q3	50.0	310.1	108.6	201.5	122.0	24.8	414.0	13.7
2004-Q4	50.0	321.5	111.9	209.6	122.0	23.9	429.1	14.0
2005-Q1	50.0	297.3	101.7	194.9	125.9	25.7	390.1	13.3
Jul-03	50.0	275.5	97.8	177.7	113.0	28.1	370.5	14.3
Aug-03	50.0	280.6	100.1	180.5	112.0	27.7	376.5	14.5
Sep-03	50.0	289.8	104.2	185.6	112.0	26.9	387.2	14.7
Oct-03	50.0	288.1	102.3	185.8	112.0	26.9	386.4	14.6
Nov-03	50.0	275.8	97.3	178.5	112.0	28.0	371.5	14.3
Dec-03	50.0	321.2	114.6	206.5	112.0	24.2	427.2	15.3
Jan-04	50.0	267.0	97.4	169.6	120.0	29.6	355.9	13.6
Feb-04	50.0	292.1	104.6	187.5	120.0	26.7	389.0	14.2
Mar-04	50.0	292.4	103.2	189.3	120.0	26.4	391.1	14.2
Apr-04	50.0	301.4	108.9	192.5	122.0	26.0	399.7	14.4
May-04	50.0	297.1	107.6	189.6	122.0	26.4	394.2	14.3
Jun-04	50.0	304.7	110.4	194.4	122.0	25.7	403.6	14.5
Jul-04	50.0	307.1	106.5	200.6	122.0	24.9	408.5	13.6
Aug-04	50.0	312.8	109.6	203.1	122.0	24.6	414.4	13.7
Sep-04	50.0	310.3	109.7	200.6	123.6	24.9	410.4	13.7
Oct-04	50.0	312.8	109.6	203.1	123.6	24.6	414.4	13.7
Nov-04	50.0	306.8	107.5	199.3	124.6	25.1	407.0	13.6
Dec-04	50.0	345.0	118.6	226.4	124.6	22.1	426.1	13.9
Jan-05	50.0	283.4	98.2	185.1	124.6	27.0	377.2	12.5
Feb-05	50.0	299.2	102.8	196.4	124.6	25.5	392.8	13.5
Mar-05	50.0	309.4	106.4	203.0	128.7	24.6	405.4	13.5
Apr-05	50.0	325.6	113.4	212.2	128.6	23.6	424.0	13.5
May-05	50.0	297.8	106.2	191.6	128.7	26.1	287.1	13.5

Minimum wage is the lowest wage that an employer is obligated to pay. Average gross wage includes the portion that employee receives as well as employee's portion of social contribution and taxes. Average disposable wage is the amount that employee receives. Average earning of employee includes basic wage of employee (earlier disposable wage), its share of contributions and taxes and all other benefits that employee receives (meal allowance, summer allowance, per diems, honoraria, etc). \*Average wage is calculated from ISSP Household survey. First survey was conducted in June 2001, up to this point, there have been 8 surveys. \*\*Total labor cost includes average gross wage/average earnings, employer part of contribution and taxes and other benefits.

### CHAPTER 3. WAGES AND SALARIES

- *The average wage and salary after taxes and contributions in the first five months of 2005 is 6.4% higher as compared to the same period last year*
- *Highest average wages and salaries after taxes and contributions in the first quarter of 2005 were achieved in the Central region*
- *The average effective tax rate in the first five months of 2005 amounted to 13.3%, while in the corresponding period last year, it was 14.1%.*

#### 3.1. WAGES AND SALARIES

The increasing trend in average wages and salaries continued in 2005. In May 2005 the average wages and salaries after taxes and contributions was €191.6, while the average for the first five months was €197.7, which was 6.4% higher than in the corresponding period last year. On the other hand, average wages and salaries were 4.5% higher in the first five months of 2005 as compared to the same period last year.

In annual terms, wages & salaries after taxes and contributions on a monthly level are significantly higher than in the corresponding months of 2004, in January by 9.2%, in February 4.8%, in March 7.2%, and in April 10.2%, while in May, wages & salaries after taxes and contributions were higher by only 1.1%. The same is true for wages & salaries, but the rates of increase are lower, 6.1%, 2.4%, 5.8%, 8%, and 0.2%, in January, February, March, April, and May, respectively.

Month to month comparisons show a decrease of average wages & salaries after taxes and contributions in January and May, as compared to their previous months, by 11.5% and 9.7% respectively. While in February, March, and April, the average wages & salaries after taxes and contributions show an increase when compared to their previous months.

*Table 3.2: Changes in average wages and salaries (in %)*

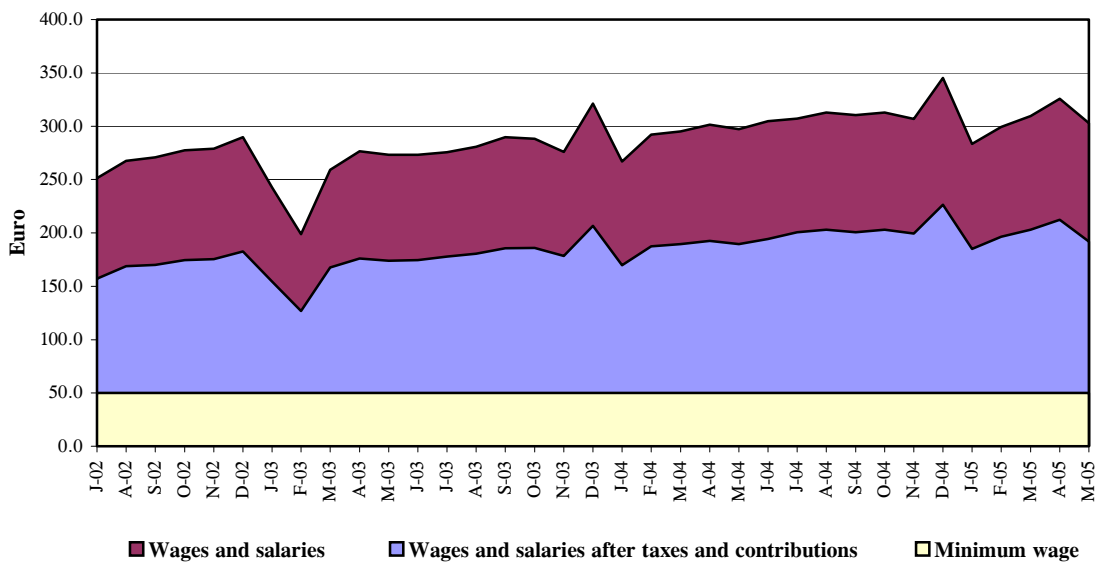
	Annual changes in w&s after taxes and contributions	Monthly changes in w&s after taxes and contributions	Annual changes in w&s	Monthly changes in w&s
Jan-05	9.2	-11.5	6.1	-12.0
Feb-05	4.8	6.1	2.4	5.6
Mar-05	7.2	3.3	5.8	3.4
Apr-05	10.2	4.5	8.0	5.2
May-05	1.1	-9.7	0.2	-8.6

*Source: Monstat and ISSP calculations*

On a quarterly level, the first quarter of 2005 finds that average wages & salaries after taxes and contributions have increased by 6.9% as compared to the same quarter last year, while they decreased by 9.0% as compared to the previous quarter (Q4-04). This big difference is caused by the strong growth of wages in December 2004 and the decrease in January of 2005, which is a typical occurrence.

Although there were some indications that it would change, the minimum wage remained constant throughout 2004 and 2005. However, the Union has announced that they will put more pressure on the Government starting in September.

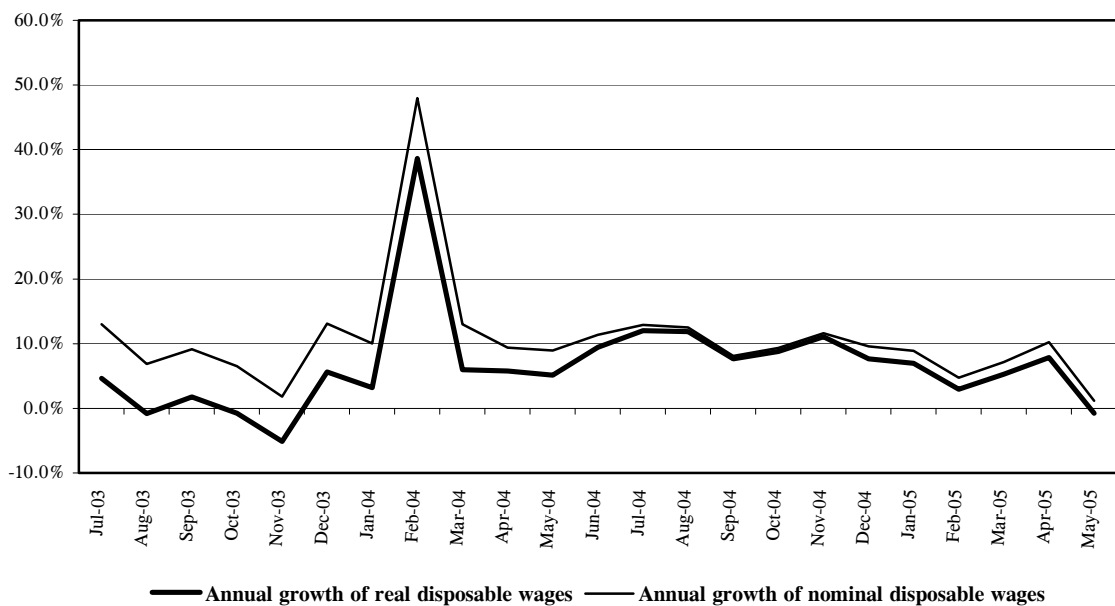
**Graph 3.1: Wages and salaries, wages and salaries after taxes and contributions and minimum wage (July 2002-May 2005)**



Source: Monstat and ISSP calculations

The average tax rate in the first five months of 2005 was 13.3%, which is 0.8 percentage points lower than in the same period of 2004.

**Graph 3.2. Annual growth of nominal and real disposable wages**



Sources: Monstat and ISSP calculations

The annual growth of real wages & salaries was close to nominal wage & salary growth in the first five months of 2005. In May, however, the annual growth of real wages was close to 0, due to low nominal wages growth.

The average pension in the first five months of 2005 amounted to 127€. In January 2005, the pensions were adjusted by 3.25%, which is a regular semi-annual adjustment, as anticipated in the Pension Law. This increase, as shown in table 3.1, is effective since March, which is due to the fact that we regard the average for the month as the pension paid in that month. Namely, the PIO Fund is delayed with its pension payments, so the pension paid in March is actually the pension for January.

### 3.2. AVERAGE WAGES BY MUNICIPALITY (2004)

In the first quarter of 2005, the highest average wages & salaries after taxes and contributions was achieved in the Central region, amounting to €217.05<sup>1</sup>, while the lowest was achieved in the Northern region (€151.25). Consequently, the highest weighted effective tax rate of 14.9% is achieved in the Central region, while the effective tax rate in the remaining two regions is 13.4%.

*Table 3.3: Average wages and salaries after taxes and contributions by region (in € per month)*

	Weighted average w&s after taxes and contributions (in € monthly)	Weighted average tax rate (% monthly)
South	181.68	13.4
Center	217.05	14.9
North	151.25	13.4

*Sources: Monstat and ISSP calculations*

*Note: Both average w&s after taxes and contributions and the tax rate are weighted by the average number of employees by municipality*

Lower wages & salaries after taxes and contributions in the Southern region can be explained by seasonal influences as the first three months are usually characterized by a lower level of economic activities in the coastal area, while the lower level of wages & salaries after taxes and contributions in the Northern region is typical.

In annual terms, average wages & salaries after taxes and contributions are higher in the first quarter of 2005 as compared to the corresponding period in 2004. Wages & salaries after taxes and contributions in the Central region are 7.3% higher in the first quarter of 2005 as compared to the first quarter in 2004, while in the Southern and Northern regions, wages have increased by 6.1% and 6.7%, respectively.

On the other hand, if we observe individual municipalities, we can see that in some municipalities wages & salaries after taxes and contributions have experienced strong growth rates (Andrijevica – 23.8%, Bijelo Polje – 20.6%, Budva – 25.1%, Tivat – 22.5%), while in others, wages & salaries after taxes and contributions have decreased as compared to the corresponding period last year (Zabljak – 22.5%, Pluzine - 21.1%, and Bar – 11.2%).

<sup>1</sup> Weighted by the number of employees in the Central region

Table 3.4: Average w&s after taxes and contributions by municipality (Q1-2005)

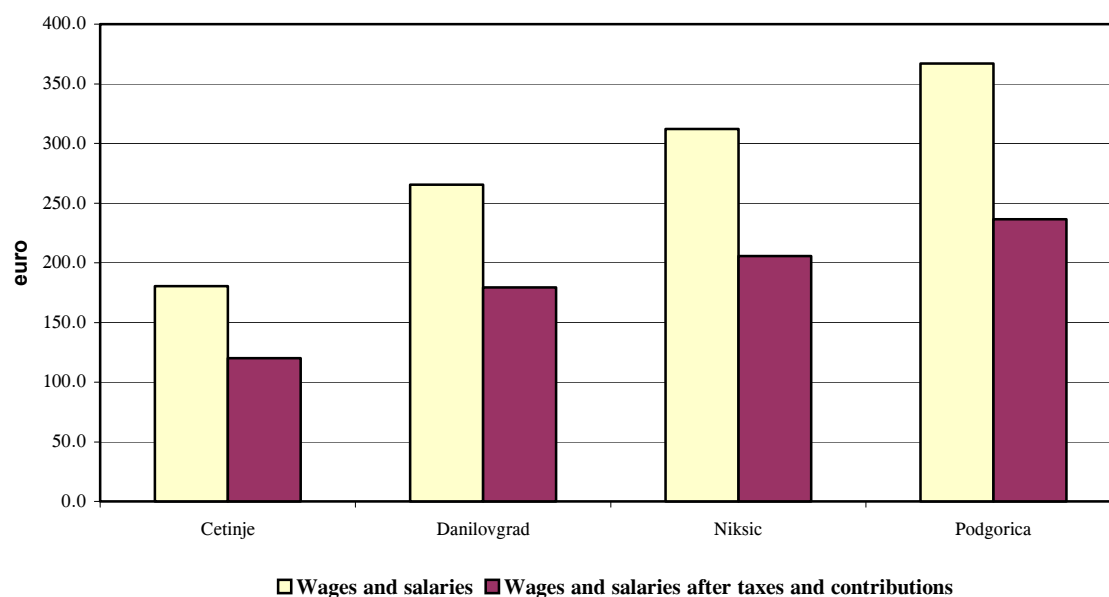
	Annual growth rate (Q1-05/Q1-04)	Average w&s after taxes and contributions
	%	€
N Andrijevica	23.8	141.3
S Bar	-11.2	161.8
N Berane	7.5	154.6
N Bijelo Polje	20.6	121.1
S Budva	25.1	185.0
C Danilovgrad	-2.2	179.2
N Zabljak	-22.2	103.9
N Kolasin	-6.4	143.9
S Kotor	-2.3	228.2
N Mojkovac	-0.8	119.5
C Niksic	17.2	205.7
N Plav	17.6	136.7
N Pluzine	-21.1	143.7
N Pljevlja	13.9	210.3
C Podgorica	5.0	236.4
N Rozaje	-0.8	105.7
S Tivat	22.5	211.3
S Ulcinj	2.1	120.4
S Herceg Novi	0.4	190.7
C Cetinje	9.1	120.0
N Savnik	11.7	167.6

Sources: Monstat and ISSP calculations

Note: N-Northern region, S-Southern region, C-Central region

Observed on a municipal level, the highest average wages & salaries after taxes and contributions are achieved in Podgorica, amounting to €236.4, while the lowest was achieved in Zabljak, amounting to €103.9.

Graph 3.3: Wages and salaries in the Central region (Q1-05)

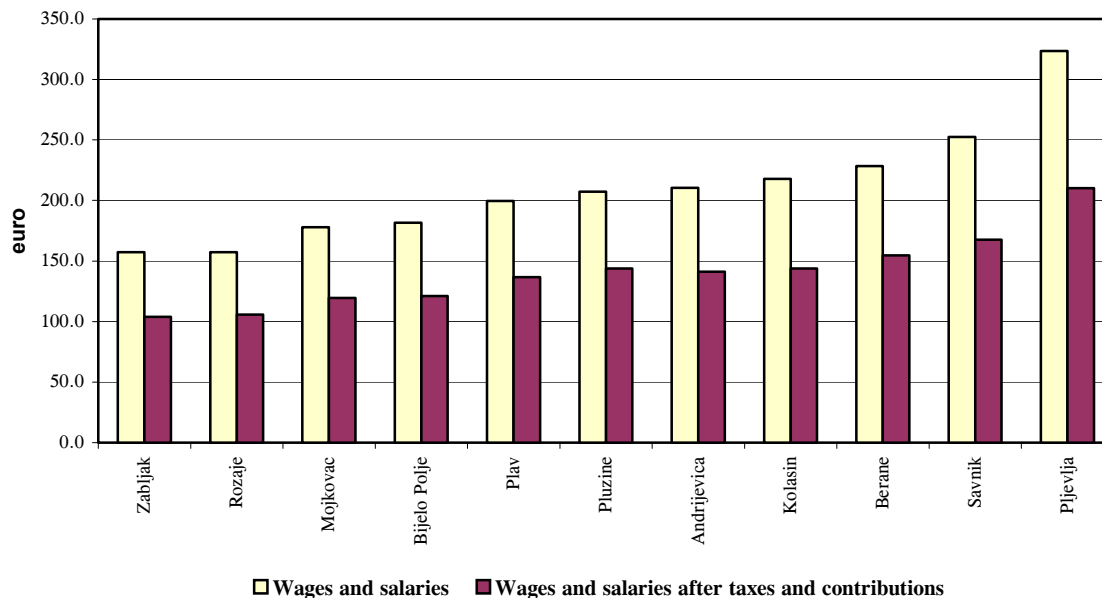


Sources: Monstat and ISSP calculations



Only five municipalities have higher average wages & salaries after taxes and contributions as compared to the national average in the same period (€194.9); these five municipalities are Kotor, Niksic, Tivat, Pljevlja, and Podgorica. However, the more important fact is that employees within these five municipalities compose over 50% of total employment.

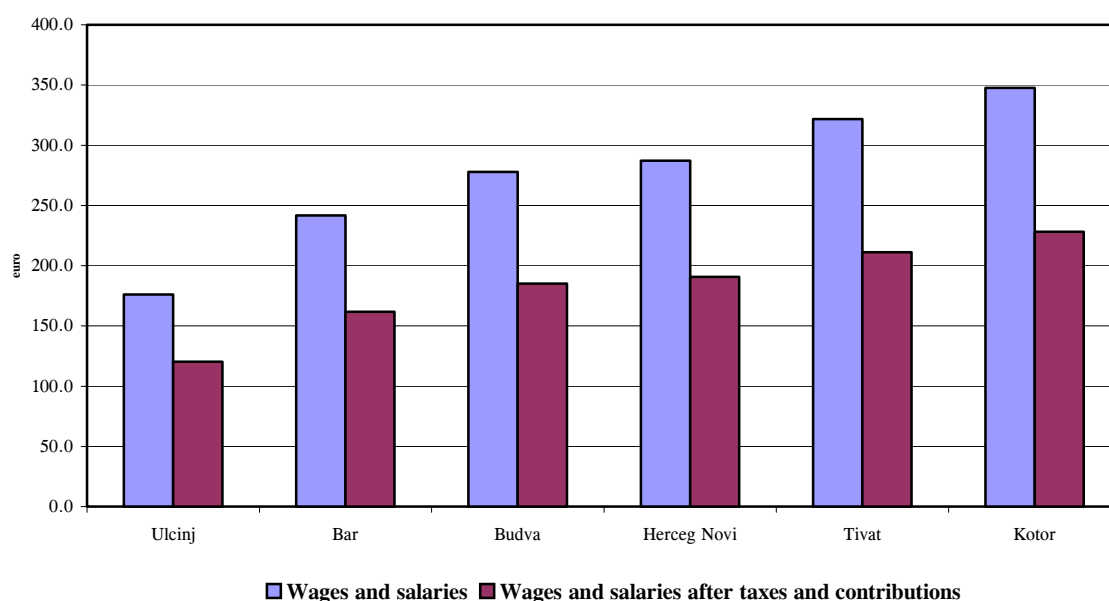
**Graph 3.4: Wages and salaries in the Northern region (Q1-05)**



Sources: Monstat and ISSP calculations

In the Northern region, the highest average wages & salaries after taxes and contributions are achieved in Pljevlja, while the lowest are in Zabljak. The highest wage in this region is twice as high as the lowest.

**Graph 3.5: Wages and salaries in the Southern region (Q1-05)**



Sources: Monstat and ISSP calculations

The highest wages & salaries after taxes and contributions in the Southern region are paid in Kotor, closely followed by Tivat, while the lowest are paid in Ulcinj.

## Chapter 4. Prices

**Table 4.1. Prices**

	Consumer Price Index (Cost of Living) <sup>1</sup>						RPI Total			Producer Price Index	
	CPI Total			Food, tobacco and beverages annual changes	Goods less food, tobacco and beverages annual changes	Services annual changes					
	2000=100	Monthly change in %	Annual change in %				2000=100	monthly change in %	annual change in %	2000=100	annual change in %
<b>PRICES IN DINARS</b>											
1995	9.8	6.2	83.7				206	6.5	100.1		
1996	18.2	3.4	89.7				379	3.3	89.1		
1997	22.9	1.4	26.5				456	1.1	20.8		
1998	29.8	3.1	29.8				582	2.9	27.5		
1999	47.1	6.2	56.6				931	7.1	58.0	85.9	
<b>DM (until December 2001) and EURO (from January 2002)</b>											
2000	100.0	3.4	36.1	10.9	23.2	12.2	100.0		25.0	100.0	16.5
2001	120.2	1.8	21.8	18.9	22.8	42.0	123.0	8.6	23.1	114.4	14.5
2002	142.0	0.7	16.8	15.7	18.7	19.5	147.6	3.1	17.4	121.6	4.6
2003	151.6	0.50	6.8	3.9	9.3	7.3	159.4	0.5	7.7	127.8	2.9
2004	155.2	0.26	2.35	0.6	3.8	9.3	164.4	0.3	3.3	138.0	5.8
2004-Q1	155.0	0.1	5.5	3.9	8.1	7.7	161.9	0.1	7.1	130.9	7.6
2004-Q2	154	0.2	6.3	4.2	7.3	9.0	161.7	0.2	7.5	129.9	7.2
2004-Q3	155	0.1	5.5	3.9	8.1	7.7	161.9	0.1	7.1	130.9	7.6
2004-Q4	156.1	1.2	1.3	-1.2	2.3	20.2	166.7	0.8	3.1	138.5	4.3
2005-Q1	160.0	0.1	103.2	98.3	101.6	142.2	172.40	0.1	105.92	139.47	3.1
Jan-04	154.9	0.1	5.2	3.5	8.6	7.3	162.2	0.1	5.2	133.0	6.3
Feb-04	155.2	0.2	5.4	3.8	8.1	8.1	163.0	0.5	5.7	133.8	6.9
Mar-04	155.3	0.1	5.8	4.3	7.6	7.6	163.1	0.1	5.5	0.0	8.7
Apr-04	155.4	0.0	2.6	2.0	2.6	7.0	163.3	0.1	2.3	139.0	6.3
May-04	156.0	0.4	2.8	-0.3	0.5	3.6	164.3	0.6	2.7	139.6	6.7
Jun-04	155.1	-0.6	0.9	-1.0	3.3	8.1	164.3	0.0	2.4	139.0	5.5
Jul-04	153.9	-0.7	0.9	-0.1	2.7	3.6	164.3	0.0	2.1	139.3	5.7
Aug-04	153.9	0.0	0.8	-0.3	2.8	3.6	164.4	0.1	2.1	139.7	6.0
Sep-04	153.8	0.0	0.3	-0.8	2.2	2.7	164.8	0.2	2.0	138.8	4.9
Oct-04	154.3	0.3	0.3	-0.9	2.4	3.5	165.6	0.5	2.4	138.7	4.6
Nov-04	154.5	0.1	0.3	-1.2	2.9	3.4	165.7	0.1	2.5	138.7	4.6
Dec-04	159.6	3.3	3.2	-1.6	1.6	53.7	172.1	3.8	6.2	138.1	3.6
Jan-05	159.8	0.1	3.2	-1.8	1.4	53.8	172.1	0.1	6.2	130.7	3.6
Feb-05	160.0	0.1	3.1	-1.8	1.7	54.8	172.4	1.1	5.8	131.0	3.3
Mar-05	160.3	0.2	3.2	-1.6	1.7	55.8	172.7	2.1	5.9	133.8	2.5
Apr-05	161.1	0.5	3.7	-0.2	1.1	56.8	173.4	3.1	6.2	131.9	0.4
May-05	162.0	0.6	3.8	-1.0	1.8	57.8	173.8	4.1	5.8		

Sources: Price indices published by Statistical Office of Montenegro except December 2004 monthly rates of change are calculated by ISSP.

Table presents end-of-period values for monthly data and average period values for quarterly and annual data.

Currencies: DIN until 1999, DM from 2000 till 2002 and € from 2002.

- One-base index is calculated as chain index according to Monstat indices based on respective previous years
- Monthly and annual changes are based on data taken from Monstat publications except December 2004 monthly rates of change are calculated by ISSP

<sup>1</sup> Cost of Living is the official name of the Consumer price index (CPI) in Montenegro

#### 4. PRICES

- Consumer prices inflation reached 3.2% in May 2005
- Retail prices inflation was 5.9% in May 2005
- Negative rate of change made total index lower
- Annual inflation of telecom services and the fuel price dynamics pushed total inflation up
- The cost of the Food consumer basket amounted to €246 in May 2005
- Producer and wholesaler prices decreased, causing its inflation to be lower than retail prices
- Inflation forecasts through June 2006 range between 1.8%-2.7%

##### 4.1. CONSUMER PRICE INDEX (CPI)

The annual change of CPI was 3.9% in May 2005. After a sharp increase in December 2004, which was caused by the sharp increase of “local call charges,” the CPI showed slow but constant increases until May 2005. As compared to May of 2004, annual inflation was more than one percentage point higher in May of 2005 (2.8% to 3.9%).

The average annual change from January to May 2005 was 3.4%. The same figure expresses the average change. The average monthly inflation was 0.18% during the first five months of 2005.

The first quarter of 2005 was characterized by higher annual inflation reaching 3.2% in March 2005.

CPI Inflation in 2005				
	Annual change <sup>2</sup>	“Average change” <sup>3</sup>	Average annual change <sup>4</sup>	Average monthly change <sup>5</sup>
Q1	3.22%	3.16	3.20%	0.14%

Source: Monstat  
Calculations: ISSP

Monthly CPI changes in the first five months of 2005 were: 0.1% in January and February, 0.2% in March, 0.5% in April, and 0.6% in May. This increase in April and May reflects seasonal effects of food products, especially fresh fruits and vegetables.

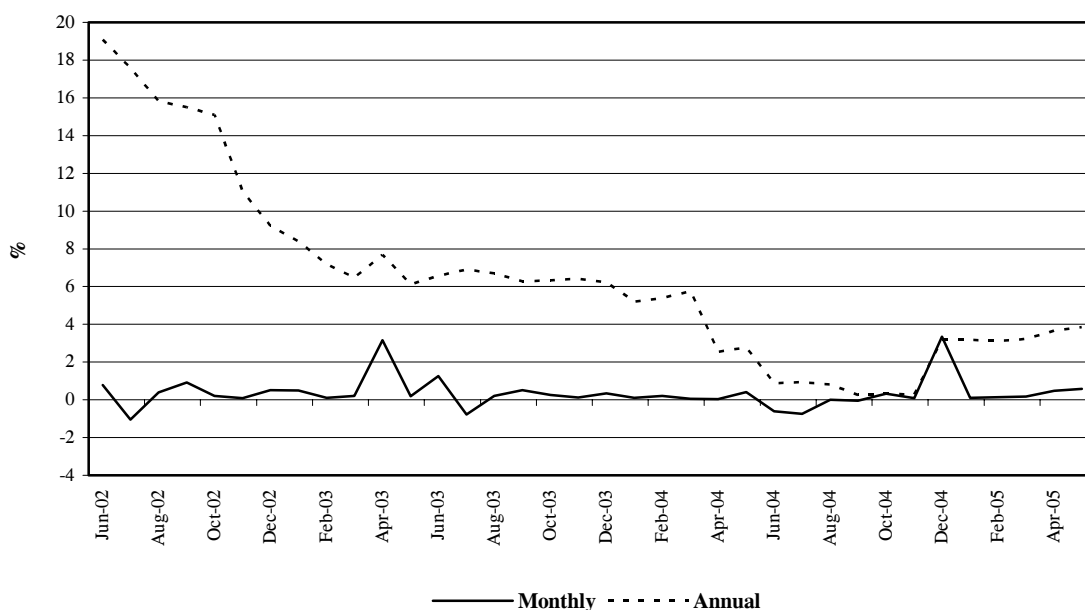
<sup>2</sup> “Annual change” represents a ratio of the index in an observed month and the respective month of the previous year. This way of measuring inflation is also called “end-of-period-inflation”. ISSP uses annual change of CPI as the main indicator of inflation. CPI “dec-on-dec” presents inflation in a certain year.

<sup>3</sup> “Average change” or “Average on average” represents ratios of an average of indices in the observed period to an average of indices in the same period of the previous year.

<sup>4</sup> “Average annual inflation” represents arithmetic average of indices of annual change in an observed period.

<sup>5</sup> “Average monthly inflation” is calculated by applying geometric averages for monthly inflation in an observed period (3 months in quarter or 12 months in year).

Graph 4.1. CPI inflation



Source: Monstat  
Calculations: ISSP

Retail prices experienced similar dynamics as CPI in the period from January to May 2005. Annual RPI inflation was 6.2% in January, 5.8% in February, 5.9% in March, 6.2% in April, and 5.8% in May. Lower monthly changes influenced the annual rates to maintain a similar level during the observed period, even to fall in May. However, this rate is still significantly higher as compared to the same in May 2004 (2.7%).

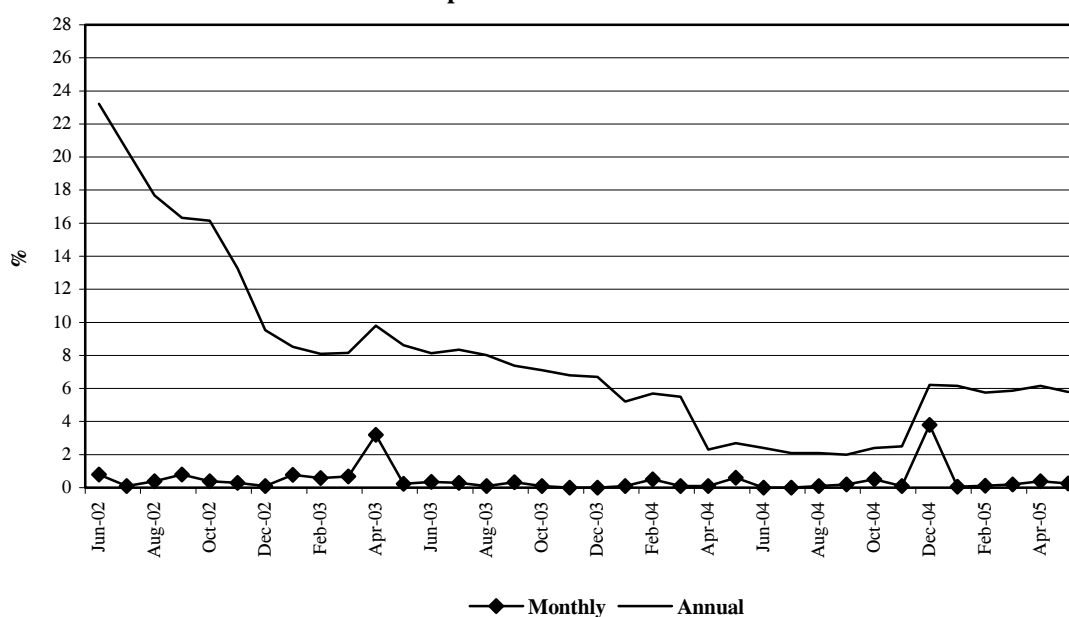
The annual rate in Q1 2005 was 5.9%, the same as in Q1 2004. The same percentage was registered for average annual inflation in Q1 2005. Average monthly inflation was 0.1%.

RPI in 2005				
	Annual change	“Average change”	Average annual change	Average monthly change
Q1	5.86%	5.92%	5.92%	0.12%

Source: Monstat  
Calculations: ISSP

Monthly inflation of retail prices in the first five months of 2005 was 0.1% in January and February, 0.2% in March, 0.4% in April, and 0.3% in May.

Graph 4.2. RPI Inflation



Source: Monstat  
Calculations: ISSP

#### 4.1.2. Disaggregated price changes

Table 4.2 Annual inflation of disaggregated CPI components

Product or service group	Total index	Food	Tobacco and beverages	Clothing and footwear	Accommodation	Hygiene and personal care	Education and culture	Traffic vehicles and transport and communication services
Consumption Weights in 2004	100	57.56	7.34	8.23	11.16	5.25	4.8	5.66
<b>2004</b>								
Jan	5.20	3.90	-0.06	6.75	15.27	4.21	9.48	4.52
Feb	5.40	4.26	-0.03	6.70	15.06	3.06	11.57	3.93
Mar	5.76	4.83	-0.02	6.85	15.44	3.04	11.92	1.22
Apr	2.55	2.14	1.57	6.09	3.11	1.86	5.90	0.09
May	2.77	-0.43	0.75	5.79	0.47	2.25	4.56	2.41
Jun	0.89	-1.15	0.75	5.54	2.66	2.25	5.95	6.67
Jul	0.93	-0.22	0.88	5.47	0.49	2.22	5.48	1.97
Aug	0.81	-0.43	0.75	5.79	0.47	2.25	4.56	2.41
Sep	0.26	-1.00	0.56	5.74	0.41	1.46	1.51	2.13
Oct	0.32	-1.12	0.68	5.49	0.72	1.50	1.60	3.93
Nov	0.27	-1.38	0.76	5.94	0.74	1.54	1.38	5.04
Dec	3.17	-1.79	0.71	4.52	2.38	1.43	1.41	68.53
<b>2005</b>								
Jan	3.17	-2.08	1.04	3.98	0.74	1.28	1.39	68.62
Feb	3.11	-2.13	1.19	3.60	0.71	1.36	0.26	71.05
Mar	3.22	-1.91	1.34	3.17	0.69	1.52	0.34	71.50
Apr	3.67	-1.54	4.34	2.29	0.67	1.59	0.35	72.76
May	3.85	-0.81	5.29	2.64	0.62	0.82	0.31	67.02

Source: Monstat  
Calculations: ISSP

Food, tobacco and beverages products exhibited average annual deflation of -1.3% in the first five months of 2005. A higher rate, but still with a deflationary effect on the total index, was registered for Goods less food, tobacco and beverages products. Services prices still had a very high average annual inflation of 42.7%.

Most of the CPI product/service groups registered decreasing annual inflation, having a deflationary effect. Food prices experienced increasing, but still negative inflation, while tobacco and beverages inflation increased during the first five months of 2005. Inflation of the clothes and footwear group of products also decreased, as well as inflation of accommodation products and services. Group hygiene and personal care registered a slow increase of inflation from January to April, but decreased in May. Education and culture prices had a decreasing trend, while vehicle, transport and telecom services were still at a very high level.

**Food product prices (57.6%<sup>6</sup>)** continued their deflationary effect on the total index during the period from January to May 2005. Corn products (8.9%) registered an average annual inflation rate of 2% from January to May 2005, while the prices of fresh and processed vegetables (6.2%) caused total Food inflation to decrease by 20% during the same period. Fresh and processed fruits (5%) prices registered higher rates, but still negative – with average annual inflation of -0.5% from January to May 2005. Prices for fresh and processed meat (17.5%) increased by 2.2% on an annual basis in the observed period. Fish (1.1%) deflated by 2% in the first five months 2005. Milk and milk products (8.9%) were priced 0.9% higher on an annual basis. The price of eggs (1.8%) increased by 9% on an annual basis due to the Eastern seasonal effect. Average Lard (3.2%) prices fell by 7.2% from January - May 2005. The rest of the food products' (5%) prices (coffee, sugar, candies, spices, etc.) also fell by 1.7%.

**Tobacco and beverages (7.3%)** product prices registered a significant increase in inflation from 1% in January to 5.3% in May 2005. This occurred due to a 6.9% increase in beverage prices (2.8%) on an annual basis for the observed period. Tobacco (4.5%) product prices remained unchanged.

Prices for the group of **Clothes and Footwear (8.2%)** continued to increase in January and February 2005, but with a lower inflationary effect, while in the rest of the observed period, they had a small but deflationary effect on total inflation. Clothes prices (4.4%) registered inflation of 2% and Footwear prices (3.8%) 4.8% annual inflation from January to May 2005. A strong inflationary effect is still coming from footwear prices and services, but at a decreasing level.

Annual inflation of **Accommodation prices (11.2%)** was around 0.6% for the observed period, pushing total inflation down. Average annual change for apartment prices was 2.9% (due to communal price increases) and 0.6% for apartment equipment (1.7%), while electricity prices (7.2%) remained unchanged.

**Hygiene and personal care (5.3%)** registered a downward trend, at 1.3% average annual inflation. Hygienic means (3.6%) prices registered an average annual change of 0.3% from January to May 2005, while medicines had higher average annual inflation of 1.4%. An

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<sup>6</sup> The weight for each group in the total consumer basket is given in brackets next to the name of the CPI products services group or subgroup.

inflationary effect came from health care services (0.8%), which increased by 6% in annual average.

**Education and culture (4.8%)** prices decreased from 1.4% in January to 0.3% in May 2005 on an annual basis. Education equipment (3.4%) prices did not change, while education services (1.5%) average annual inflation was 1.8% in the observed period.

**Traffic vehicles and transport and communication services** created strong inflationary pressure on the total index, partly due to higher telecom charges and partly due to increased fuel prices on an annual basis from January to May 2005. The average annual inflation of traffic vehicles (0.2%) prices was 0.9%. Fuel and lubricants (1.8%) experienced volatile price changes at the monthly and annual level, just like in previous months. Thus, we have average annual inflation of fuel prices at 7%, which led to increased prices of outlay for keeping cars (0.5%), with a high average annual inflation of 10.7%. Communication services prices (2.3%) still have a high annual rate of change (116%).

To summarize, food continued to have a significant downward effect on total inflation with a negative rate of change. Deflationary effect came from products and services prices like Education and Culture, Accommodation, Hygiene, and Health Care, as well as from Clothing and Footwear. On the other side there were Tobacco and Beverages and Vehicles, Transport, and Telecom Services, all of which pushed total inflation up.

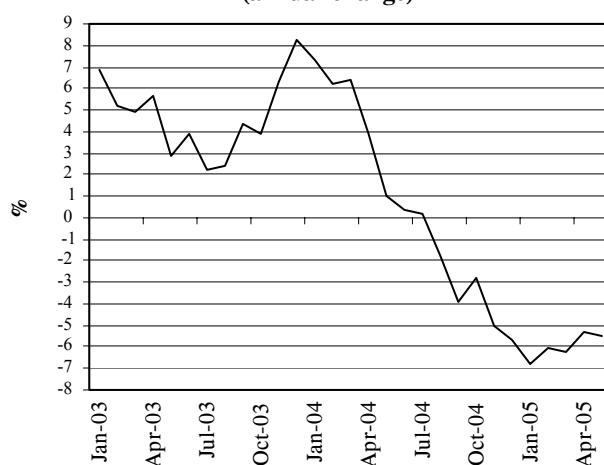
#### 4.1.3. COST OF THE FOOD CONSUMER BASKET (FCB)<sup>7</sup>

Table 4.2 Cost of the food consumer basket in Montenegro (in €)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2004	257.73	257.08	257.11	255.51	260.36	264.52	253.43	255.45	253.82	254.85	245.61	244.07
2005	240.22	241.54	241.09	241.99	246.21							

Source: Monstat

Graph 4.3. Food consumer basket  
(annual change)



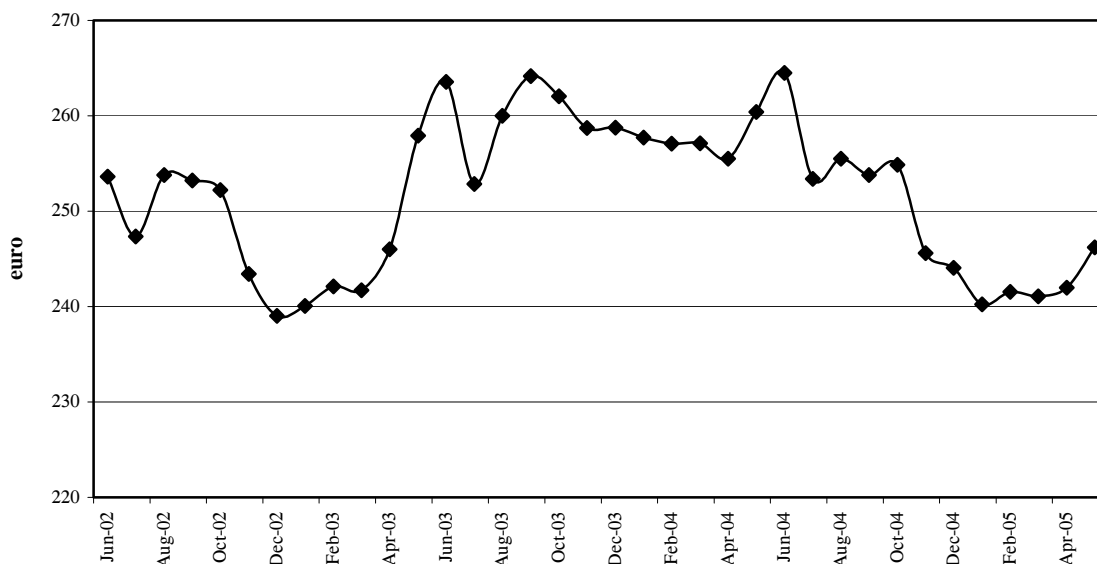
A four-member family had to spend € 246.21 for the food consumer basket in May 2005. Due to fresh vegetables and fruits, which are a major component of this basket, the price varies monthly due to the seasonal impact. At the annual level, FCB registers a decreasing trend and deflation of 6% in the annual average since the beginning of 2005. This confirms the falling trend of the food category in the consumer basket of CPI.

Prices of most fresh Vegetable and Fruit products registered high negative

<sup>7</sup> The food consumer basket consists of a group of basic food products in the quantities adequate for a four-member family. The concept of the basket was developed following the guidelines of the EU to approximate the cost of basic food needs for a four-member family. Thus, it allows for easy comparisons between countries.

annual rates of change. The most significant average annual changes in the first five months of 2005 were observed for: potatoes -36%, onion -40% in Q3, spinach -22%, lettuce -13%, and lemon -14%. The most significant average annual increases in Q4 2004 came from fruits: apples 10% and pears 25%. Sugar registered a constant decrease in prices at an annual level.

Graph 4.4. Cost of FCB in Montenegro (in euro)



Source: Monstat and Federal Statistical Office ([www.szs.sv.gov.yu](http://www.szs.sv.gov.yu))

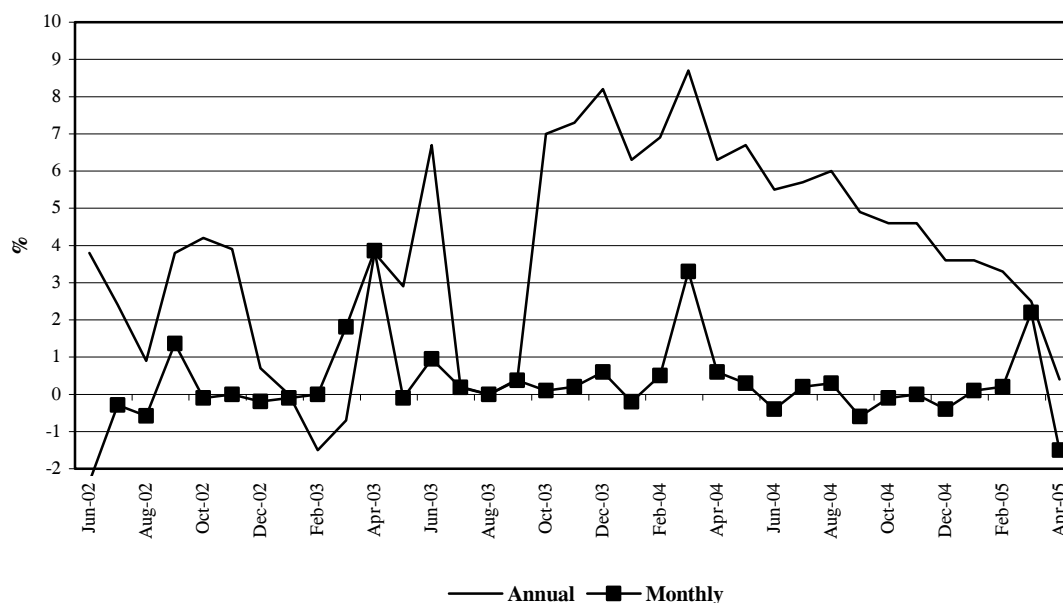
## 4.2. PRODUCER PRICE

### 4.2.1. PPI Inflation

Producer and Wholesale inflation, measured by the end-period rate of change of the Producer Price Index (PPI), fell significantly during the first five months of 2005, to 0.4% in May (the same indicator was 6.7% in April 2005). January, February and March registered annual inflation of 3.6%, 3.3% and 2.5% respectively, while at the monthly level, they were 0.1% in January, 0.2% in February, and a sharp increase of 2.2% in March followed by a decrease of 1.5% in April. The average annual inflation in the observed period is 4.6 percentage points lower as compared to the same indicator last year.



Graph 4.5 PPI inflation



Source: Monstat

#### 4.2.2 PPI disaggregated changes

Deflationary effect of PPI came from the production price of food, tobacco, and beverages, while most of the other costs were unchanged at a monthly level from January to April.

**Mining and stone extraction** prices remained unchanged on a monthly basis in Q4 2004, while average annual inflation was 1.2% in January and February and 1.6% in March and April 2005.

**Processing industries prices** decreased during the first five months of 2005, going from 4.6% in January to 1.6% in April. Cost of production of nonmetal products, furniture, and construction materials at an annual level has still been pushing the total PPI up.

- Average annual price change of food, tobacco and beverage production registered inflation of 3% from January to April 2005.
- Chemical products production prices decreased 5.5% in January at a monthly level. The rest of the observed period registered negative annual inflation, but with inflation of 0.7% and 2.2% at a monthly level in February and March respectively.
- Textile production remained the same at a monthly and annual level up until April 2005.

The average annual increase of **Construction materials** prices from January to April 2005 was 2.8%.

**Electricity, gas and water prices** did not change on an annual or monthly basis.

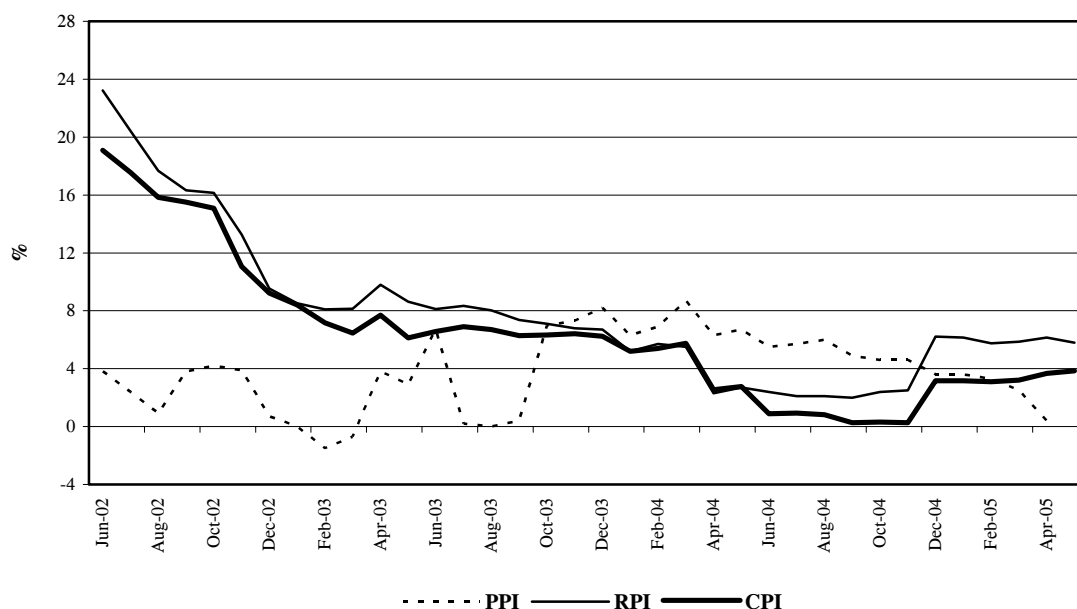
We can conclude that total PPI confirmed the falling trend over the past twelve months. This deflationary effect came from the prices of food tobacco and beverages production and chemical products, while mining and stone extraction costs and construction materials influenced an increase of the total index.

**4.3 INFLATION MEASURED BY DIFFERENT INDICATORS: PPI, RPI AND CPI**

Graph 4.10 shows the annual rates of change of consumer, retailer and producer price indices. Since April 2004, PPI has experienced a falling trend. Besides this, PPI's rate of change was still higher than either CPI or RPI through the end of 2004. The beginning of 2005 brought lower PPI inflation than RPI and CPI.

Cost of Production of food, beverages, and tobacco followed the trend of retail food prices, as well as tobacco and beverages. Production prices of textiles are still at the same monthly and annual levels. The monthly change of retail prices were registering a decreasing trend, but still at a higher level than the same category production prices.

**Graph 4.6. PPI, RPI and CPI - annual changes**



Source: Monstat

**4.4. FORECASTS**

Actual annual inflation in 2004 was 3.2%, while our optimistic forecast had foreseen a 2.8% rate and our pessimistic forecast was 3.3%. Thus, we can conclude that actual inflation followed the pessimistic scenario of ISSP prognosis.

There are assumptions that create the main trends of our optimistic and pessimistic prognosis; these are made on past trends and expectations for electricity<sup>8</sup> and fuel price increases. With the exception of these two prices, we did not forecast some significant changes in the prices of other groups.

The optimistic scenario for inflation developments in the next 12 months (June 2005 – May 2006) assumes:

<sup>8</sup> Estimations are based on Energy Law of the Republic of Montenegro.

- Continuation of the CPI dynamics throughout the rest of 2005 and into the first five months of 2006
- Increase of Electricity price by 15% in November 2005
- Projected monthly increase of fuel price by 0.15%

The pessimistic scenario of inflation developments in the next 12 months (June 2005 – May 2006) assumes:

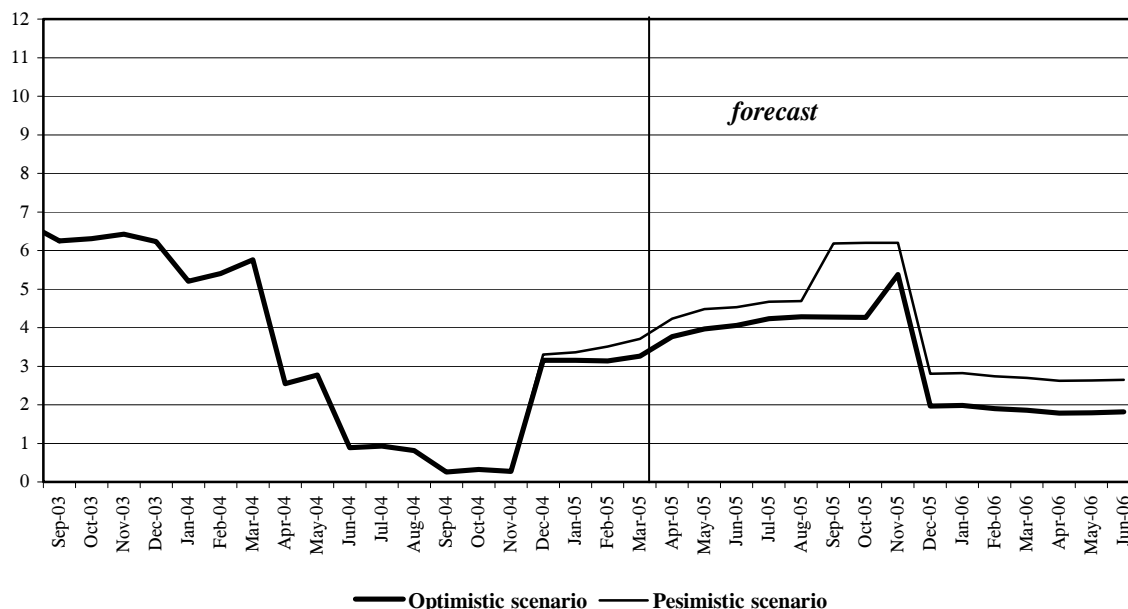
- The consumer prices increase a bit faster in 2005 and 2006 compared with the previous period
- Electricity price increase of 18% in September 2005
- Projected monthly increase of fuel price by 0.20%

The resulting **projected inflation in the next 12 months ranges from 1.8% to 2.7% in June 2006**, as shown in Graph 4.11.

According to the optimistic scenario, the inflation rate in the next four quarters is projected to be: 4.3% in Q3 2005, 2% in Q4 2005, 1.9% in Q1 2006, and 1.8% in Q2 2006.

According to the pessimistic scenario, the inflation rate for the coming four quarters is projected to amount to: 6.2% in Q3 2005, 2.8% in Q4 2005, 2.7% in Q1 2006, and 2.7% in Q2 2006.

Graph 4.7 Twelve months inflation forecast



## 5. BUDGET

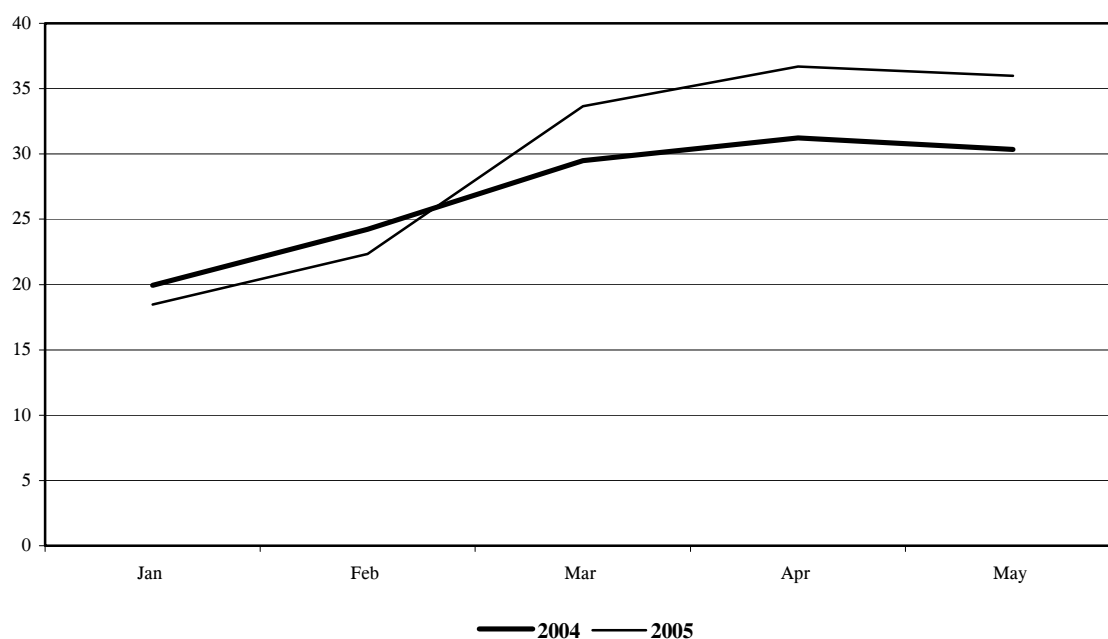
- Total budget revenues for the period January-May 2005 were 147.1 million euro, which represents 34.3% of the total planned for 2005 (432.1 million euro).
- Budget revenues increased 8.8% in the first five months of 2005 compared to the same period in 2004.
- Total expenditures and net lending amounted to €138.50 million, which is about 31% of planned annual budget consumption.
- In the first five months of 2005, the Republic Budget had a surplus in the amount of €8.64 million.
- GoM<sup>1</sup> adopted the Law on Final Account for 2004, according to which total budget revenues amounted to €379.73 million while total expenditures were at the level of €405.49 million and the Republic budget finished this fiscal year with a deficit in the amount of €32.70 million, or 2.09% of GDP.

### 5.1. BUDGET EXECUTION IN 2005

#### 5.1.1. Budget revenues and grants

Total budget revenues constantly increased from January to May 2005. The lowest level of the observed category was in January, while the highest was in April.

Graph 5.1 Monthly budget revenues<sup>2</sup>



Source: Ministry of finance of Montenegro, ISSP calculations  
 Notice: All data in million euro

<sup>1</sup> Government of Montenegro

<sup>2</sup> Total budget revenue includes grants.

Table 5.1. Central Budget Revenues and Expenditures, 2001-2005 ( millions €)

	2001	2002	2003	2004	2005							
	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan-Dec	Jan '05	Feb '05	Mar '05	Apr '05	May '05	Jan-May '05	Jan-May '05
	Execution	Execution	Execution	Execution	Plan	Execution	Execution	Execution	Execution	Execution	Execution	Execution/Plan
Deposits from previous year												
Total revenue and grants (1+2)	233.140	256.804	350.103	379.730	432.155	18.473	22.339	33.655	36.690	35.979	147.136	34.047
Total revenue (1.1+1.2)	221.220	229.847	337.519	372.783	428.464	18.473	22.339	33.655	36.690	35.979	147.136	34.340
Current revenue (1.1.1+1.1.2)	221.220	229.847	337.519	369.696	423.064	18.473	22.339	33.600	36.690	35.979	147.081	34.766
Tax revenue (1.1.1.1+1.1.1.2+1.1.1.3+1.1.1.4+1.1.1.5)	187.999	208.931	312.918	337.513	383.369	17.580	20.695	31.553	34.365	30.495	134.687	35.133
Personal income	56.654	57.889	63.961	61.235	71.900	2.003	4.150	5.509	5.875	5.084	22.622	31.463
Turnover (retail sales) tax	58.488	56.528	137.222	158.096	177.100	8.791	9.488	14.982	14.959	15.507	63.727	35.983
Excises	35.664	50.786	58.197	61.527	66.597	4.658	3.003	4.591	6.636	3.779	22.667	34.036
Taxes on international trade and transactions	27.274	26.376	36.845	36.653	43.779	1.477	2.221	3.424	3.178	3.774	14.074	32.148
Custom tariffs	13.894	12.605	35.078	33.803	42.434	1.358	2.096	3.157	3.016	3.618	13.244	31.210
Custom transit fees	13.380	13.771	1.766	2.850	1.345	0.119	0.125	0.267	0.163	0.156	0.830	61.727
Other taxes	9.920	17.342	16.694	20.002	23.994	0.651	1.834	3.046	3.716	2.350	11.598	48.335
Nontax revenues	33.221	20.916	24.601	32.183	39.694	0.894	1.643	2.047	2.325	5.485	12.394	31.224
Capital revenue				3.087	5.400	0.000	0.000	0.055	0.000	0.000	0.055	1.010
Grants	11.920	26.958	12.584	6.947	3.691	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Total expenditure and net lending (1+2)	259.309	266.771	381.090	405.487	454.064	10.969	26.881	32.747	38.621	29.281	138.499	30.502
Total expenditure (1.1+1.2)	252.585	247.517	358.924	390.211	443.364	10.446	26.319	31.380	38.321	29.062	135.528	30.568
Current expenditure (1.1.1+1.1.2)	233.287	236.697	345.235	377.561	415.432	10.427	26.028	30.609	37.247	26.416	130.727	31.468
Interest	0.622	12.880	14.136	24.025	19.500	0.465	0.254	2.923	0.355	0.492	4.489	23.019
Non-interest (1.1.2.1+1.1.2.2+1.1.2.3+1.1.2.4+1.1.2.5+1.1.2.6)	232.665	223.818	331.099	353.536	395.932	9.962	25.774	27.686	36.892	25.924	126.238	31.884
wages and salaries	108.464	110.178	134.262	164.389	170.905	1.220	11.141	11.167	22.255	11.205	56.988	33.345
goods and services	55.351	41.817	37.858	46.913	58.316	0.880	3.279	4.243	5.346	4.405	18.152	31.128
Social insurance and social security transfers	45.327	35.825	132.795	103.782	144.658	7.257	8.699	10.323	7.886	8.674	42.839	29.614
Subsidies to enterprises	12.249	18.169	14.631	8.481	5.642	0.048	0.389	0.158	0.275	0.883	1.754	31.078
Reserve	6.461	14.819	8.388	16.689	12.636	0.479	2.118	1.533	0.836	0.508	5.474	43.319
Other non - interest expenditure	4.813	3.010	3.165	13.282	3.774	0.078	0.148	0.262	0.294	0.249	1.031	27.321
Capital expenditure	19.298	10.820	13.688	12.650	27.932	0.019	0.291	0.771	1.074	2.646	4.801	17.188
Net lending	6.723	19.254	22.167	15.276	10.700	0.523	0.562	1.367	0.300	0.219	2.971	27.768
Lending	13.974	19.490	22.590	17.803	10.700	0.523	0.562	1.367	0.540	0.236	3.228	30.168
Repayment	7.250	0.236	0.423	2.527	0.000	0.000	0.000	0.000	0.240	0.017	0.257	
Overall budget balance excluding grants (cash) (A-B-2)	-38.089	-36.925	-43.571	-32.704	-25.600	7.505	-4.542	0.908	-1.931	6.698	8.638	
Overall budget balance (cash) (A-B)	-26.169	-9.967	-30.987	-25.757	-21.909	7.505	-4.542	0.908	-1.931	6.698	8.638	
Financing ( 1+2)	26.129	38.254	18.395	23.427	21.909	-3.461	2.291	1.915	90.962	-10.397	81.310	
Domestic and foreign financing (net)	17.007	0.568	6.234	19.886	15.909	-3.461	2.291	1.915	-20.108	-10.397	-29.760	
Borrowing	76.436	40.445	48.246	51.110	53.609	0.000	3.055	3.568	1.909	1.582	10.114	
Repayment	59.430	39.877	42.012	31.224	37.700	3.461	0.764	1.653	22.017	11.979	38.874	
Privatization receipts	9.122	37.686	12.161	3.541	6.000	0.000	0.000	0.000	111.070	0.000	111.070	

Source: Ministry of Finance of Montenegro, ISSP calculations / Note: Data for 2004 are from the Final Account and that is why they differ, to some extent, from those presented in MONET 19, which were preliminary; Data for May are preliminary.

Cumulative budget revenues in the first five months of 2005 were 147.13 million euro, which is 8.8% higher than in the same period of 2004. Total budget revenues in the first five months represent 34% of executions compared with the plan for 2005.

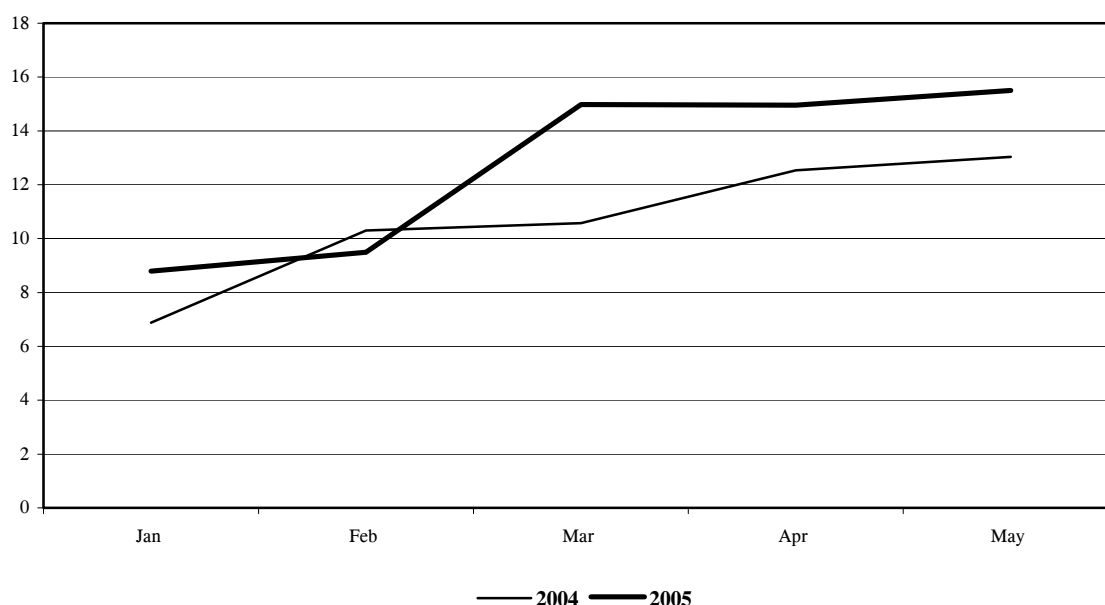
*Total revenue*<sup>1</sup> in the period January-May 2005 increased 13.8% compared to the same period in 2004. If we consider the amount of collected taxes in the first five months of 2005, its execution was 34.3% of the plan,

The lowest budget revenue was in January (18.4 million euro) while the highest was in April of 2005 (36.7 million euro).

### *Structure and execution of individual revenues*

- **Personal income tax** - Compared with the plan, personal income tax shows execution of 31.4% in the first five months of 2005. Personal income tax decreased in the first five months of 2005 by 1.8% compared to the same category in 2004.
- **Turnover tax** represents the most important budget revenue category and it increased about 35.9% as compared to the plan for the first five months of 2005. Executions of turnover tax are 19.5% higher in the first five months of 2005 as compared to the same period in 2004. The highest level of turnover tax execution was held in May (63.7 million euro) due to the start of the summer tourist season.

Graph 5.2 Turnover (retail sales) tax



Source: Ministry of finance of Montenegro, ISSP calculations

Notice: All data in million euro

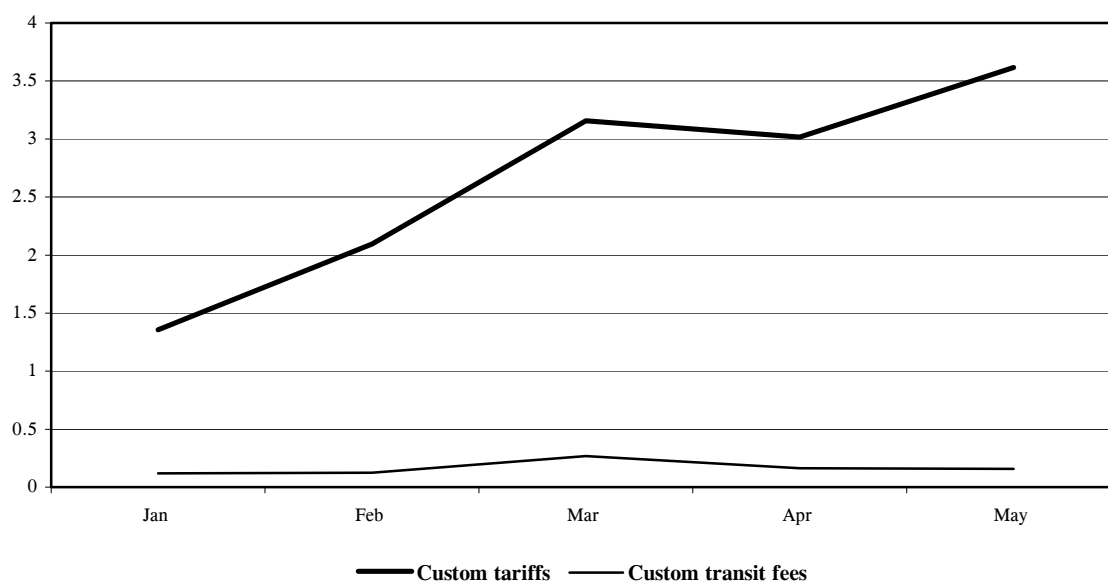
<sup>1</sup> Total revenue consists of the category "Other taxes," which includes: motor vehicle tax, insurance services and games of chance tax.

**Box 1. Corporate tax law**

The New Corporate tax law began its implementation on January 1st 2005, thus delaying progressive taxation. In order to increase entrepreneurial activities, the new corporate tax rate is at the level of 9%. According to that, Montenegro has the lowest corporate tax rate in region.

- **Excise tax**– In the first five months of 2005, execution was about 34% as compared to the existing plan for 2005. Excise tax is 2.4% higher in the first five months of 2005 as compared to the same period of 2004.
- **Taxes on international trade and transactions**– Compared to the first five months of 2004, taxes on international trade and transaction are 6.3% higher in the same period of 2005. Compared to the plan for 2005, the execution of these taxes is at a level of 32.1%. *Custom tariffs* show execution of 31.2% compared to the existing plan for the first five months of 2005. Comparing the existing category with the same period in 2004, we find that it increased by 8.2%. *Custom transit fees* decreased by about 23.7% when comparing 2005 with 2004. Executions, as compared to the plan for 2005, are 61.7%.

**Graph 5. 3 Fluctuations of customs and transit in the period  
January-May 2005**



Source: Ministry of finance of Montenegro, calculations ISSP

Notice: All data in million euro

- **Non-tax revenues**– In the first five months of 2005, non-tax revenues amounted to 12.4 million euro, which is 31.2% of the plan for 2004.

**Grants**

Grants planned for 2005 are at 3.691 million euro. For the first five months of 2005, there have been no grants.

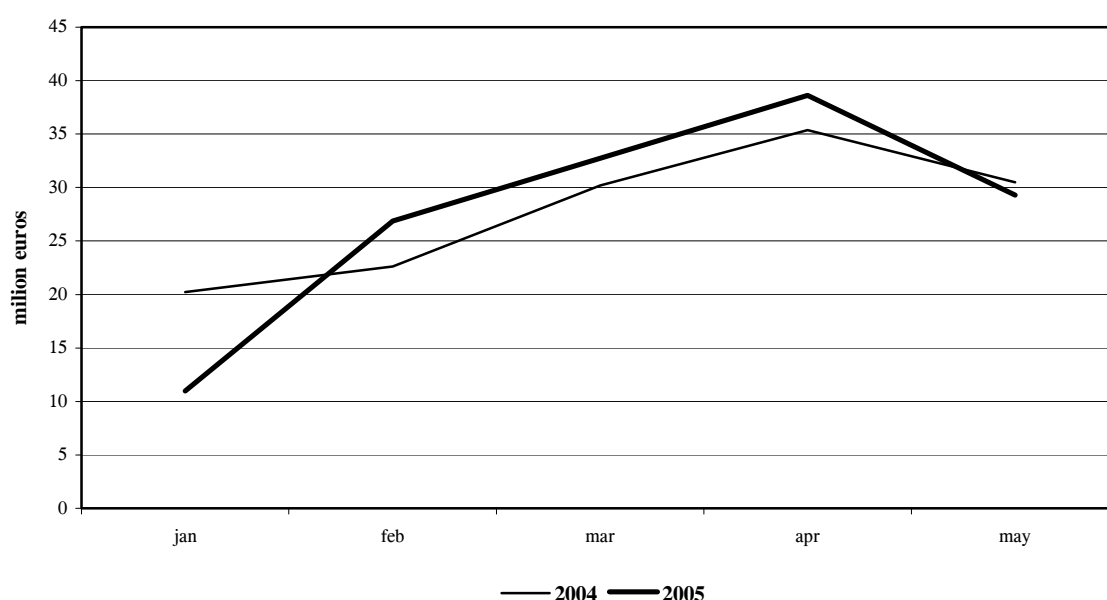
### 5.1.2 Budget expenditures and net lending

In the first five months of 2005, total expenditures and net lending amounted to €138.50 million, which is approximately the same execution level as the same period of the previous year, and at the end of May, this figure represents almost 31% of the planned annual budget consumption. Total expenditures in the amount of €135.53 million are approximately 2% higher than in the first five months of the previous year, while net lending was at the level of 49% of last year's execution and amounted to €2.97 million.

At the end of May, current expenditures of the Republic budget were at €130.73 million, or 1% higher than in the same period of the previous year. Out of that amount, 96.6%, or €126.24 million, is related to non-interest expenditures, which is 5% higher than the same period last year, while the rest, or about 3%, represents interest payments.

The following graph shows that in the period February-April of 2005, expenditures had the same movement as in the same period last year.

Graph 5.4 Budget expenditures in the period January-May of 2004 and 2005



Source: Ministry of Finance, ISSP calculations

#### Execution of expenditures categories

- As usual, the biggest expenditures category in the analyzed period, with a share of 41.1% of total expenditures, is the *public sector employees' wages, salaries and other payments*. In the first five months of 2005, €56.99 million was paid cumulatively on this expenditure, which is 17% higher in comparison with the same period of the previous year, and thus, one-third of the planned annual payment of this budget category was executed<sup>2</sup>. Net salaries were at €31.3 million, which is 8% higher as compared to 2004, and payment of contributions increased by 72%, amounting to €14.9 million. On the other hand, in comparison with last year's execution, tax payments were about 11% lower. *Other public sector' employees' payments* (meal allowances, accommodation, travel, regress, etc.) amounted to €3.6 million, which is approximately 5% higher than the same period last year.

<sup>2</sup> This year's plan is approximately 1% lower than last year's plan and, at the same time, 4% higher than 2004's execution.



- *Expenditures on goods and services* amounted to €18.15 million and were 16% higher than the same period in 2004 and their execution in the first five months of this year was 31% of this year's plan. The largest share of this category is for current maintenance of the Republic's buildings (34%).
- *Social insurance and social transfers*, with a share of 31% in total expenditures, is the second largest expenditures category. At the end of May of 2005 they amounted to €42.84 million and were 8% lower than their execution in the same period last year. Almost 50% of this category is related to the Republic's budget transfers to the social funds and to the Ministry of Defense of the Union of Serbia and Montenegro, to which is cumulatively transferred €20.87 million, which is 21% lower than the same period in 2004. The Pension Fund received €15.87 million, while the Health insurance Fund received €2.00 million, and the Employment Fund received €1.52 million. The whole range of cash allowances to socially vulnerable castes amounted to €13.87 million, through which, 41% of the annual plan has been executed.
- *Subsidies to enterprises* amounted to €1.8 million, which is 56% of last year's level, and thus, 31% of the annual plan is executed<sup>3</sup>. Out of that amount, €1.4 million is related to the public enterprises subsidies, while the rest, €0.3 million, are subsidies for other enterprises.
- *Reserves* amounted to €5.5 million, out of which 85%, or €4.6 million, is related to the current budget reserve, and the rest, €0.8 million, is permanent budget reserve.
- The lowest share in total expenditures is held by *other expenditures* (rents and other non-interest expenditures)<sup>4</sup> (0.7%).
- In the first five months of 2005, cumulatively was paid €4.5 million in interest, which represents only 52% of last year's execution and 23% of this year's plan<sup>5</sup>. The reason why interest has been paid in a lower amount is that, although interest paid to residents was higher by 124% from the determined plan, interest paid to non-residents amounted to only 17% of the planned amount.
- The lowest execution in comparison with the plan (17% of the planned amount) during the analyzed period was had by *capital expenditures*, which amounted to €4.8 million, and thus, continued the trend from 2004 when this expenditures category had as well the lowest execution in comparison with the plan.

**Box 2.**

At the end of the three-year agreement with IMF, Montenegro negotiated with this institution for their achievements thus far and to possibly extend their collaboration. Agreement to extend the agreement was successful, which is important for Montenegro since it will lead them to write off their debt to the Paris Club.

<sup>3</sup> This year GoM decided to significantly reduce the amount of subsidies (by about 40%) in comparison with 2004 due to the reduced amount of subsidies to public enterprises by about 45% in comparison with last year's plan.

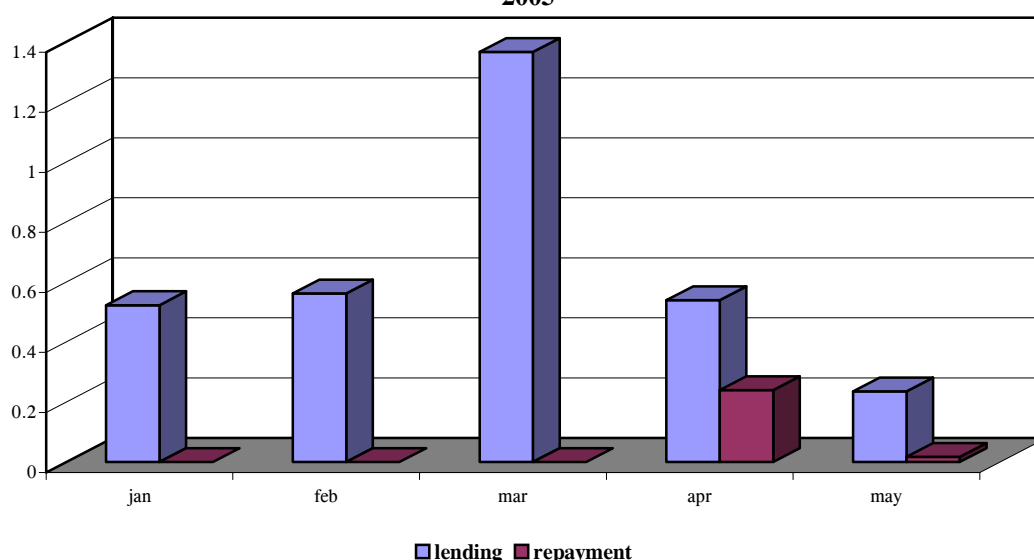
<sup>4</sup> In the last year this category included as well repayment of the frozen savings and that is why its comparison with this year is not relevant.

<sup>5</sup> Due to the very good discipline of GoM regarding interest payments in the previous year, their payment for this year is planned in an amount 11% higher, thus the dynamic of their payment in the analyzed period in this year is not satisfactory.

*Net lending*

At the end of May 2005, total lending from the Republic budget amounted to €3.2 million and was at 50% of last year's execution. The trend from 2004 was followed, for about 58% of lending, or €1.9 million, is related to the repayment of loans on the basis of given guarantees, while the rest, €1.4 million, are given as loans to public and other enterprises, as well as other loans. While at the beginning of the year the highest repayment was planned for other loans<sup>6</sup> in the total amount of €5.6 million, in the analyzed period only 7% of the annual plan for these loans has been executed, while 99% of planned loans to public enterprises have been executed in the first five months, and loans to other enterprises were at about 77% of the annual plan. On the other hand, repayment of loans amounted to €0.3 million and was 50% lower as compared to the previous year, and thus, net lending at the end of May 2005 amounted to almost €3 million, which is 50% lower than the same period last year.

**Graph 5. 5 Net receivables of Republic budget in the period January-May of 2005**



Source: Ministry of Finance, ISSP calculations

Net receivables were highest in the month of May in the amount of €1.4 million, this is likely due to total lending being the highest in that month as compared to the whole observed period and the fact that there were no loan repayments.

**Box 3.**

A budget rebalance was announced at the beginning of the year and so far has not taken place. The received money from “Telekom’s” privatization will not be used for infrastructure purposes, but rather for the repayment of debt and strengthening of reserves. This was IMF’s recommendation, all in the aim of achieving macroeconomic stability and avoiding deficit budget financing.

<sup>6</sup> This category comprises funds for enterprise restructuring, which are planned in the Ministry of Finance and for student credits and development of small and medium enterprises.

### **5.1.3 Budget balance and financing**

#### **Total budget balance**

In February and April, the budget balance was negative and amounted to -€4.49 million and -€1.93 million, respectively. In January, March and May the budget was positive, amounting to €7.51 million, €0.85 million and €6.70 million, respectively. So, at the end of the first five months of 2005, the Republic's budget had a surplus of €8.64 million.

#### **Financing**

In the analyzed period, privatization receipts totaled €111.07 million, while net domestic and foreign financing was negative, amounting to -€29.76 million, since debts were repaid in higher amounts as compared to the Government's borrowing. So, total financing of the republic budget amounted to €81.31 million.

#### **Box 4.**

In order to collect data from all banks on payment of the first frozen savings bonds tranche, the Ministry of Finance temporarily stopped repayment of the frozen savings as well as bonds trading on the stock market.

### **5.1.4 Treasury bills**

In the period from January to April 2005, 17 auctions of 28-day, 56-day, 91-day and 182-day treasury bills were held. Total offered value amounted to 76.9 million euro, with a weighted interest rate of 9.05%.

#### **Box 5. Treasury bills**

Government of Montenegro will issue treasury bills in 2005 in an amount that will not increase the net debt by more than 14 million euro. Treasury bills can be issued in a series, starting on February 1st 2005. They can be issued on the date of maturity from 28, 56, 91 and 182 days. Treasury bills will be issued in dematerialized form in appointments of 100 euro. They can be sold as discounted, by auction method.

#### **January 2005**

In January 2005 four auctions of treasury bills were held, one each for 28-day, 56-day, 91-day and 182-day. The total offered value was 19.9 million euro and the weighted average interest rate at the auctions in January was 9.05%. The weighted average interest rate on auction of 28-day treasury bills was 8.89%; on auction of 56-day treasury bills was 8.78%; on auction of 91-day treasury bills was 8.65% and on auction of 182-day treasury bills was 9.88%. The weighted average interest rates in January, as compared with December 2004, were 3.6% lower. The lowest weighted interest rate at auctions in January was 7.80%, while the highest was 9.88%.

#### **February 2005**

In February 2005 three auctions of treasury bills were held and their total offered value was 16.5 million euro. Auctions held in February included 28-day, 56-day and 182-day treasury bills. The weighted average interest rate on auctions in February was 8.96%. According to each auction, the weighted average interest rate was 9.0% on 28-day treasury bills, 8.95%

## Chapter 5. Budget

on 56-day treasury bills, and 8.95% on 182-day treasury bills. The weighted average interest rates in February as compared to January 2005 were 1.0% lower. The lowest weighted interest rate at auctions in February was 8.50%, while the highest was 9.70%.

### *March 2005*

In March 2005 six auctions of treasury bills were held with total offered value of 31.5 million euro. Auctions in March included one auction of 28-day and 182-day treasury bills; two auctions of 56-day, and three auctions of 91-day treasury bills. The weighted average interest rate was 9.4%. Observing each auction, the weighted average interest rate of 28-day treasury bills was 9.22%, 9.35% and 9.39%, while the weighted average interest rate on 56-day treasury bills was 9.03% and 10.20%, on 91-day treasury bills it was 9.68%, and it was 8.95% on 182-day treasury bills. The weighted average interest rates in March, as compared with February 2005, were 4.9% higher. The lowest weighted interest rate at auctions in March was 8.0%, while the highest was 12.0%.

### *April 2005*

In April 2005 three auctions of treasury bills were held with a total offered value of 9 million euro. The weighted average interest rate was 8.81%. On the auction of 28-day treasury bills, the weighted average interest rate was 8.33%, while it was 8.61% on the auction of 91-day treasury bills, and 9.48% on the auction of 182-day treasury bills. The weighted average interest rates in April, as compared with March 2005, were 4.25% lower. The lowest weighted interest rate at auctions in April was 7.50%, while the highest was 9.50%.

### *May 2005*

In May 2005 only one auction of 56-day treasury bills was held with a total offered amount of 4 million euro and a weighted average interest rate of 8.3%.

**Table 5. 2 Overview of 28-day T-bill auctions, held in period January-May 2005**

No.	Date of auction	Date of maturity	Amount of issue	Amount of sold T-bills	Weighted average interest rate
1	20.01.2004.	17.02.2005.	8.7	8.273	8.89%
2	17.02.2005.	17.03.2005.	8.5	8.5	9.00%
3	17.03.2005.	14.04.2005.	9	9	9.22%
4	14.04.2005.	12.05.2005.	5	5	8.33%

Source: Central Bank of Montenegro

Note 1: Interest rates are expressed in annual terms.

Note 2: Amount of issued and sold T-bills in million euro

**Table 5.3 Overview of 56-day T-bill auctions, held in period January-May 2005**

No.	Date of auction	Date of maturity	Amount of issue	Amount of sold T-bills	Weighted average interest rate
1	12.01.2005.	8.03.2005.	5.6	5.6	8.78%
2	3.02.2005.	31.03.2005.	5	4.7	8.95%
3	9.03.2005.	4.05.2005.	6	6	9.35%
4	31.03.2005.	26.5.2005.	5	5	9.38%
5	05.05.2005.	30.06.2005.	4	4	8.30%

Source: Central Bank of Montenegro

Note 1: Interest rates are expressed in annual terms.

Note 2: Amount of issued and sold T-bills in million euro

**Table 5.4 Overview of 91-day T-bill auctions, held in period January-May 2005**

No.	Date of auction	Date of maturity	Amount of issue	Amount of sold T-bills	Weighted average interest rate
1	20.01.2005.	21.03.2005.	2	2	8.65%
2	24.03.2005.	23.06.2005.	2.5	2	9.03%
3	30.03.2005.	29.06.2005.	2.5	2.5	10.20%
4	31.03.2005.	30.06.2005.	5.5	4.830	9.68%

Source: Central Bank of Montenegro

Note 1: Interest rates are expressed in annual terms.

Note 2: Amount of issued and sold T-bills in million euro

**Table 5.5 Overview of 182-day T-bill auctions, held in period January-May 2005**

No.	Date of auction	Date of maturity	Amount of issue	Amount of sold T-bills	Weighted average interest rate
1	13.01.2005.	13.07.2005.	3.6	3.517	9.88%
2	24.02.2005.	25.08.2005.	3	3	8.95%
3	11.03.2005.	09.09.2005.	1	1	8.95%
4	07.04.2005.	06.10.2005.	2	2	9.48%

Source: Central Bank of Montenegro

Note 1: Interest rates are expressed in annual terms.

Note 2: Amount of issued and sold T-bills in million euro

## 5.2 SOCIAL FUNDS

The remainder of this chapter presents a short analysis of revenue and expenditures execution in social funds (Pensions, Health and Employment) during the analyzed period.

**Table 5.6: Social funds revenues and expenditures (in million €)**

Social funds	I-V revenues in 2004	I-V revenues in 2005	I-V expenditures in 2004	I-V expenditure in 2005
Pension Fund	66.439	65.24	64.869	64.91
Health insurance Fund	33.824	35.512	36.500	36.508
Employment Fund	4.318	7.187	3.771	6.672

Source: Social Funds, Ministry of Finance, ISSP calculations

### *Pension Fund*

News in the pension system:

- Ministry of Finance prepared a Draft Law on Voluntary Pension Funds, according to which the cash portion of the seed capital of a Company for management of voluntary pension funds cannot be lower than €0.125 million. The Pension Fund does not have the status of a legal entity and it is planned that it should conduct its business on the principles of security, reduction, and dispersion of risk and professional management. At the moment, all interested parties in this process are giving suggestions and recommendations on this Draft Law.
- On the basis of a specific Decree, the GoM permitted certain categories of bearers of pension rights, those who received their rights on the basis of the previous regulation, to receive compensation from the central budget. The Republic Budget will transfer money to the Pension Fund on the basis of the Pension Fund's financial plan.

### *Pension Fund budget*

At the end of May of 2005 the Pension Fund had a surplus of €0.33 million, with total revenues at €65.24 million and total expenditures at €64.91 million. In comparison with the same period last year, revenue execution is 2% lower, while expenditures are at the same level.

- The Pension Fund receives the largest part of its revenues from contributions payments. In the analyzed period, they were at €39.72 million, which is 17% higher than in the same period last year<sup>7</sup>. That means that until the end of May, about 37% of the planned amount of contributions has been paid. The coverage rate of pension expenditures (as the biggest expenditures category) by contributions payments was 0.82%, which means that contributions payments, still, are not at a satisfactory level. The second largest revenues category is related to the republic budget transfers, which totals €15.8 and represents about 24% of the planned annual amount. On the basis of shareholder capital, €3.68 million, or 5.6% of total revenues, was received. This amount is mainly due to the received amount of €3.38 million in the month of May. The rest of the revenue is related to the funds from loans, withdrawal of Jugopetrol funds, and other revenues (pensions return, interest, etc.).
- Traditionally, the greatest share is had by pensions, representing 74.2%, or in absolute terms, €48.44 million. So far, pension payments represent 35.64% of the annual planned amount. In the first five months of 2005, the Pension Fund paid €7.10 million in contributions, which is less than 1% lower as compared with the same period last year. At the same time, contributions payments execution represents about 26% of the annual plan. Compensations amounted to €1.59 million. “Other people care” was at €1.03 million, or about 40% of the planned amount. Material costs represented 1.4% of total expenditures, amounting to €0.91 million. The rest of expenditures in the amount of €0.72 million are related to the costs of pensions payments, funds for Special Service, investments, and loans repayments.

### *Health insurance Fund*

In the first five months of 2005, total revenues and expenditures of the Health insurance Fund amounted to €35.5 and €36.5 million, respectively. To that effect, the Health insurance Fund, in the analyzed period, had a deficit of €1.0 million. The deficit was impacted by the non-payment of funds from the republic (health care of unemployed persons, refugees and displaced persons and transfers for capital expenditures) in the months of January<sup>8</sup> and April, as well as the very low level of paid contributions from the republic budget in the amount of €1.3 million in the month of March<sup>9</sup>.

- In the first five months of 2005, the biggest revenues of the Health insurance Fund were *contributions for health care from the public sector*,<sup>10</sup> which amounted to €17.8 million, 19% higher than last year’s execution (primarily because of the higher payments from the Pension Fund). *Health care contributions from the real sector*<sup>11</sup> amounted to €15.6

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<sup>7</sup> Last year, the Pension Fund received 22% less than the planned contributions.

<sup>8</sup> In the month of March Health insurance Fund deficit amounted to € 0.9 million.

<sup>9</sup> In the month of March Health insurance Fund deficit amounted to €2.8 million.

<sup>10</sup> contributions for health care of employees, pensioners and non-employed persons (from Employment Fund)

<sup>11</sup> contributions from economic activity, self employed persons and agricultural workers

million, which is 4% lower than the same period in 2004, and generated 44% of total revenues. Innovation in comparison with last year is payment of refugees' and displaced persons' contributions from the Republic budget into the pension Fund budget. *Revenues from the republic budget* were at €2.0 million, which represents 27% of the planned annual transfer. *Other revenues*<sup>12</sup> amounted to €0.07 million.

- *Ambulant and clinic services* have the greatest share of about 35% in total revenues and amount to €12.9 million. In the period January-May of 2005, expenditures on medicines amounted to €10.8 million and were slightly higher than the same period of the previous year. Expenditures of treatments in hospitals amounted to €9.9 million or 23% of the planned annual amount. *Administrative expenditures of the Health insurance Fund* have a share of 3.3% in total expenditures and amount to €1.2 million. The rest, €1.8 million, is related to: orthopedic devices, travel expenses, compensation during sick leave, and other health care.

### ***Employment Fund***

At the end of May 2005, total revenues of the Employment Fund amounted to €7.19 million and were approximately 66% higher than the level in the same period of 2004. On the other hand, total expenditures amounted to €6.67 million and were 77% higher in comparison with the first five months of 2004. Consequently, the Employment Fund in this period had a surplus of €0.52 million.

- Uncommonly, in comparison with the previous years, the Employment Fund earned the greatest revenue in the amount of €2.58 million from the sale of shares. That revenue is the main reason for the much higher total revenue execution in comparison with 2004 when the sale of shares in the first five months amounted to only €0.16 million. In this period, the second largest revenue category was budget transfers, which amounted to €1.52 million, out of which 66% is related to cash compensation to unemployed persons and the rest are funds for new employees on the basis of the GoM program. At the same time, budget transfers were 51% higher than last year. About 21% of total revenues were generated by employment contributions, which were 4% higher than the same period in the previous year. On the basis of self-employment loans, €0.93 million was received, while fees for non-residents' employment amounted to €0.26 million.
- As usual, the greatest expenditures of the Employment Fund, in the analyzed period, are administrative costs of the Employment Fund employees, totaling €1.18 million. Gross cash compensation to unemployed persons is given in the amount of €1.63 million, which is 60% higher than the cash compensation that was given to unemployed persons during all of 2004. Similarly, self-employment loans amounted to €1.34 million and were 2% higher than those granted in 2004. To that effect, cash compensations and self-employment loans contributed to much higher expenditures execution as compared with the same period in 2004. Expenditures for new employees on the basis of the GoM program amounted to € 0.82 million, while material and other expenditures amounted to €0.77 million. The rest of expenditures (14%) are related to the preparation of workers, work of observatory, and the purchase of non-financial assets.

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<sup>12</sup> Revenues from insurance holders participation in health care and other revenues

**6. MONEY****6.1. MONETARY AGGREGATES**

In the first four months of 2005, monetary aggregates registered positive annual growth rates.

Monetary aggregate M0 registered an annual growth rate of 6.37% in April 2005, as well as increasing by 2.05% compared to the end of 2004. This increase was influenced by the increase of bank deposits within the Central Bank. Annual growth rates of these deposits were: 0.99% in January, 36.79% in February, 30.61% in March, and 61.11% in April 2005.

Monetary aggregate M1 (deposits of the Central Bank and Government are excluded) amounted to € 444 million at the end of April 2005, which is 13.97% higher compared to the same month in 2004, or 3.12% higher as compared to the end of the previous year. This aggregate realized the highest annual growth rate in March 2005, when it had a growth rate of 16.65%. This increase of M1 was influenced by the growth of demand deposits in euros, which was the majority of bank deposits. Bank demand deposits in euro (without Government deposits) registered growth of 45.49% in April 2005 compared to the same month last year. Nevertheless, the second component of the M1 monetary aggregate - demand deposits in other currencies (without Government deposits), registered negative annual growth of 27.30%.

Monetary aggregate M11 amounted to € 463.5 million at the end of April, which is 16.94% higher as compared to April of 2004, or 6.11% higher compared to the end of 2004. This increase was mainly influenced by the increase of demand deposits in euro within the Central Bank of Montenegro, which registered an increase of 238.77% in April. These deposits registered growth of 1,076.87% in April 2005 when compared to the end of 2004. This increase was caused by the inflow of money from “Telecom’s” privatization. Demand deposits in euros in banks (with Government deposits) also registered an increase of 50.69% in April 2005 as compared to April 2004. At the other side, demand deposits in other currencies (with the Governance deposits) registered negative annual growth rates during all four months of 2005, falling between -24.15% in March and -51.04% in January 2005.

The already mentioned inflow of money from the privatization of Telecom was reflected in the level of the monetary aggregates M2 and M21. In April 2005, the monetary aggregate M2 registered an annual growth rate of 18.67%. Additionally influencing the increased value of M2 were term deposits in euro (without Government deposits), which, compared to April 2004, increased 38.15%. However, term deposits in other currencies (without Government deposits) registered a negative annual growth rate of -82.84% in April.

The widest monetary aggregate, M21, amounted to € 677 million at the end of April 2005 and registered growth of 38.9% compared to the same month in 2004. Term deposits of the Government, in euro and in other currencies, showed a growth trend, which influenced the increase of overall deposits of this type (annual growth rate of term deposits in April 2005 amounted to 138.96% and 71.60% of the term deposits in other currencies).

The majority of M21 is related to the aggregate M11, which consists of demand deposits (68% of M21) and term deposits (32% of M21).



Table 6.1 Monetary aggregates, end of month, in 000 euro

	2003	2004												2005			
	XII	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	I	II	III	IV
<b>M0</b>	<b>284,909</b>	<b>287,193</b>	<b>280,347</b>	<b>281,275</b>	<b>279,117</b>	<b>281,920</b>	<b>283,695</b>	<b>288,879</b>	<b>299,300</b>	<b>292,280</b>	<b>290,181</b>	<b>290,897</b>	<b>290,935</b>	<b>287,562</b>	<b>291,512</b>	<b>290,848</b>	<b>296,909</b>
Banks' deposits with CBM- Payment Operations	34,909	37,193	30,347	31,275	29,117	31,920	33,695	38,879	49,300	42,280	40,181	40,897	40,935	37,562	41,512	40,848	46,909
Estimate of cash in circulation	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000	250,000
<b>M1</b>	<b>386,121</b>	<b>391,052</b>	<b>382,434</b>	<b>387,310</b>	<b>389,670</b>	<b>389,576</b>	<b>393,308</b>	<b>410,620</b>	<b>439,927</b>	<b>417,157</b>	<b>427,968</b>	<b>418,685</b>	<b>430,659</b>	<b>416,111</b>	<b>428,064</b>	<b>451,793</b>	<b>444,089</b>
M0	284,909	287,193	280,347	281,275	279,117	281,920	283,695	288,879	299,300	292,280	290,181	290,897	290,935	287,562	291,512	290,848	296,909
Demand deposits in EUR	83,148	84,268	85,445	90,508	94,638	91,435	98,495	109,231	126,067	110,533	126,168	118,148	130,220	118,566	124,830	148,976	135,610
Demand deposits within banks in EUR	82,688	82,445	83,518	89,168	93,181	89,423	94,889	105,902	123,326	107,996	122,653	115,362	129,813	118,413	124,793	148,963	135,570
Demand deposits within CBM- Payment Operations in EUR	460	1,823	1,927	1,340	1,457	2,012	3,606	3,329	2,741	2,537	3,515	2,786	407	153	37	13	40
Demand deposits in other currencies	18,064	19,591	16,642	15,527	15,915	16,221	11,118	12,510	14,560	14,344	11,619	9,640	9,504	9,983	11,722	11,969	11,570
<b>M11</b>	<b>402,586</b>	<b>400,366</b>	<b>391,913</b>	<b>394,775</b>	<b>396,409</b>	<b>398,675</b>	<b>399,198</b>	<b>416,972</b>	<b>447,869</b>	<b>424,993</b>	<b>434,108</b>	<b>427,719</b>	<b>436,876</b>	<b>430,423</b>	<b>439,820</b>	<b>476,246</b>	<b>463,571</b>
M0	284,909	287,193	280,347	281,275	279,117	281,920	283,695	288,879	299,300	292,280	290,181	290,897	290,935	287,562	291,512	290,848	296,909
Demand deposits in EUR	98,776	91,992	93,954	97,531	100,908	100,043	103,921	115,080	133,591	117,472	131,943	126,805	136,064	132,491	136,408	173,286	154,936
Demand deposits within banks in EUR	97,894	89,923	88,621	95,050	99,376	96,127	99,425	110,357	130,159	112,810	127,128	122,477	135,623	126,023	132,762	155,678	149,746
Demand deposits within CBM- Payment Operations in EUR	882	2,069	5,333	2,481	1,532	3,916	4,496	4,723	3,432	4,662	4,815	4,328	441	6,468	3,646	17,608	5,190
Demand deposits in other currencies	18,901	21,181	17,612	15,969	16,384	16,712	11,582	13,013	14,978	15,241	11,984	10,017	9,877	10,370	11,900	12,112	11,726
<b>M2</b>	<b>460,837</b>	<b>470,602</b>	<b>465,199</b>	<b>467,799</b>	<b>473,032</b>	<b>480,053</b>	<b>485,328</b>	<b>503,033</b>	<b>535,928</b>	<b>517,416</b>	<b>531,556</b>	<b>523,180</b>	<b>535,550</b>	<b>522,016</b>	<b>537,908</b>	<b>565,852</b>	<b>561,341</b>
M1	386,121	391,052	382,434	387,310	389,670	389,576	393,308	410,620	439,927	417,157	427,968	418,685	430,659	416,111	428,064	451,793	444,089
Term deposits in EUR	71,229	75,811	78,422	75,681	77,120	84,555	85,872	86,265	84,034	97,414	98,423	97,928	98,128	97,304	102,132	104,334	106,541
Term deposits in other currencies	3,487	3,739	4,343	4,808	6,242	5,922	6,148	6,148	11,967	2,845	5,165	6,567	6,763	8,601	7,712	9,725	1,071
<b>M21</b>	<b>494,290</b>	<b>489,035</b>	<b>483,563</b>	<b>485,177</b>	<b>487,620</b>	<b>496,274</b>	<b>497,293</b>	<b>516,633</b>	<b>551,720</b>	<b>533,682</b>	<b>545,950</b>	<b>540,472</b>	<b>546,287</b>	<b>540,856</b>	<b>555,080</b>	<b>707,024</b>	<b>677,325</b>
M11	402,586	400,366	391,913	394,775	396,409	398,675	399,198	416,972	447,869	424,993	434,108	427,719	436,876	430,423	439,820	476,246	463,571
Term deposits in EUR	88,203	84,916	87,293	85,580	84,969	91,677	91,947	93,513	91,884	105,844	106,677	106,186	102,648	101,832	107,548	221,053	203,043
Term deposits in other currencies	3,501	3,753	4,357	4,822	6,242	5,922	6,148	6,148	11,967	2,845	5,165	6,567	6,763	8,601	7,712	9,725	10,711

\* without excluded required which banks have in treasure bills

\*\* without Government

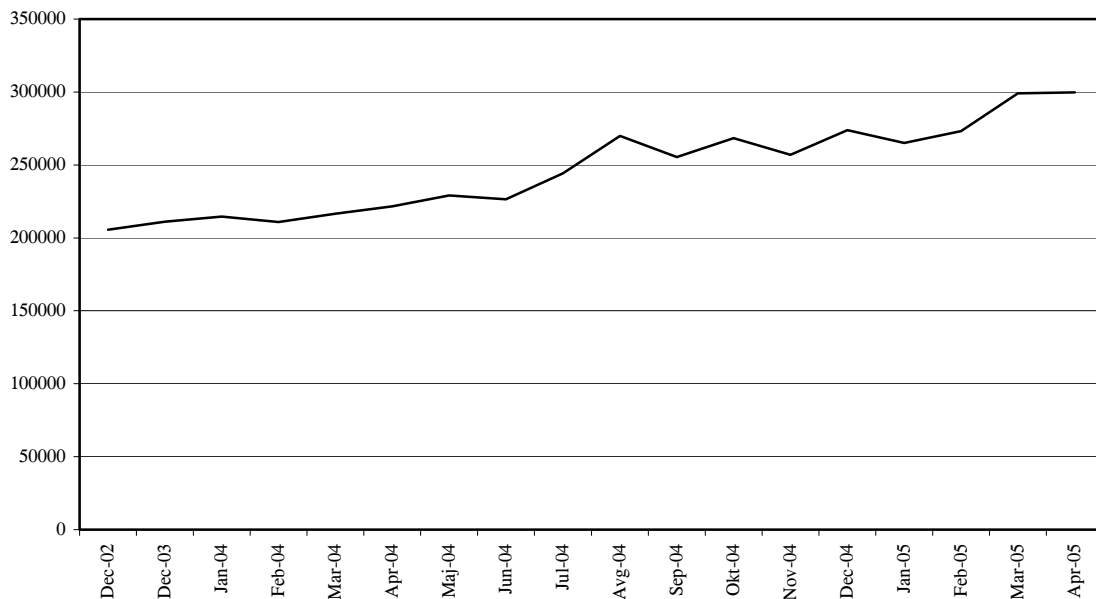
\*\*\* with Government

**6.2. DEPOSITS**

**Total deposits**

Total deposits continue to grow and at the end of April 2005 they reached € 299.8 million and were 35.25% higher as compared to the same month in 2004.

**Graph 6.1: Total deposits in 000 €**



Observed by deposit categories, financial institutions' deposits realized annual growth of 77.23% in April 2005, while non-financial institutions' deposits registered a negative growth rate of -8.22%. From April 2004 to April 2005, deposits of the government increased by 33.79% and deposits of physical entities increased by 101.2%, while deposits of non-profit organizations in the same period decreased by 23.60%. The categories of deposits that registered the highest growth rates in April 2005 are deposits of other domestic financial institutions (569.66%) and deposits of foreigners (442.87%). Domestic private companies registered negative growth rates (-17.67%).

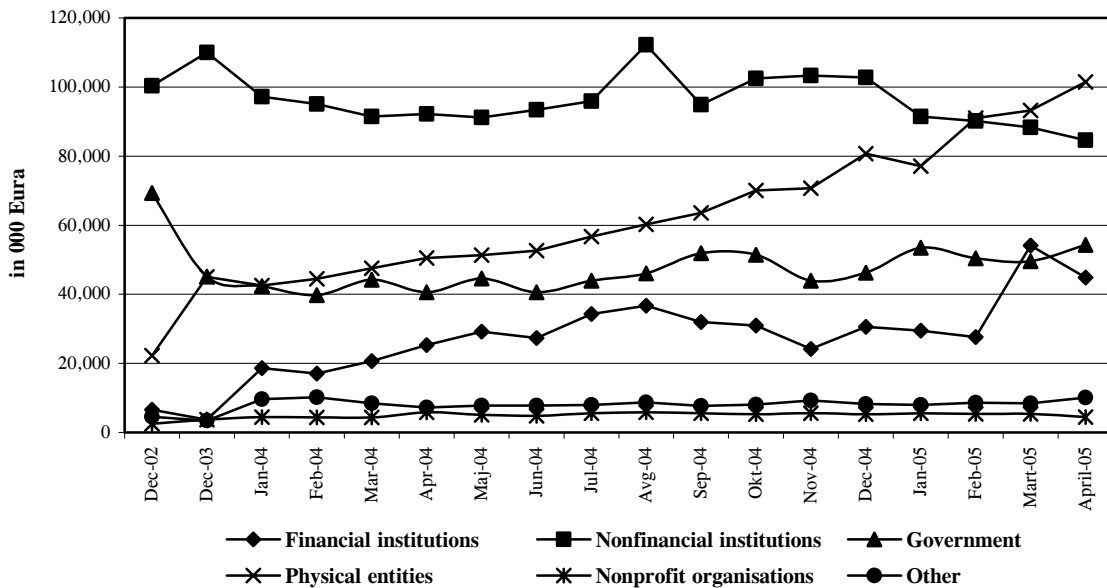
From the total amount of deposits, 55.03% are related to demand deposits and 44.97% to term deposits. The term structure of deposits varies when observed by deponents. Participation of demand deposits is lowest at financial institutions, and significantly higher at non-financial institutions and physical entities. For example, in April 2005, the highest participation of demand deposits in total deposits was registered at entrepreneurs (demand deposits share - 99.86%) and the lowest at foreign banks (demand deposits share - 9.54%). It is very interesting to note that the structure of deposits of physical entities in April 2005 was 47.82% of demand deposits and 52.18% of term deposits.

Table 6.2: Total deposits, in 000 EUR

Description/ Period	2002			2003			2004			2005											
	Demand deposits	Term deposits	Total	Demand deposits	Term deposits	Total	Demand deposits	Term deposits	Total	I			II			III			IV		
1 Financial institutions	4.938	1.662	6.600	2.454	1.284	3.738	10.706	19.876	30.582	8.402	21.107	29.509	9.347	18.304	27.651	30.486	23.632	54.118	14.168	30.670	44.838
Banks	3.658	1.653	5.311	1.081	764	1.845	6.006	12.297	18.303	4.406	13.888	18.294	3.375	10.873	14.248	1.765	14.244	16.009	3.511	11.922	15.433
Domestic	485	992	1.477	489	364	853	4.846	368	5.214	3.156	395	3.551	2.385	380	2.765	1.256	773	2.029	2.350	919	3.269
Foreign	3.173	661	3.834	592	400	992	1.160	11.929	13.089	1.250	13.493	14.743	990	10.493	11.483	509	13.471	13.980	1.161	11.003	12.164
Other financial institutions	1.280	9	1.289	1.373	520	1.893	4.700	7.579	12.279	3.996	7.219	11.215	5.972	7.431	13.403	28.721	9.388	38.109	10.657	18.748	29.405
Domestic	1.262	9	1.271	1.359	520	1.879	4.569	6.679	11.248	3.865	6.319	10.184	5.941	6.531	12.472	28.680	8.488	37.168	10.512	17.848	28.360
Foreign	18	0	18	14	0	14	131	900	1.031	131	900	1.031	31	900	931	41	900	941	145	900	1.045
2 Non financial institutions	69.331	30.999	100.330	69.942	40.042	109.984	68.475	34.289	102.764	59.519	31.970	91.489	59.002	31.161	90.163	57.282	30.981	88.263	56.655	27.979	84.634
Public non fin. corporations	22.779	7.347	30.126	12.037	9.986	22.023	12.687	10.730	23.417	6.613	13.076	19.689	6.640	11.843	18.483	8.559	11.319	19.878	9.096	8.129	17.225
State companies	3.746	3.667	7.413	4.670	4.791	9.461	5.581	6.734	12.315	4.902	9.200	14.102	4.769	8.978	13.747	6.173	9.592	15.765	5.987	5.666	11.653
Publicly owned organizations	19.033	3.680	22.713	7.367	5.195	12.562	7.106	3.996	11.102	1.711	3.876	5.587	1.871	2.865	4.736	2.386	1.727	4.113	3.109	2.463	5.572
Other non financial corp.	46.552	23.652	70.204	57.905	30.056	87.961	55.788	23.559	79.347	52.906	18.894	71.800	52.362	19.318	71.680	48.723	19.662	68.385	47.559	19.850	67.409
Domestic private companies	41.972	23.370	65.342	52.640	28.916	81.556	51.555	19.251	70.806	48.539	16.576	65.115	48.084	16.022	64.106	43.274	15.630	58.904	40.544	15.828	56.372
Entrepreneurs			0			0	1.057	2	1.059	1.227	12	1.239	1.188	12	1.200	1.321	12	1.333	1.424	2	1.426
Foreign companies	4.580	282	4.862	5.265	1.140	6.405	3.176	4.306	7.482	3.140	2.306	5.446	3.090	3.284	6.374	4.128	4.020	8.148	5.591	4.020	9.611
3 Government	58.238	11.078	69.316	19.402	25.685	45.087	18.124	28.111	46.235	24.457	29.053	53.510	21.352	29.062	50.414	20.753	28.813	49.566	28.267	25.995	54.262
Central government	40.221	7.077	47.298	5.738	8.223	13.961	6.176	4.507	10.683	7.996	4.516	12.512	8.147	4.416	12.563	4.948	5.651	10.599	14.333	5.650	19.983
Agencies and institutions of central gov.	13.907	1.246	15.153	9.468	258	9.726	6.342	6.339	12.681	9.757	7.339	17.096	6.072	7.351	13.423	9.377	5.744	15.121	9.553	3.686	13.239
Local government-municipalities	339	44	383	1.324	10	1.334	1.843	186	2.029	1.958	436	2.394	1.888	396	2.284	1.498	219	1.717	1.333	316	1.649
State funds	3.771	2.711	6.482	2.872	17.194	20.066	3.763	17.079	20.842	4.746	16.762	21.508	5.245	16.899	22.144	4.930	17.199	22.129	3.048	16.343	19.391
4 Physical entities	11.469	10.743	22.212	22.206	22.864	45.070	40.143	40.536	80.679	35.620	41.465	77.085	45.877	45.104	90.981	43.572	49.661	93.233	51.794	49.680	101.474
Domestic	11.469	10.743	22.212	22.206	22.864	45.070	37.027	38.613	75.640	31.459	39.601	71.060	34.782	43.100	77.882	37.530	42.963	80.493	41.698	45.493	87.191
Foreign			0			0	3.116	1.923	5.039	4.161	1.864	6.025	11.095	2.004	13.099	6.042	6.698	12.740	10.096	4.187	14.283
5 Non profit organizations	1.315	1.229	2.544	2.452	1.285	3.737	5.089	171	5.260	5.368	194	5.562	5.086	243	5.329	5.177	243	5.420	4.227	243	4.470
Domestic	298	234	532	1.601	235	1.836	3.928	110	4.038	4.816	110	4.926	3.940	159	4.099	3.335	159	3.494	3.943	159	4.102
Foreign	1.017	995	2.012	851	1.050	1.901	1.161	61	1.222	552	84	636	1.146	84	1.230	1.842	84	1.926	284	84	368
6 Other	2.954	1.574	4.528	1.376	2.016	3.392	7.864	371	8.235	7.433	522	7.955	7.370	1.260	8.630	8.006	464	8.470	9.869	255	10.124
Total	148.245	57.285	205.530	117.832	93.176	211.008	150.401	123.354	273.755	140.799	124.311	265.110	148.034	125.134	273.168	165.276	133.794	299.070	164.980	134.822	299.802

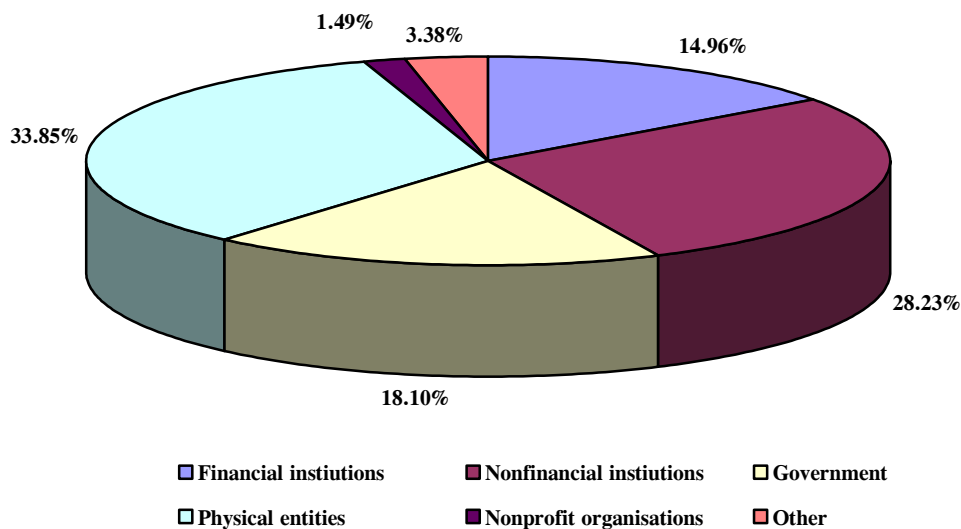
Source: Central Bank of Montenegro

Graph 6.2. Trend of different categories of total deposits



The structure of total deposits by deponents in April 2005 shows that the biggest deponents are domestic physical entities (29.08%) and public non-financial corporations (28.23%). Participation of domestic private company deposits in total deposits amounted to 18.80%. Significant deponent is the Government, and participation of these deposits in the total amounted to 18.10%. The following graph presents the structure of total deposits.

Graph 6.3.: Structure of total deposits by clients (April 2004)



If we compare the structure of total deposits in April 2005 with the structure in April 2004, we can conclude that participation of deposits of financial institutions in total deposits showed a negligible increase, while participation of Government deposits was on almost the same level. However, participation of non-financial institutions' deposits decreased from 41.60% (April 2004) to 28.23% (April 2005). Analysis of domestic private companies' deposits show that their participation decreased from 30.89% (April 2004) to 18.80% (April 2005). The share of deposits of domestic physical entities increased from 21.59% (April 2004) to 29.08% (April 2005).

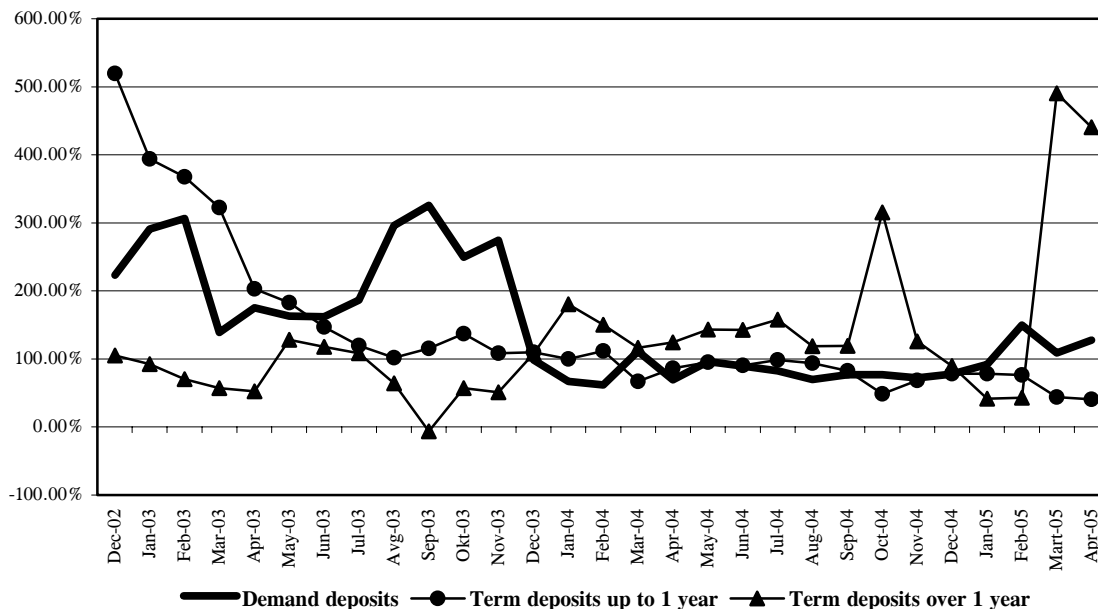
*Deposits of households in 000 euros*

	1. Demand deposits	2. Term savings up to 1 year	3. Term savings over 1 year	Total (1+2+3)
Dec-00	2,034.94	428.46	2.05	2,465.45
Okt-01	1,750.66	655.48	56.75	2,462.89
Nov-01	2,092.21	809.38	466.30	3,367.88
Dec-01	3,516.67	1,557.40	549.64	5,623.70
Jan-02	2,843.81	2,089.65	617.13	5,550.58
Feb-02	2,791.00	2,336.00	702.00	5,829.00
Mar-02	4,139.00	3,418.00	741.00	8,298.00
Apr-02	4,874.00	4,443.00	773.00	10,090.00
Maj-02	4,329.00	4,732.00	525.00	9,586.00
Jun-02	4,629.00	5,609.00	615.00	10,853.00
Jul-02	5,036.00	6,089.00	702.00	11,827.00
Avg-02	4,269.00	7,217.00	928.00	12,414.00
Sep-02	3,984.00	7,669.00	1,663.00	13,316.00
Okt-02	5,686.00	8,012.00	1,038.00	14,736.00
Nov-02	5,205.00	9,515.00	1,099.00	15,819.00
Dec-02	11,370.00	9,650.00	1,127.00	22,147.00
Jan-03	11,122.00	10,326.00	1,188.00	22,636.00
Feb-03	11,339.00	10,926.00	1,194.00	23,459.00
Mar-03	9,887.00	14,446.00	1,166.00	25,499.00
Apr-03	13,409.00	13,466.00	1,179.00	28,054.00
Maj-03	11,379.00	13,368.00	1,199.00	25,946.00
Jun-03	12,133.00	13,848.00	1,340.00	27,321.00
Jul-03	14,433.00	13,386.00	1,463.00	29,282.00
Avg-03	16,917.00	14,576.00	1,522.00	33,015.00
Sep-03	16,967.00	16,512.00	1,554.00	35,033.00
Okt-03	19,863.00	18,983.00	1,633.00	40,479.00
Nov-03	19,502.00	19,851.00	1,658.00	41,011.00
Dec-03	22,559.00	20,258.00	2,341.00	45,158.00
Jan-04	18,560.00	20,639.00	3,331.00	42,530.00
Feb-04	18,359.00	23,115.00	2,987.00	44,461.00
Mar-04	20,865.00	24,108.00	2,525.00	47,498.00
Apr-04	22,730.00	25,102.00	2,647.00	50,479.00
Maj-04	22,314.00	26,104.00	2,914.00	51,332.00
Jun-04	22,986.00	26,393.00	3,254.00	52,633.00
Jul-04	26,320.00	26,592.00	3,770.00	56,682.00
Avg-04	28,716.00	28,277.00	3,327.00	60,320.00
Sep-04	29,980.00	30,168.00	3,407.00	63,555.00
Okt-04	35,105.00	28,203.00	6,786.00	70,094.00
Nov-04	33,571.00	33,388.00	3,743.00	70,702.00
Dec-04	40,143.00	36,097.00	4,433.00	80,673.00
Jan-05	35,621.00	36,794.00	4,722.00	77,283.00
Feb-05	45,877.00	40,828.00	4,267.00	90,982.00
Mar-05	43,573.00	34,753.00	14,902.00	93,234.00
Apr-05	51,794.00	35,366.00	14,306.00	101,474.00

Source: Central Bank of Montenegro

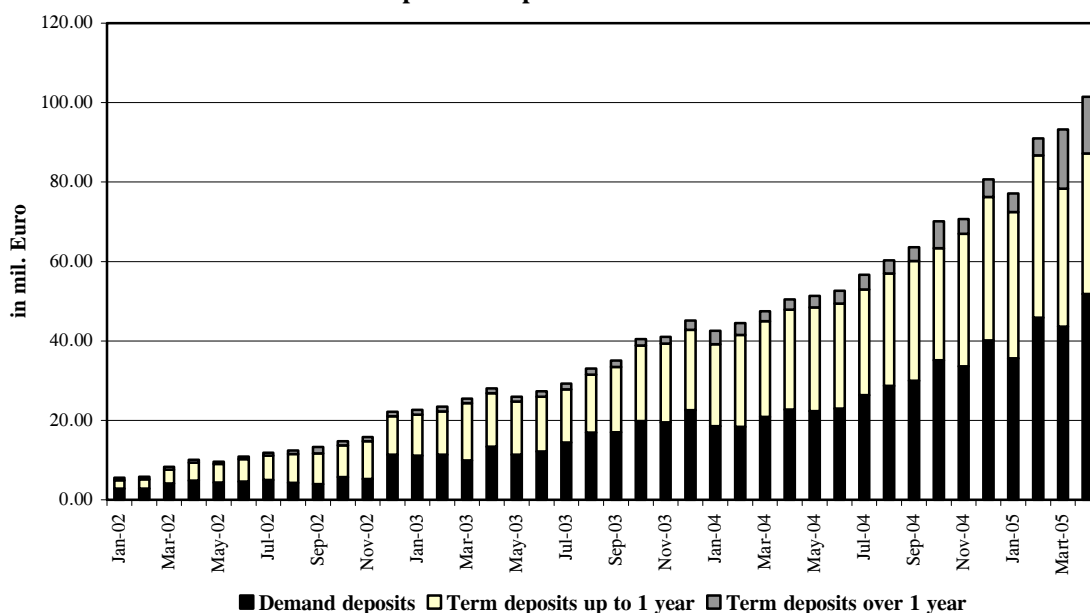
Total household deposits registered an increasing trend during the first four months of 2005 and at the end of April they reached € 101.47 million, which is growth of 101.02% compared to April 2004.

Graph 6.4. Annual change of deposits



Demand deposits registered significant annual growth rates – 91.92% in January, 149.89% in February, 108.83% in March, and 127.87% in April 2005. It is very important to note that term deposits over the one-year period registered significant growth. Annual growth rates of this category of household deposits amounted to around 42% in January and February and 490.18% in March and 440.46% in April 2005. At the end of April 2005, term deposits over one year reached € 14.3 million.

Graph 6.5. Deposits of households



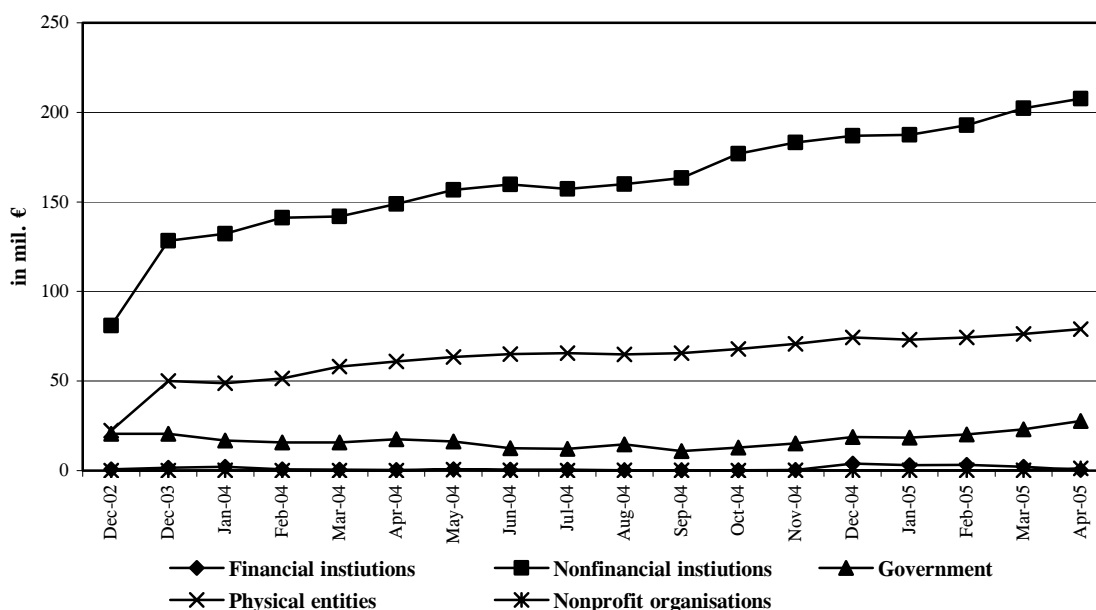
As the previous graph presented, the highest participation was had by demand deposits (51.04% in April 2005). The share of term deposits up to one year in total deposits decreased, especially in March and April 2005. Namely, the share of these deposits in total households' deposits in the first 5 months of 2005 amounted to 47.61% in January, 44.87% in February, 37.28% in March, and 34.85% in April. The share of term deposits over one year increased; it was 6.11% in January, 4.69% in February, 15.98% in March, and 14.10% in April 2005. The share realized in March and April was the highest share of these deposits in total since December 2000.

### 6.3. LOANS

Total loans provided by Montenegrin banks have been growing during the first four months of 2005 and reached € 315.81 million in April, which is 38.57% higher compared to the same month of 2004.

Loans approved for financial institutions registered annual growth rates of 49.66% in January, 380.54% in February, 340.04% in March, and -18.66% in April 2005. Loans to other (non-banking) financial institutions registered high annual growth rates of 1132.46% in January, 1795.10% in February, and 251.68% in March; while in April, these loans registered a negative rate of -27.54%.

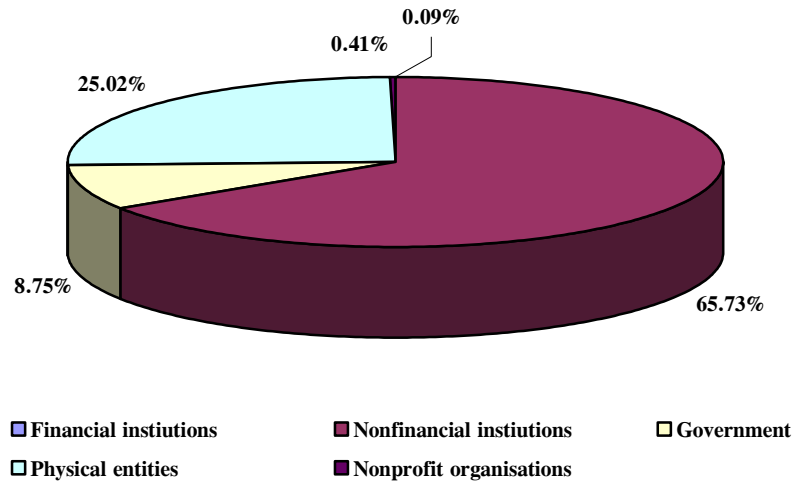
Graph 6.6. Loans provided by banks in Montenegro



Loans to non-financial institutions registered annual growth rates of 41.73% in January, 36.59% in February, 42.56% in March, and 39.39% in April 2005. Part of these loans, loans to domestic private companies registered annual growth rates of 46.90% in January, 38.74% in February, 44.21% in March, and 38.68% in April 2005. At the end of April 2005, the level of loans approved for domestic private companies amounted to € 177.12 million. Loans to foreign companies registered the highest annual growth of all loan categories: 44,950% in January, 44,750% in February, and 45,100% in March 2005. At the end of April 2005, loans to foreign companies reached € 1.8 million. Loans to physical entities were 29.48% higher in April 2005 compared to the same month in 2004 and reached

€ 79.01 million. Loans to the Government amounted to € 27.63 million at the end of April 2005, which is 57.44% higher compared to the same month in 2004.

Graph 6.7. Structure of loans provided (April 2004)



The structure of approved loans in April 2005 shows that the majority of loans (65.73%) were approved to non-financial institutions. More precisely, the majority of total loans were approved to domestic private companies (56.08%). Loans approved to physical entities accounted for 25.02% of total loans.



Table 6.2. Approved loans in 000 euros

	2002	2003	2004												2005			
	XII	XII	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	I	II	III	IV
<b>1 Financial institutions</b>	<b>788</b>	<b>1,695</b>	<b>2,078</b>	<b>668</b>	<b>472</b>	<b>359</b>	<b>646</b>	<b>609</b>	<b>488</b>	<b>121</b>	<b>128</b>	<b>160</b>	<b>424</b>	<b>3,854</b>	<b>3,110</b>	<b>3,210</b>	<b>2,077</b>	<b>292</b>
<b>Banks</b>	<b>35</b>	<b>1,525</b>	<b>1,850</b>	<b>525</b>	<b>25</b>	<b>25</b>	<b>323</b>	<b>400</b>	<b>325</b>	<b>0</b>	<b>25</b>	<b>25</b>	<b>32</b>	<b>1,000</b>	<b>300</b>	<b>500</b>	<b>505</b>	<b>50</b>
Domestic	35	1,525	1,825	525	25	25	23	100	25	0	25	25	32	1,000	300	500	505	50
Foreign	0	0	25	0	0	0	300	300	300	0	0	0	0	0	0	0	0	0
<b>Other financial institutions</b>	<b>753</b>	<b>170</b>	<b>228</b>	<b>143</b>	<b>447</b>	<b>334</b>	<b>323</b>	<b>209</b>	<b>163</b>	<b>121</b>	<b>103</b>	<b>135</b>	<b>392</b>	<b>2,854</b>	<b>2,810</b>	<b>2,710</b>	<b>1,572</b>	<b>242</b>
Domestic	753	170	228	143	447	334	323	209	163	121	98	130	392	2,819	2,810	2,705	267	238
Foreign	0	0	0	0	0	0	0	0	0	0	5	5	0	35	0	5	1,305	4
<b>2 Non financial institutions</b>	<b>80,984</b>	<b>128,338</b>	<b>132,275</b>	<b>141,169</b>	<b>141,941</b>	<b>148,918</b>	<b>156,730</b>	<b>159,832</b>	<b>157,311</b>	<b>159,958</b>	<b>163,248</b>	<b>176,912</b>	<b>183,237</b>	<b>186,934</b>	<b>187,470</b>	<b>192,828</b>	<b>202,348</b>	<b>207,570</b>
<b>Public non financial corporations</b>	<b>10,641</b>	<b>14,186</b>	<b>17,198</b>	<b>16,859</b>	<b>16,211</b>	<b>16,423</b>	<b>17,747</b>	<b>18,061</b>	<b>18,382</b>	<b>16,188</b>	<b>14,026</b>	<b>15,483</b>	<b>17,329</b>	<b>18,969</b>	<b>17,325</b>	<b>18,595</b>	<b>21,725</b>	<b>24,377</b>
State companies	8,448	12,413	15,401	14,963	13,945	13,464	14,364	14,018	14,213	11,847	9,370	10,004	11,874	11,267	9,687	10,644	12,932	15,834
Publicly owned organizations	2,193	1,773	1,797	1,896	2,266	2,959	3,383	4,043	4,169	4,341	4,656	5,479	5,455	7,702	7,638	7,951	8,793	8,543
<b>Other non financial corporations</b>	<b>70,343</b>	<b>114,152</b>	<b>115,077</b>	<b>124,310</b>	<b>125,730</b>	<b>132,495</b>	<b>138,983</b>	<b>141,771</b>	<b>138,929</b>	<b>143,770</b>	<b>149,222</b>	<b>161,429</b>	<b>165,908</b>	<b>167,965</b>	<b>170,145</b>	<b>174,233</b>	<b>180,623</b>	<b>183,193</b>
Domestic private companies	70,305	114,148	110,638	120,020	121,168	127,717	133,802	136,664	132,656	137,385	142,763	154,597	158,874	161,188	162,529	166,511	174,740	177,121
Entrepreneurs			4,435	4,286	4,558	4,778	5,177	5,103	5,269	5,385	5,455	5,828	6,030	5,773	5,814	5,928	4,075	4,263
Foreign companies	38	4	4	4	4	0	4	4	1,004	1,000	1,004	1,004	1,004	1,004	1,802	1,794	1,808	1,809
<b>3 Government</b>	<b>20,531</b>	<b>20,570</b>	<b>16,844</b>	<b>15,760</b>	<b>15,705</b>	<b>17,555</b>	<b>16,194</b>	<b>12,433</b>	<b>12,177</b>	<b>14,728</b>	<b>10,832</b>	<b>12,911</b>	<b>15,110</b>	<b>18,788</b>	<b>18,438</b>	<b>20,281</b>	<b>22,990</b>	<b>27,638</b>
Central government	16,373	16,495	13,813	13,050	12,349	13,832	12,933	8,213	7,755	7,379	6,278	5,905	6,027	9,162	6,758	6,726	6,814	5,097
Agencies and institutions of central government	916	141	678	160	598	505	490	477	460	661	504	1,134	1,049	435	255	364	405	387
Local government-municipalities	842	910	1,129	1,136	1,165	1,459	1,467	1,463	1,644	1,392	1,435	1,334	1,390	1,735	2,116	2,199	2,018	2,743
State funds	2,400	3,024	1,224	1,414	1,593	1,759	1,304	2,280	2,318	5,296	2,615	4,538	6,644	7,456	9,309	10,992	13,753	19,411
<b>4 Physical entities</b>	<b>22,290</b>	<b>49,959</b>	<b>48,809</b>	<b>51,504</b>	<b>58,138</b>	<b>61,022</b>	<b>63,350</b>	<b>65,029</b>	<b>65,668</b>	<b>64,816</b>	<b>65,578</b>	<b>67,977</b>	<b>70,734</b>	<b>74,325</b>	<b>73,154</b>	<b>74,377</b>	<b>76,268</b>	<b>79,014</b>
Domestic	22,290	49,959	45,817	51,504	58,138	61,013	63,341	65,020	65,660	64,808	65,570	67,970	70,650	74,236	73,066	74,287	76,180	78,927
Foreign			2,992	0	0	9	9	9	8	8	8	7	84	89	88	90	88	87
<b>5 Non profit organizations</b>	<b>70</b>	<b>63</b>	<b>142</b>	<b>66</b>	<b>9</b>	<b>49</b>	<b>561</b>	<b>126</b>	<b>83</b>	<b>120</b>	<b>127</b>	<b>88</b>	<b>104</b>	<b>180</b>	<b>114</b>	<b>124</b>	<b>178</b>	<b>1,301</b>
Domestic	70	63	142	66	9	49	48	126	83	120	127	88	104	180	114	124	178	227
Foreign	0	0	0	0	0	0	513	0	0	0	0	0	0	0	0	56	0	1,074
<b>6 Other</b>		<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total</b>	<b>124,663</b>	<b>200,625</b>	<b>200,148</b>	<b>209,167</b>	<b>216,265</b>	<b>227,903</b>	<b>237,481</b>	<b>238,029</b>	<b>235,727</b>	<b>239,743</b>	<b>239,913</b>	<b>258,048</b>	<b>269,609</b>	<b>284,081</b>	<b>282,288</b>	<b>290,820</b>	<b>303,861</b>	<b>315,815</b>

Source: Central Bank of Montenegro

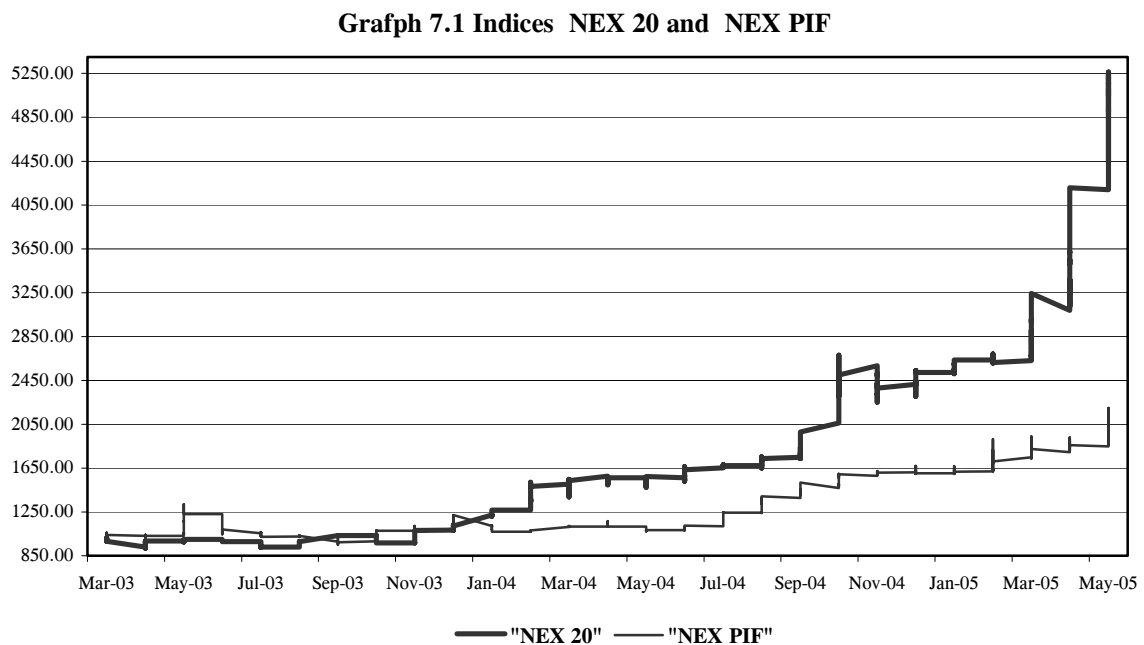
**7. CAPITAL MARKET**

- *High growth rates of indices*
- *Stock exchange turnover in the first five months of 2005 was two times higher than the entire 2004 year*
- *The stock exchanges realized 140% more transactions than in the same period in 2004*

**7.1. INDICES**

Indices values in 2005 are a good indicator of the situation on the Montenegrin stock exchanges. High indices growth rates indicate that the Montenegrin capital market is developing, as well as that the capital market has become a significant part of the Montenegrin economy.

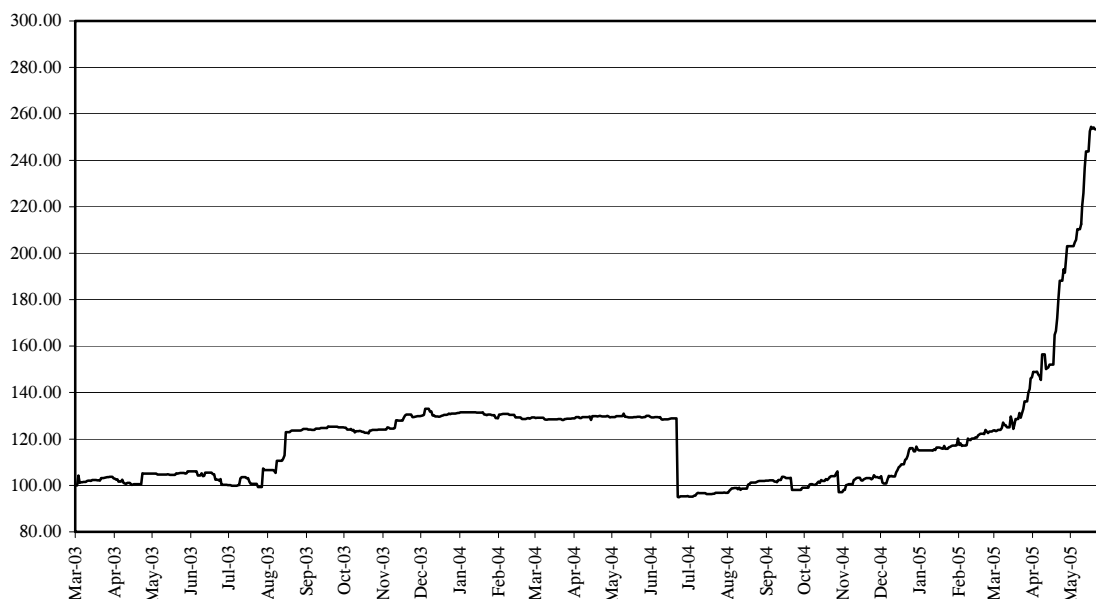
The next graph presents the indices from their introduction through the end of May 2005<sup>1</sup>.



Source: NEX Montenegro and Montenegroberza

<sup>1</sup> We presented the MOSTE index separate from NEX 20 and NEX PIF because the initial value for MOSTE was 100, while for NEX PIF and NEX 20, it was 1000 points.

Graph 7.2 Stock exchange index MOSTE



Source: NEX Montenegro and Montenegroberza

The movement of every index will be analyzed individually for the first 5 months of 2005.

The value of the Montenegroberza stock exchange, *MOSTE*, has remained at or near its initial value (100 index points) from the time of its introduction until the end of 2004, and then began to increase gradually in 2005, with marked increases in April and May. The lowest value in the 2005 index was recorded in January (115 points), and it has experienced continuous growth since then. The index realized its highest value at the end of May (260 points). The greatest influence on the index value increase was the price increase of the shares of Coal Mine Pljevlja, Lovcen Insurance and Plantaze, as well as investment units of PIFs MIG and HLT. Additionally, in 2005, trade with these securities was also reinforced, which also contributed to the index increase. At the end of May 2005, the index had doubled in value as compared to the same month in the previous year, while compared to the initial value, the index increased 160%.

Values of both NEX Montenegro stock exchange indices showed significant increases in value in 2005. The *NEX PIF* index, which presents the price trend of the investment units of PIFs, showed a growing value trend during 2005. The highest value for this index was reached at the end of May and it was 2,186 points. Compared to its initial value, the value of the index increased about 120%. Compared to the same period last year however, the value of the index at the end of May was two times higher. Influencing the index value increase was the price increase of investment units of all six Privatization Investment Funds, par excellence PIFs MIG, HLT and Trend.

The second index of the NEX Montenegro stock exchange, *NEX 20*, continued to gain value in 2005. This index, as we have already written in previous MONET<sup>2</sup> issues, since the moment of its introduction has shown a continuous value increase. In 2005, the index recorded very high growth rates. On a monthly level, annual growth rates of the index amounted to: 107%, 76%, 111%, 170% and 213% (in January, February, March, April and May, respectively). The highest index value was reached on May 20<sup>th</sup>, and it was 5,263 points. The lowest index value occurred at the beginning of January (2,523 points), after

<sup>2</sup> MONET 14-19, chapter Capital market

## Chapter 7. Capital Market

which it exhibited continuous growth. The greatest influence on the increasing index value was the price increase of Telekom shares, as well as an increase of trade with these shares. At the end of May 2005, the value of the index was 400% higher than its initial value.

*Table 7.1. Stock exchange trade in Montenegro*

MONTH	MONTENEGROBERZA				NEX MONTENEGRO				TOTAL			
	TURNOVER (in €)			Number of transactions	TURNOVER (in €)			Number of transaction	TURNOVER (in €)			Number of transactions
	Primary	Secondary	Total		Primary	Secondary	Total		Primary	Secondary	Total	
<b>Total 03</b>	<b>8,799,736</b>	<b>17,636,926</b>	<b>26,436,662</b>	<b>5,993</b>	<b>1,990,881</b>	<b>15,126,802</b>	<b>17,117,683</b>	<b>15,331,107</b>	<b>10,790,617</b>	<b>32,763,728</b>	<b>43,554,345</b>	<b>21,324</b>
Jan-04	230,000	464,477,4	694,477,4	389	0	314,863	314,863	1,555	230,000	779,340	1,009,340	
Feb-04	0	530,885,3	530,885,3	639	0	1,822,403	1,822,403	2,347	0	2,353,288	2,353,288	2,986
Mar-04	780	1,008,168	1,008,948	1,853	0	474,788	474,788	2,589	780	1,482,956	1,483,736	4,442
Apr-04	0	429,683	429,683	2,082	0	960,508	960,508	2,424	0	1,390,191	1,390,191	4,506
May-04	0	547,176	547,176	1,470	0	1,701,167	1,701,167	1,812	0	2,248,343	2,248,343	3,282
Jun-04	0	1,001,662	1,001,662	1,698	1,584	767,002	768,586	1,563	1,584	1,768,664	1,770,248	3,261
Jul-04	0	2,628,140	2,628,140	1,292	1,000	1,009,365	1,010,365	1,617	1,000	3,637,505	3,638,505	2,909
Aug-04	0	961,001	961,001	2,377	0	2,072,318	2,072,318	1,962	0	3,033,319	3,033,319	4,339
Sep-04	0	985,597	985,597	3,070	0	989,159	989,159	3,048	0	1,974,756	1,974,756	6,118
Oct-04	0	723381	723,381	2,951	0	3,660,613	3,660,613	3,631	0	4,383,994	4,383,994	6,582
Nov-04	592,829	4,156,832	4,749,661	4,493	0	1,481,573	1,481,573	3,900	592,829	5,638,405	6,231,234	8,393
Dec-04	822,679	3,802,987	4,625,666	3,389	0	8,741,632	8,741,632	5,206	822,679	12,544,619	13,367,298	8,595
<b>Total-04</b>	<b>1,646,288</b>	<b>17,239,990</b>	<b>18,886,278</b>	<b>25,703</b>	<b>2,584</b>	<b>23,399,539</b>	<b>23,997,975</b>	<b>31,654</b>	<b>1,648,872</b>	<b>41,235,381</b>	<b>42,884,253</b>	<b>57,357</b>
Jan-05	0	605,009	605,009	1,992	0	1,886,401	1,886,401	3,007	0	2,491,410	2,491,410	4,999
Feb-05	0	1,161,632	1,161,632	2,615	0	9,708,671	9,708,671	4,719	0	10,870,303	10,870,303	7,334
Mar-05	11,964	3,430,230	3,442,194	3,919	0	39,747,684	39,747,684	6,794	11,964	43,177,914	43,189,878	10,713
Apr-05	137,219	2,794,549	2,93,768	2,971	0	17,486,055	17,486,055	6,202	137,219	20,280,604	20,417,823	9,173
May-05	0	5,783,934	5,783,934	4,241	0	7,453,604	7,453,604	4,214	0	13,237,538	13,237,538	8,455
<b>Total 05</b>	<b>149,183</b>	<b>13,775,354</b>	<b>13,924,537</b>	<b>15,738</b>	<b>0</b>	<b>76,282,415</b>	<b>76,282,415</b>	<b>24,936</b>	<b>149,183</b>	<b>90,057,769</b>	<b>90,206,952</b>	<b>40,674</b>

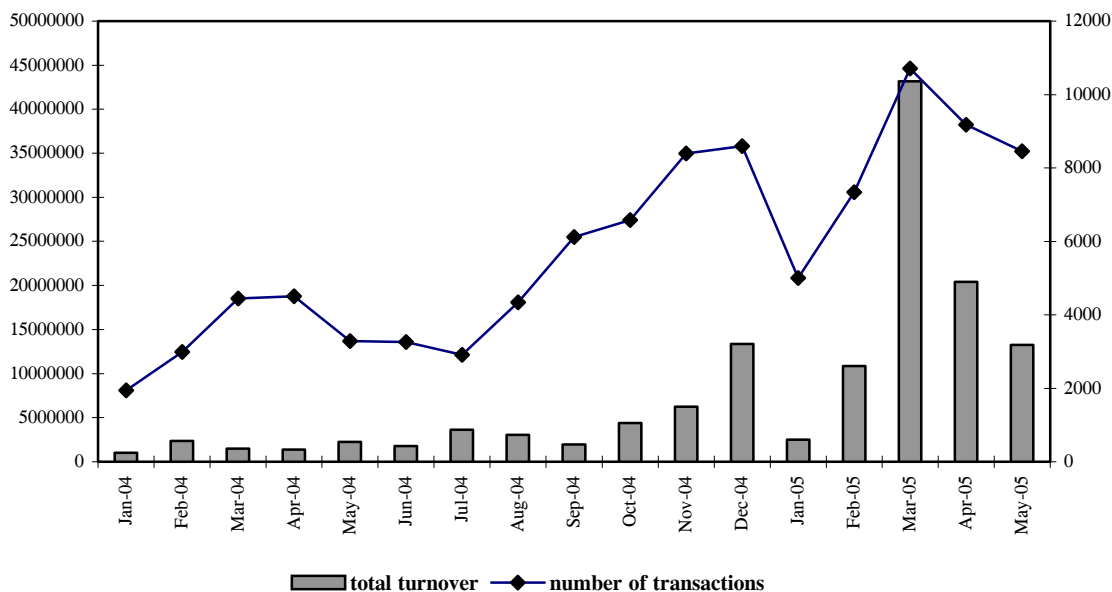
Source: Montenegroberza and NEX Montenegro

### 7.2 TURNOVER ON STOCK EXCHANGES

The trade volume realized in the first five months of 2005, which amounted to about € 90 million, put the Montenegrin capital market in the sectors of economy which has significant contribution to the GDP growth. The total turnover realized on the stock exchanges in the first 5 months of 2005 is twice as high as the turnover realized in the entire year last year. Additionally, the number of transactions (40,674) indicates that Montenegrin citizens now comprehend the capital market as a financial resource, as well as a possibility to earn money.

The next graph presents total turnover and the number of transactions in 2004 and 2005.

Graph 7.3 Total turnover and number of transactions

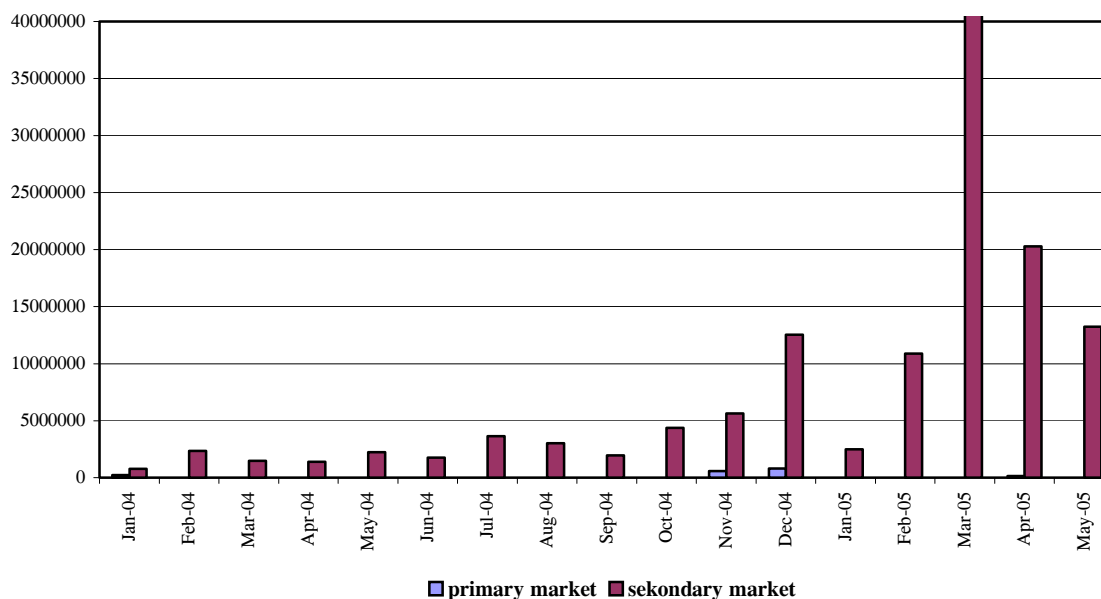


Source: Montenegroberza and NEX Montenegro

The increase in turnover that was recorded in 2004 was continued and reinforced in 2005. The realized number of transactions also followed the turnover trend. The highest turnover was realized in March in the amount of € 43 million, of which 92% was realized on the NEX Montenegro stock exchange. The majority of turnover on the NEX Montenegro stock exchange was related to trade with Telekom shares (40%). The greatest number of transactions was also registered during the March (10,713). The lowest turnover, as well as the fewest transactions, was realized in January (€ 2.4 million of turnover and 4,999 transactions).

Trade on the primary market in the first five months of 2005, similar to 2004, was negligible (0.2%). Nearly all turnover was realized on the secondary market (99.8%).

Graph 7.4 Primary and secondary market



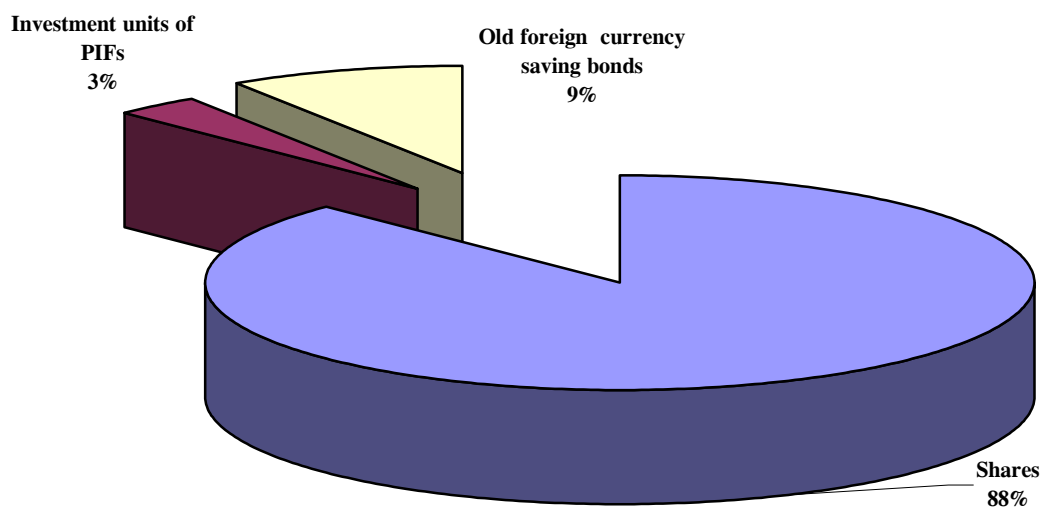
Source: Montenegroberza and NEX Montenegro

**7.2.1. Trade in the secondary market**

Turnover of € 90,057,769 was realized on the secondary market in the first five months of 2005. Compared to the same period in 2004, turnover increased more than 10 times. Furthermore, turnover on the secondary market in 2005 was two-times higher than total turnover for the whole 2004 year.

Increased interest of domestic and foreign investors for shares of Montenegrin companies' such as Telekom, Plantaze, the Coal Mine and Electricity Company, as well as for PIFs, reinforced capital market development and put it closer to the level of the capital markets in the region of development.

**Graph 7.5 Structure of turnover on secondary market**



Source: NEX Montenegro and Montenegroberza

Graph 7.5 presents the structure of trade on the secondary market. The majority of turnover was realized with shares (88%), followed by foreign currency saving bonds (9%) and the rest are related to trade with investment units of PIFs (3%).

**Trade with shares**

During the analyzed period, shares of more than 60 companies were traded on the NEX Montenegro stock exchange. A similar situation was found on the Montenegroberza, where shares of more than 70 companies were traded. The following tables present shares with the highest turnover and those with the highest number of transactions.

Total turnover realized from shares of the following ten companies amounted to €59,886,217, making 66% of the total turnover realized on the secondary market. It is important to note that trade with Telekom shares recorded € 46 million, or more than 51% of all secondary trade.

Table 7.2 Ten shares with the highest turnover in first 5 months of 2005.

Issuer	Turnover in €
TELEKOM CRNE GORE A.D. PODGORICA	46,137,584 €
HTP "PRIMORJE"	3,361,141 €
SOLANA "BAJO SEKULIĆ"-ULCINJ	1,955,979 €
HTP "BOKA" AD - HERCEG NOVI	1,955,714 €
"LOVČEN OSIGURANJE" PODGORICA	1,725,251 €
"ELEKTROPRIVREDA CRNE GORE" A.D. NIKŠIĆ	1,506,530 €
AD PLANTAŽE	1,103,247€
RUDNIK UGLJA A.D.	966,837 €
HIPOTEKARNA BANKA A.D.	583,348 €
TI TITEX AD	570,586 €

Source: Security Exchange Commission of Montenegro

The total number of transactions realized with shares of the next ten companies amounted to 15,463, making 40% of the total number of transactions realized on the secondary market during the analyzed period. Half of these are related to trade with Telekom.

Table 7.3 Ten shares with the highest number of transactions in first 5 months of 2005

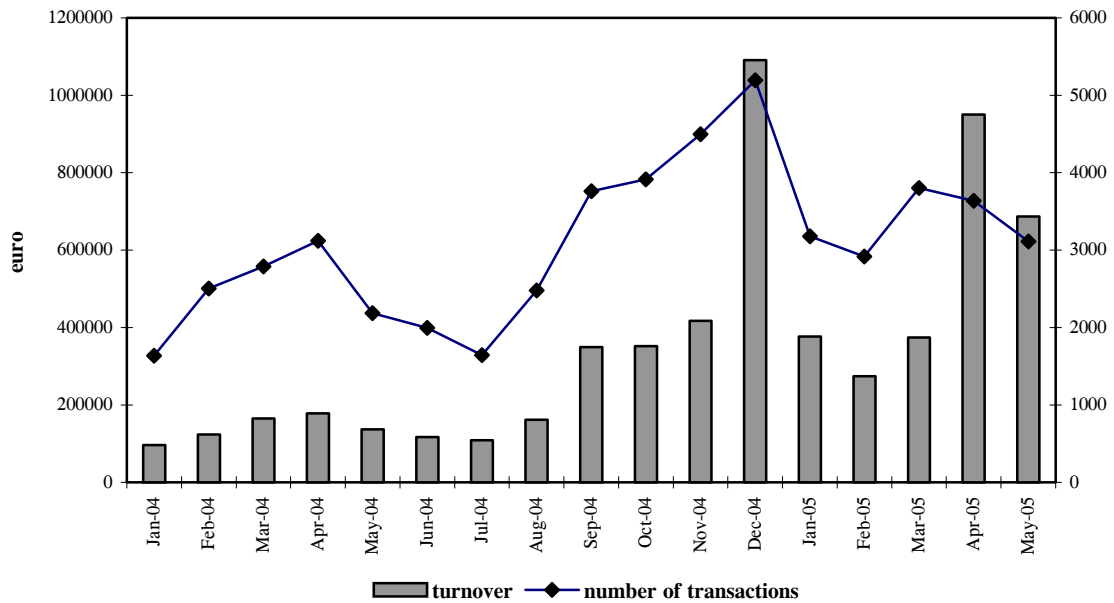
Issuer	Turnover in €
TELEKOM CRNE GORE A.D. PODGORICA	6,785
HK ŽELJEZARA NIKŠIĆ AD NIKŠIĆ	1,398
HTP "BOKA" AD - HERCEG NOVI	1,117
AD PLANTAŽE	1,207
"ELEKTROPRIVREDA CRNE GORE" A.D. NIKŠIĆ	1,343
RUDNIK UGLJA A.D.	944
JUGOPETROL AD	682
AD LUKA BAR - BAR	855
AD INDUST. KOŽE " POLIMKA " BERANE	386
HTP BUDVANSKA RIVIJERA	746

Source: Security Exchange Commission of Montenegro

*Trade with investment units of Privatization Investment Fund*

Investment units of all six Privatization Funds were traded on the Montenegrin stock exchanges in the first five months of 2005. In this period, a total of € 2,963,125 turnover were realized (33% on *NEX Montenegro* and 67% on *Montenegroberza*), with a total of 16,644 transactions (41% on *Montenegroberza* and 59% on *NEX Montenegro*).

**Graph 7.6 Turnover with investment units of PIFs**



*Izvor: Montenegroberza i NEX Montenegro*

As table 7.4 presents, the highest turnover was realized with investment units of HLT (60%), while the lowest turnover was realized by Eurofond (1.6%). The highest price increase was had by investment units of MIG (166%), then Eurofond (71%) and Atlas Mont (66%).

**Table 7.4 Prices and turnover with PIF investment units in the first five months of 2005**

Fund	min price	max price	turnover
"ATLAS MONT"	0.0128 €	0.0200 €	225,236 €
"EURO-FOND"	0.0070 €	0.0120 €	48,077 €
"MIG"	0.0151 €	0.0400 €	436,600 €
"MONETA"	0.0118 €	0.0228 €	96,385 €
"TREND"	0.0161 €	0.0230 €	366,350 €
"HLT-FOND"	0.0150 €	0.0220 €	1,769,701 €

*Source: Security Exchange Commission of Montenegro*



*Trade with shares of old foreign currency saving bonds*

Trade with old foreign currency saving bonds was reinforced during the first months in 2005. Total turnover realized with these securities amounted to € 8,339,718 million, through a total of 2,609 transactions. In *Montenegroberza*, 1 euro of old foreign currency savings was worth between € 0.41 and €0.95, while in the *NEX Montenegro*, 1 euro of old foreign currency savings was sold for between €0.47 and €0.95, depending on the maturity.

## **8. EXTERNAL SECTOR**

- *Exports within the foreign trade sector 6 – “manufactured goods that are classified chiefly by materials” had the highest share in the first quarter of 2005, amounting to €64 million, or 67.2% of goods export. Export of aluminium was one of the exports within this sector and it amounted to € 52.3 million, or 54.8% of total goods exports;*
- *Imports of goods within the foreign trade sector 3 – “Mineral fuels, lubricants and related materials,” were the most dominant in total goods imports, amounting to € 38.8 million, or 23.8% of total goods import within the first three months of 2005 (€ 28.2 million, or 17.3% of total import);*
- *Considering the goods export structure by country in the first quarter of 2005, the most dominant were Serbia and Kosovo (30.6%), Italy (28%), Greece (11.4%), Slovenia (11.3%), and Bosnia and Herzegovina with a share of 3.6% in total goods export.*
- *With respect to goods import by origin, the most dominant foreign trade countries were Serbia and Kosovo (30.2%), Greece (9.1%), Croatia (8.5%), Italy (7.2%), Great Britain (6.9%), and Slovenia with a share of 6.2% in total goods import in the first quarter of 2005;*
- *The trade deficit (goods + services) within the first quarter of 2005 amounted to € 69.3 million, a nominal decrease of 36% compared to the same period of 2004;*
- *The current account deficit amounted to € 34.5 million in the first quarter of 2005, a nominal decrease of 54% compared to the corresponding period of 2004.*

### **8.1. FOREIGN TRADE**

#### **8.1.1 Foreign Trade Structure by Goods**

Data, in compliance with SITC<sup>1</sup>, was obtained from the Central Bank of Montenegro and covers the divisional structure of imported and exported goods for the first quarters of 2004 and 2005.

On the export side, the most dominant sector in the first quarter of 2005 was sector 6<sup>2</sup>, which amounted to € 64 million, or 67.2% of total exported goods. Within sector 6, the most dominant sub-sector was #68, or “ferrous metals” (aluminium) on the export side, whose share amounted to € 52.3 million, or 54.8%, in the first quarter of 2005. The second most dominant sub-sector was #67, “iron and steel.”

Other dominant sectors on the export side were sector 0 (7.6% of total goods exported in Q1-2005) and sector 1, which shared 7.3% in total exports. The fourth dominant export sector was sector 7, which accounted for 6.4% of total goods exported, while its sub-sector 79 (“other transport equipment”) accounted for approximately 3% of total goods exported in the first quarter of 2005. Sector 8 accounted for 4.4% of total goods exported and the most important sub-sector within this sector was 89 – “other finished products.” The sixth most

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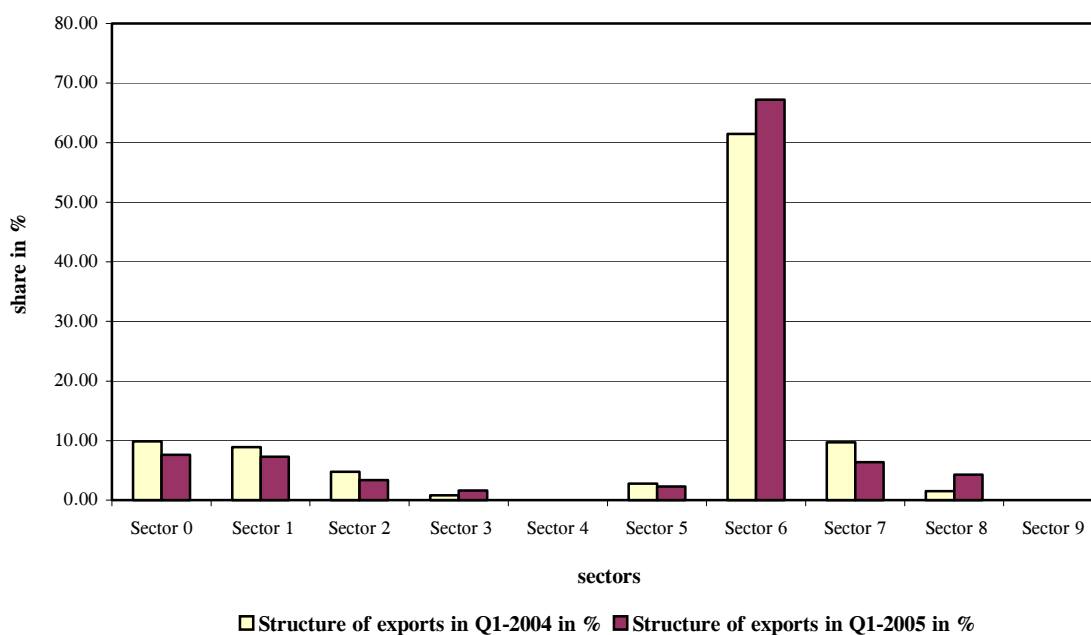
<sup>1</sup> Standard International Trade Classification

<sup>2</sup> Nine sectors according to SITC are the following: Sector 0: Food and live animals; Sector 1: Beverages and tobacco; Sector 2: Crude materials, inedible, except fuels; Sector 3: Mineral fuels, lubricants and related materials; Sector 4: Animal and vegetable oils and fats; Sector 5: Chemicals; Sector 6: Manufactured goods classified chiefly by materials; Sector 7: Machinery and transport equipment; Sector 8: Miscellaneous manufactured articles; Sector 9: Commodities and transactions, n.e.s.

dominant export sector in the first quarter of 2005 was sector 2 whose share accounted for 3.4% of total exports in the first quarter of 2005. The most dominant sub-sector within sector 2 was sub-sector 28 -“metal ores (nickel, aluminium and copper).” Generally, exports within sectors 6 and 8, as well as their share in total goods export, increased in the first quarter of 2005 as compared to the corresponding period of 2004, while exports within sectors 0, 1, 2, and 7, as well as their share in total goods export, decreased.

All together, the above-mentioned six export sectors (0, 1, 2, 6, 7, and 8) amounted to €91.6 million, or 96% of total exports in the first quarter of 2005 (see graph 8.1).

Graph 8.1: Structure of exports by SITC sectors



With respect to **imports** by sectors in the first quarter of 2005, sector 3 was the most dominant sector in the first quarter of 2005, accounting for 23.8% of total imported goods (or € 38.8 million). The most dominant sub-sectors within sector 3 were sub-sector 33 (Oil and oil derivatives) and sub-sector 35 (Electricity).

Sector 7, ranked second in the first quarter, accounted for 20.5% of total goods imported, or € 33.5 million. Its share decreased compared to the same period of 2004 when it accounted for 22.5% of total goods imported. The most dominant sub-sectors within sector 7 in the first quarter of 2005 were sub-sector 78 (vehicles) and sub-sector 77 (Electrical machines and equipment).

Other key imports in the first three months of 2005 were within sector 0, which accounted for 15.9% of total goods imported (or € 26 million). The most dominant sub-sectors within sector 0 were 01 (Meat and meat products), 07 (Coffee, tea, cocoa and spices), and 05 (Vegetables and fruits).

Sector 8, ranked fourth in the first three months of 2005, accounted for 13.8% of total imports, or € 22.5 million. Compared to the first quarter of 2004, imports within the most dominant sectors (3 and 8), as well as their share in total goods imported, increased in the first quarter of 2005. On the other hand, imports within sectors 0, 5, 6, and 7 declined compared to the same period of 2004.

Other key imports were within sectors 6 and 5 and accounted for 12.3% and 8.6% of total goods imported, respectively.

All together, the above-mentioned import sectors amounted to €141 million, or 94.9% of total goods imported in the first quarter of 2005 (see graph 8.2).

Graph 8.2: Imports structure by sectors



### 8.1.2 Foreign Trade Structure by Country of Destination and Origin

Foreign trade structure in the first quarter of 2005 and the corresponding period of 2004, by countries, is presented in table 8.1.

Table 8.1 Foreign Trade Structure by Countries

Country	Imports				Exports			
	2004 (jan-mart) in 000 €	2004 (jan-mart) In % of total imports	2005 (jan-mart) in 000 €	2005 (jan-mart) In % of total imports	2004 (jan-mart) in 000 €	2004 (jan-mart) In % of total imports	2005 (jan-mart) in 000 €	2005 (jan-mart) In % of total imports
Bonia and Herzegovina	5060.00	2.46	4618	2.83	2736	2.68	3459	3.63
Croatia	16692.00	8.12	13924	8.53	1271.2	1.25	1138	1.20
Slovenia	19140.00	9.32	10197	6.25	637.5	0.62	10775	11.30
Serbia and Kosovo	58070.00	28.26	49281	30.21	35910	35.20	29216	30.60
Italy	20638.00	10.04	11830	7.25	20584	20.18	26747	28.00
Greece	7499.00	3.65	14979	9.18	4542	4.45	10874	11.40
Germany	10086.00	4.91	6396	3.92	498	0.49	331	0.35
Cyprus	3621.00	1.76	1339	0.82	215.4	0.21	490	0.51
Hungary	2982.00	1.45	3388	2.08	702	0.69	874	0.92
Albania	504.40	0.25	298	0.18	1877	1.84	671	0.70
Austria	9237.00	4.50	7199	4.41	27.8	0.03	137	0.14
Great Britain	10508.00	5.11	11291.00	6.92	73.5	0.07	3180	3.33
Switzerland	4843.00	2.36	3068.00	1.88	17965	17.61	2296.2	2.41
USA	4337.40	2.11	1756.50	1.08	266.8	0.26	91.4	0.10
Other	32240.20	15.69	23578.90	14.45	14698.8	14.41	89.4	0.09
<b>Total</b>	<b>205458.00</b>	<b>100.00</b>	<b>163142.00</b>	<b>100.00</b>	<b>102005</b>	<b>100.00</b>	<b>95369</b>	<b>100.00</b>

Source: Central Bank of Montenegro.

In the first quarter of 2005, Serbia and Kosovo, Italy, Greece, and Slovenia were the most dominant destinations of exported goods with respective shares of 30.5%, 28.1%, 11.4% and 11.3% of total goods exported. The share of goods exported to Italy, Greece and Slovenia increased compared to the same period of 2004 when Italy's share was 20.17%, Greece had 4.5% of total exports, and Slovenia had 0.6% of exports. On the other hand, the share of exports to Serbia and Kosovo decreased from € 35.9 million, or 35.2%, in the first quarter of 2004 to € 29.2 million, or 30.6% of total exports, in the first quarter of 2005. The share of exports to Switzerland also declined from € 17.9 million, or 17.6% of total goods exported, in the first quarter of 2004 to € 2.3 million, or 2.4%, in the first quarter of 2005. The reason for this structural change is the export of aluminium, which is now recorded to be exported to Italy, Greece and Slovenia, which have aluminium plants and use primary aluminium for their production. During the previous years, it was recorded that aluminium was exported only to Switzerland where its main purchasing company (Glencor) was set up.

Exports to Bosnia and Herzegovina (BiH) accounted for 3.6% of total exports in the first quarter of 2005, compared to 2.7% in the same period of the previous year. Exports to Croatia declined from 1.3% in the first quarter of 2004 to 1.2% of total goods exported in the first quarter of 2005. In this period of 2005, Great Britain had a significant share of total exports (3.3%) compared to just 0.07% in the first quarter of 2004. The share of Albania and the USA decreased in total goods exported in 2005 and accounted for 0.7% and 0.1% respectively, while in same period of the previous year their respective shares were 1.8% and 0.3%.

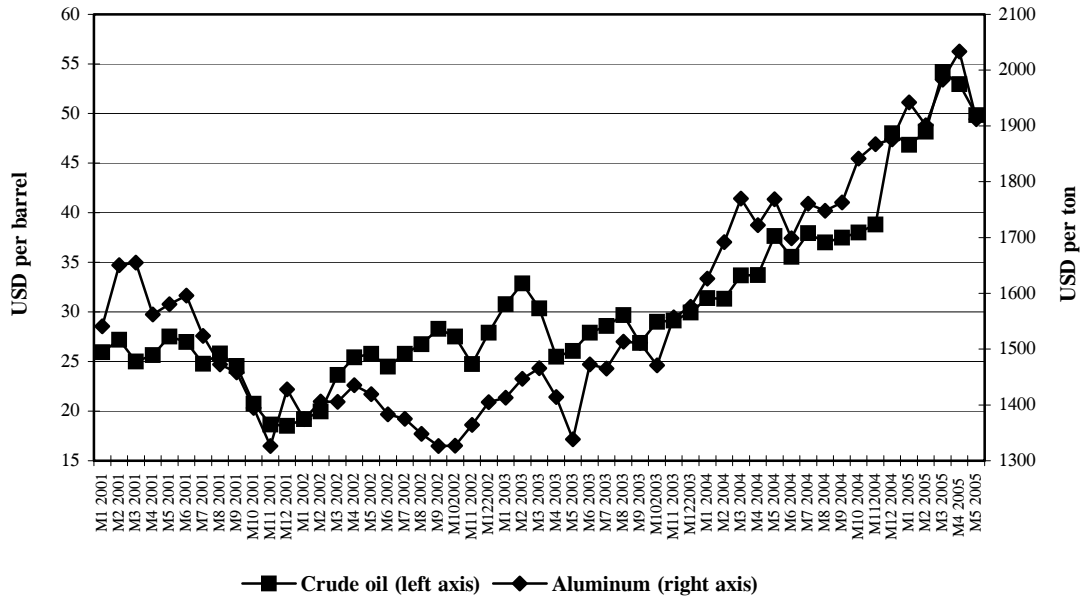
With respect to imports, according to the country of origin, in the first quarter of 2005, the most dominant trade partners were Serbia and Kosovo, Greece, Croatia, Italy, and Great Britain, which accounted for 30.2%, 9.2%, 8.5%, 7.2%, and 6.9% of total goods imported, respectively. Compared to the first quarter of 2004, these trade partners increased their share of total goods imported, they had 28.3% for Serbia and Kosovo, 3.7% for Greece, 28.1% for Croatia, and 5.1% for Great Britain.

Besides Italy, Great Britain and Greece, other important countries of origin within the developed countries were Austria (4.4% of total goods imports) and Germany (2.6%). The share of Slovenia declined from 9.3% in the first quarter of 2004 to 6.2% of total imports in the same period of 2005.

### **8.1.3 TERMS OF TRADE**

Terms of trade are defined as a ratio of the price level of the most important exports and the price level of the most important imports. In the last several years in Montenegro, the highest import share was held by oil and oil derivatives (8.0% in 2004 and 17% in the first quarter of 2005), while on the exports side, the most dominant is aluminium (49.7% of total exports in 2004 and 54.8% in the first quarter of 2005). Thus, the ratio of aluminium prices and the ratio of oil prices are used to measure Montenegrin terms of trade, despite the fact that they do not precisely represent the profitability of those terms of trade.

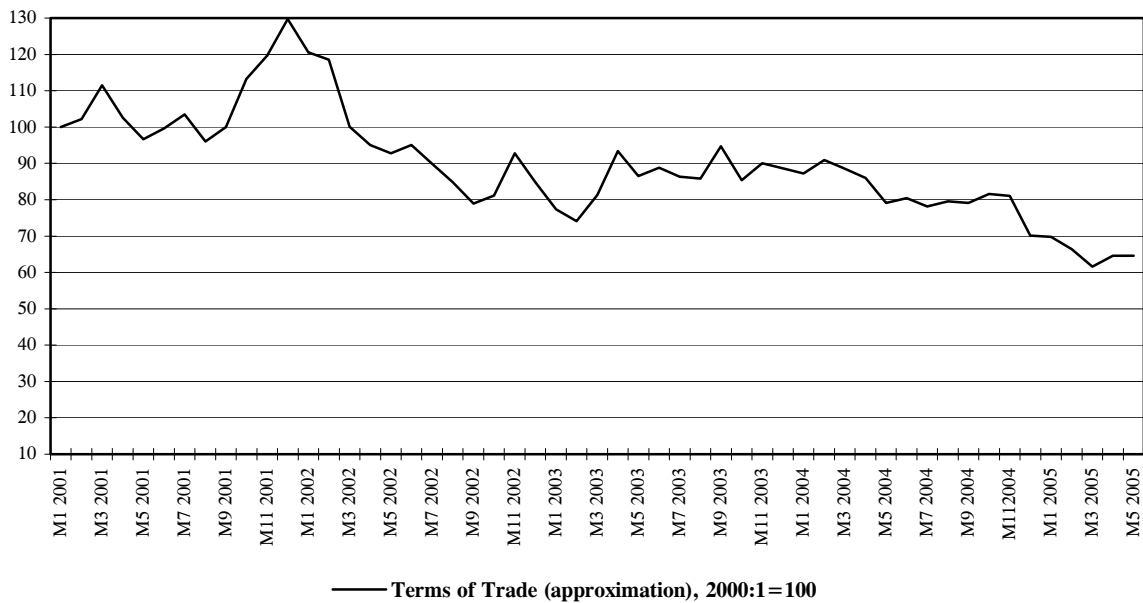
Graph:8.3 Prices of crude oil and aluminium prices



Source: KAP (export prices), International financial statistics (IFS)- average crude oil prices, SPOT oil)

Within the analysis, export prices of aluminium are given in USD per ton as provided by the Aluminium Plant Podgorica (KAP), along with world prices of crude oil (USD per barrel), as published by the IMF’s International Finance Statistics.

Graph 8.4: “Terms of trade” in Montenegro (approximation)



Source: ISSP calculations based on the data obtained from KAP and International Financial Statistics

Terms of trade estimation in Montenegro is shown in graph 8.4. The graph shows that Montenegrin terms of trade were improved in 2001 and then deteriorated in 2002. After that, they again improved in 2003 and then again deteriorated in 2004, due to the increased price of oil. In December 2004, terms of trade were at 70.1 (compared to 100 in 2000:1). At the end of the first quarter of 2005, terms of trade were deteriorated when the index was 61.6, and then again improved in May 2005, when they were 64.6. The reason for the general deterioration of the Montenegrin terms of trade was that the price of crude oil increased much faster than the price of aluminium exports, despite the fact that export prices

of aluminum in 2005 increased compared to 2004, when aluminum's price per ton reached € 2,033 in April and € 1,912 in May 2005.

## 8.2. BALANCE OF PAYMENTS

The following text presents the latest data on the Balance of Payments of Montenegro in the first quarter of 2005 and the corresponding period of 2004. The data are provided in € and were obtained from the Central Bank of Montenegro. The data are preliminary, due to the fact that there are some statistical weaknesses within the statistical system of Montenegro, which means that possible deviations from the final data are expected.

Generally, the Balance of Payments of Montenegro at the beginning of 2005 was followed by positive trends. This means that the most important positive changes in the first quarter of 2005 were a decrease of the current account deficit and a rather significant increase of inward FDI.

### 8.2.1 Current account

The current account deficit in Montenegro in the first quarter of 2005 amounted to € 34.5 million, a nominal decrease of 54% compared to the same quarter of 2004. Total revenues were equal to € 162.4 million, a decrease of 2% compared to the first quarter of 2004. On the other hand, total expenditures of the current account in the first quarter of 2005 amounted to €196.9 million, a nominal decrease of 18% compared to the same period of the previous year.

#### *Goods trade*

Total goods trade deficit in the first quarter 2005 was € 69.3 and nominally decreased by 36% compared to the same period of 2004. Total trade of goods (imports plus exports) was € 258.5 million in Q1-2005, a decrease of 16% compared to the corresponding period of 2004. Exports of goods amounted to € 95.4 million, a decrease of 6.5% compared to the same period of the previous year. Imported goods amounted to € 163.1 million and decreased by 20.6% compared to the first quarter of 2004. Overall, the ratio of exports to imports in the first quarter of 2005 was 58.5%, or 8.9 percentage points more than in the corresponding period of 2004.

Generally, the goods trade deficit in the first quarter of 2005 decreased due to the decrease in imports, especially imports from Serbia and Kosovo.

On the other hand, exports in the first quarter of 2005 increased as a result of a 6.4% increase in production in the processing industry sector, the main contributor to Montenegrin exported goods.

#### *Balance of services*

The balance of services deficit amounted to € 1.5 million in the first quarter of 2005 and decreased 68.2% compared to the corresponding period of 2004. Generally, this deficit for the entire year is positive due to the increase of revenues from tourism and transport during the summer season. However, in the first quarter of 2005, revenues from tourism amounted to € 3.6 million and increased 34.5%, while revenues from transport amounted to € 10.5 million and increased 12.7% compared to the first quarter of 2004. On the other hand,

expenditures from other services registered in the Balance of Payments statistics were higher than revenues, thus causing a deficit within the balance of services for the first quarter of 2005.

### *Income*

The surplus of income amounted to € 22.8 million, a nominal increase of 53.4% in the first quarter of 2005 compared to the same period of 2004. This increase is mainly due to a 17% increase of income of compensations of employees compared to the first quarter of 2004.

### *Transfers*

The net balance of transfers in the first quarter of 2005 was in surplus, amounting to € 12.1 million, a decrease of 36% compared to the corresponding period of 2004. This decrease of the surplus is primarily due to lower foreign assistance, which decreased by 44.6 % in Q1-2004 to € 1.6 million in Q1-2005.

## **8.2.2 Capital and financial account**<sup>3</sup>

### *Financial account*

In the financial account of Montenegro, “*foreign direct investments*” still make up the most significant position, amounting to € 161.2 million in the first quarter of 2005, a very significant increase of 1626% compared to the corresponding period of 2004. The main reason for the increase of foreign direct investments is the privatization process of the Telecom of Montenegro.

*Net portfolio investments* amounted to € 7.9 million, a significant increase from the € 0.14 million in the first quarter of 2004. The position of “*change in net foreign asset of commercial banks*” was negative and amounted to € -0.78 million in the first quarter of 2005. *The change in CBM foreign reserve assets* was also negative (€-109.7 million) in Q1-2005 while it was positive (€ 01.7 million) in the same period of 2004.

### *Net errors and omissions*

The total balances of the current, as well as capital and financial accounts, was positive and amounted to € 23.5 million in the first quarter of 2005 and was significantly improved compared to the same period of 2004, when it was negative. This surplus of the current, capital and financial account is set explicitly equal to the position “*net errors and omissions*”, in order to achieve the balance of payments equilibrium.

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<sup>3</sup> Data on capital and financial transactions are, until now, rather limited due to the ongoing process of adopting international standards, which would allow for proper registration of these transactions. Consequently, capital account transactions have not been registered in Montenegro at all since 2001.



Table 8.2: Balance of payments in 000 €

	2001	2002	2003	2004	Jan-mart 2004	Jan-mart 2005	Change in 2004 (in %) compared to the same period of 2004
<b>CURRENT ACCOUNT BALANCE</b>	<b>-195</b>	<b>-163409</b>	<b>-101,986</b>	<b>-142,968</b>	<b>-74568</b>	<b>-34501</b>	-54
Total current account revenues	631606	692315	642,531	830,398	166317	162370	-2
Total current account expenditures	827017	855724	744,517	973,366	240885	196871	-18
<b>GOODS AND SERVICES BALANCE</b>	<b>-390675</b>	<b>-323883</b>	<b>-247,597</b>	<b>-291,021</b>	<b>-108308</b>	<b>-69319</b>	-36
<b>GOODS BALANCE</b>	<b>-487527</b>	<b>-424705</b>	<b>-359,330</b>	<b>-430,900</b>	<b>-103453</b>	<b>-67773</b>	-34
Total export of goods	235365	322624	270574	381,607	102005	95369	-7
Export of goods excl. trade with Serbia and Kosovo	51952	54015	67849	101,484	66095	66153	0
Export of aluminum	157973	166715	109,726	158,069			
Export to Serbia and Kosovo	25440	101895	92,999	122,054	35910	29216	-19
Total import of goods	722892	747329	629,904	812,507	205458	163142	-21
Import of goods excl. oil, electricity and trade with Serbia and Kosovo	400629	413082	316,441	456,559	147388	113861	-23
Import of electricity	37211	48816	46,526	48,777			
Import of oil and oil derivatives	170558	106030	50,124	61,380			
Import from Serbia and Kosovo	114495	179401	216,813	245,791	58070	49281	-15
<b>SERVICES BALANCE</b>	<b>96852</b>	<b>100822</b>	<b>111,733</b>	<b>139,879</b>	<b>-4855</b>	<b>-1546</b>	-68
Total revenues from services	150228	175969	191,395	241,123	16576	21004	27
Total expenditures for services	53376	75147	79,662	101,244	21431	22550	5
Total Transportation Revenues	28384	32041	35,009	45,341	9308	10486	13
Transport official data about revenues	26404	29084	29,634	39,756	8464	8514	1
Transport revenues from Serbia	1981	2957	5,375	5,585	844	1972	134
Total Transportation Expenditures	20059	22029	25,904	29,378	6280	6697	7
Transport official data about expenditures	18652	17790	19,801	19,262	4282	4793	12
Transport expenditures to Serbia	1407	4239	6,103	10,116	1998	1904	-5
Balance of transportation services	8326	10012	9,105	15,963	3028	3789	25
Total Revenues from Tourism	105970	124236	136,046	163,495	2710	3644	34
Revenues from tourists abroad (estimate)	40580	61655	61,753	82,204	1247	2199	76
Revenues from tourists from Serbia	65390	62581	74,293	81,291	1463	1445	-1
Total Expenditures to Tourism	5020	8009	10,096	6,951	1656	1991	20
Expenditures for tourism abroad	4852	6394	8,043	5,214	1211	1040	-14
Expenditures for tourism in Serbia	167	1615	2,053	1,737	445	1445	225
Balance of tourism	100950	116227	125,950	156,544	1054	1653	57
Revenues from Financial Services	4094	2686	2,848	4,035	469	885	89
Commission fee	4044	2262	1,567	3,308	377	683	81
Commission fee on Serbian import/export (estimate)	50	424	1,281	727	92	202	120
Expenditures to financial services	3191	3332	6,761	6,462	1133	1821	61
Commission fee	3113	2814	5,517	5,290	953	1394	46
Commission fee on Serbian import/export (estimate)	78	52	1,244	1,172	180	427	137
Balance of financial services	903	655	-3913.00	-2427.00	-664	-936	41
Revenues from other Services	11779	12755	17,492	28,252	4089	5989	46
Expenditures for other services	25106	39133	36,901	58,453	12362	12041	-3
Balance of other services	-13327	-26378	-19409.00	-30201.00	-8273	-6052	-27
<b>INCOME BALANCE</b>	<b>46482</b>	<b>74201</b>	<b>99510</b>	<b>103834</b>	<b>14837</b>	<b>22763</b>	53
Income revenues	86777	99569	125,337	152,722	26198	30475	16
Compensation of employees	40841	46342	85,496	129,822	24072	28229	17
Revenues from Serbia for physical persons	44329	53226	39,261	22,314	1979	1981	0
Received dividends	170		3	45	13	0	-100
Interest revenues	1438	158	577.00	541	134	265	98
Income Expenditures	40295	25368	25,827	48,888	11361	7712	-32
Compensation of employees	33544	3155	3,362	6,289	609	2168	256
Expenditures for physical persons in Serbia	115	313	1,083	2,782	387	375	-3
Interest expenses	2287	13807	12,568	24,524	7444	5164	-31
Paid dividends	4349	8405	8,814	15,293	2921	5	-100
<b>CURRENT TRANSFERS BALANCE</b>	<b>148781</b>	<b>87056</b>	<b>46,101</b>	<b>44,219</b>	<b>18903</b>	<b>12055</b>	-36
Current transfers to Montenegro	159235	97267	55,225	54,946	21538	15522	-28
Transfers to Montenegro from abroad	11361	5488	3,188	8,568	7060	7508	6
Foreign assistance	69518	42074	21,807	20,078	7903	1607	-80
Foreign assistance financial and material (NGO, humanitarian organisations)	78357	50	30,230	26,300	6575	6407	-3
Expenditures	10454	10211	9,124	10,727	2635	3467	32
Transfers from Montenegro abroad	10454	10211	9,124	10,727	2635	3467	32
<b>CAPITAL AND FINANCIAL ACCOUNT BALANCE</b>	<b>11900</b>	<b>71843</b>	<b>133030</b>	<b>170,905</b>	<b>44407</b>	<b>58014</b>	31
<b>CAPITAL ACCOUNT</b>			0	0		0	
<b>FINANCIAL ACCOUNT</b>	11900	71843	133,030	170,905	44407	58014	31
Direct investment	10632	89183	38,725	50,015	9343	161244	1,626
Equity capital	4710	78112	38,725	50,015	9343	161244	1,626
Reinvested earnings and undistributed branch profits	5922	11071				0	
Portfolio investment-net	-12	-213	942	5,524	149	7883	5,191
Other investments	-6088	17369	47,047	98,170	13598	-673	-105
Loans	2925	24888	114,597	176,103	34490	8743	-75
Repaid loans	9014	7518	67,550	77,933	20892	9416	-55
Change in Net Foreign Assets	7369	-24144	45,759	32,237	19569	-780	-104
Change in CBM for. reserve assets (term deposits of CBM in for. banks)	0	-10352	557	-15,041	1748	-109660	-6,373
<b>BALANCE OF CURRENT ACCOUNT AND CAPITAL AND FINANCIAL ACCOUNT</b>	<b>-183511</b>	<b>-91566</b>	<b>31,044</b>	<b>27,937</b>	<b>-30161</b>	<b>23513</b>	-178
<b>NET ERRORS AND OMISSIONS</b>	<b>-183511</b>	<b>-91566</b>	<b>31,044</b>	<b>27,937</b>	<b>30161</b>	<b>23513</b>	-22

Source: Central Bank of Montenegro.

### 9. REGIONAL COMPARISON

- *All SEE countries increased their industrial production in first five months 2005, except Serbia and Montenegro where the level of industrial production within this period declined by 2.3% and 1.6% respectively compared to the corresponding period of 2004;*
- *CPI inflation in May 2005 decreased on an annual basis in Albania, Romania, and Montenegro;*
- *The lowest unemployment rates have been registered in Romania, Bulgaria, and Albania, while the highest were estimated in Bosnia and Herzegovina, Macedonia, and Serbia in the first quarter of 2005;*
- *Within the future process of EU enlargement, it has been estimated<sup>1</sup> that for the countries of the Western Balkans, the financial support from the EU within the IPA<sup>2</sup> is going to amount to € 1.2 billion to Serbia, € 270 million to Kosovo, € 108 million to Montenegro, € 485 million to Albania, and € 622 million to Bosnia and Herzegovina over the years 2007 to 2013.*

#### 9.1 MACROECONOMIC INDICATORS

Real GDP growth for 2005 has been estimated at similar levels as found in 2004 when the real GDP growth rates amounted to 7% in Serbia, 6% in Albania, 3.1% in Montenegro, 3.8% in Croatia, 5.6% in Bulgaria, and 4.5% in Romania.

In the first quarter of 2005, as well as within the first five months of 2005, the physical volume of industrial production increased in almost all SEE countries compared to the corresponding periods of 2004. However, the average level of industrial production declined in Serbia and Montenegro by 2.3% and 1.6% respectively compared to the same period of 2004. The reasons for the decline in production in these republics are the negative impact of the seasonal factor, old technology, and insufficient use of the reduction capacities, which especially caused a decline in production within several sub-sectors of the processing industry. On the other hand, all other SEE countries increased their production compared to the same period of 2004.

**Annual CPI inflation rate** in May 2005 was 0.7% in Macedonia, 2.0% in Montenegro, 2% in Bosnia and Herzegovina, 2.4% in Albania, 3.5% in Croatia, 4.6% in Bulgaria, 10% in Romania, and 17.1% in Serbia. Generally, the main reason for the increased inflation rate in several countries at the beginning of 2005 was the increased oil prices, the influence of several internal factors in the countries, fiscal policy changes, as well as depreciation of the national currencies against the euro in 2004. This is especially the case for Serbia and Romania, as the two countries with the highest inflation rates in the region. On the other hand, Macedonia had the lowest inflation rate on an annual basis in May 2005, with one of the contributing factors being their foreign trade regime liberalization.

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<sup>1</sup> www.esiweb.org

<sup>2</sup> Instrument of Pre-Accession Assistance

Table 9.1: Macroeconomic indicators of SEE countries

		Albania	Bosnia iHerzegovina/ Republika Srpska	Bulgaria	Croatia	Macedonia	Montenegro	Serbia	Rumunia
<b>Real annual growth rate of GDP (in %)</b>	2001	6.5	4.5	4.0	3.8	-4.5	4.0	5.7	5.0
	<b>2002</b>	<b>4.7</b>	<b>5.5</b>	4.3	5.2	0.7	0.8	3.3	3.8
	2003	6.0	3.5	4.3***	4.3	2.2	1.5	2.5**	4.9***
	2004	6.0****	-	5.8	3.8	-	3.0	7.0	4.5
<b>Annual change of industrial production (in %)</b>	2001	6.5	12.2/-12.9	1.6	6.0	-23.2	-2.7	0.0	8.4
	2002	2.0	9.2/-2.5	6.5	5.7	13.7	0.7	1.7	6.0
	2003	2.7	2.0/-1.6 (Mar)	15.6	4.0	0.5 (Nov) 6.5	2.4	-3.1	3.1
	2004	-	9.0	23.4	3.0	-12.7 (Jan-Dec)	13.8	7.2	5.3
	<b>2005</b>	12.7 (Jan-Mar)	3.8 (May)	13.1 (Apr)	2.6 (Jan-Mar)	0.3 (Mar) 4.8 (Jan-mar)	-1.6 (Jan-May)	-2.3 (jan-may)	7.8 (Apr) 5.9 (Jan-Apr)
<b>Annual inflation rate (CPI, in %)</b>	2001	3.5	3.2	4.8	2.6	1.2	24.0	38.7	34.5
	<b>2002</b>	2.1	0.3	3.8	2.3	2.2	9.2	1.8	22.5
	2003	3.3	<b>0.3</b>	4.7	1.8	-1.1 (jul) 0.3 (jan-jul)	6.1 (dec)	9.9	15.3
	2004	3.5	<b>-1.0 (Dec)</b>	4.0 (Dec)	2.7 (Dec)	-1.9 (dec) -0.4 (jan-dec)	3.2 (dec) 2.4 (jan-dec)	13.2 (dec) 11.4 (jan-dec)	11.9
	<b>2005</b>	2.4 (May)	2.2 (May)	4.6 (may)	3.5 (apr)	0.7 (May)	2.0 (Maj) 1.4 (Jan-May)	17.1 (May)	10 (May)
<b>National currency (against €)</b>	Currency name	Lek	Convertible Mark; BAM	Leva	Kuna	Denar	Euro	Dinar	Lei
	2005 (against €)	123.9 (Jun)	1.956 (Jun)	1.958 (Jun)	7.3 (May)	57.8 (Jun)	-	82.04 (May)	27,931.0 (Apr)
	<b>Annual change in %</b>	<b>-2.45</b>	-	-	<b>-1.5</b>	<b>-5.6</b>	-	15.3	-9.28
<b>Unemployment rate (in %)</b>	2001	15.4	39.9/ 40.2	17.3	22.2	30.5	24.8	27.7	8.8
	<b>2002</b>	15.8	<b>42.7/ 38.2</b>	16.3	<b>22.3</b>	<b>31.9</b>	23.7	31.3	8.4
	2003	15.0	43.1/36.6 (Mar)	<b>13.5</b>	<b>19.1</b>	<b>36.7</b>	21.6 (dec)	30.2 (dec)	7.2
	2004	-	-	<b>12.6</b>	<b>18.7</b>	<b>37.0</b>	19.5 (Dec)	31.9 (Jul)	6.2
	<b>2005</b>	<b>14.3 (Jan-mar)</b>	<b>45.5 (Apr)</b>	13.1 (Feb.)	18.7 (Apr)	-	20.0 (May)	33.2 (Apr)	6.0 (Mar)
<b>Trade Balance (as % of GDP)</b>	2001	-22.6	-59.0	-11.6	-	-15.3	-31.3	-26.1	-13.2
	<b>2002</b>	<b>-17.5</b>	<b>-59.2</b>	-10.2	<b>-11.5</b>	-	-22.0	-34.8	-8.6
	2003	-21.5****	-48.2	<b>-12.0</b>	<b>-7.9</b>	-21.0	-17.3	-32.3**	-8.9
	2004	-	-53.2	-13	-7.0	-21.7	-16*	-	-9.1
<b>Current account (as % of GDP)</b>	2001	-5.3	-25.3	-6.5	-3.7	-6.9	-17.1	-5.5	-5.9
	<b>2002</b>	<b>-9.5</b>	<b>-35.0</b>	-4.5	-8.7	<b>-9.4</b>	-14.8	-8.2	-4.5
	2003	-8.5****	-45.7	<b>-7.0</b>	<b>-6.9</b>	<b>-3.0</b>	-7.1	-9.0	-4.6
	2004	-	-39.7	-5.8	-4.6	-7.7	-9.1	-11.0	-6.6

## Sources:

- Data for Montenegro are from ISSP database
- Data for other countries are from their central banks and statistical offices
- Data for Bosnia and Herzegovina in 2003 are from IMF
- \*Estimated by ISSP

*The exchange rate, or the value of national currencies* against the Euro, was changed at the beginning of 2005. The national currencies of Albania, Romania, Croatia, and Macedonia were stronger against the Euro in this period compared to the same period of 2004 (see table 9.1). One of the reasons for such a situation was the slight weakening of the EMU official currency against the USD, as well as some political issues that the EU was faced with during the first five months of 2005. However, the Serbian dinar (CSD) continued to depreciate against the Euro as a consequence of some internal factors in the

country; the average exchange rate in May 2005 was 1 EUR = 82.04 CSD. The national currencies of Bulgaria and Bosnia and Herzegovina are pegged to the Euro and their exchange rate to the Euro is stable. Furthermore, the Euro is the official currency in Montenegro, so there are no exchange rates against the official currency of EMU, in the case of Montenegro.

*Unemployment rates*<sup>3</sup> within the countries of the region were the lowest in Romania, Bulgaria, Albania, and Croatia. On the other hand, Bosnia and Herzegovina, Serbia, and Macedonia still have the highest unemployment rates in the region, amounting to 45.5% in Bosnia and Herzegovina, 33.2% in Serbia, and 36% in Macedonia.

### ***9.2 REALITY OF THE WESTERN BALKAN ACCESSION TO THE EU***<sup>4</sup>

#### ***9.2.1 Results of the European integrations process up until now and the scenario for EU accession of the Balkan countries***

In order to further analyze the process of integration within the EU, it is necessary to place attention on the progress of each SEE country, especially the Balkan countries, up to this point.

With respect to that, Romania and Bulgaria have significantly progressed within the EU, and due to the fact that they signed the Treaty for EU Accession in 2005, their accession is expected in 2007. These two countries signed the “Association Agreement” or the “Stabilization and Association Agreement,” (as it is called now) 12 years ago and they went through all phases related to entering the Association Agreement and putting it into force, membership application, candidate status, opening negotiations, and closing negotiations for EU accession.

Croatia is the closest to EU accession, followed by Romania and Bulgaria. Croatia earned its candidate status in 2004 and it will begin negotiations for EU membership after it improves its cooperation with the Hague Tribunal and resolves all of its political barriers. It is expected that Macedonia will become a candidate for EU membership in late 2005 or early 2006 at the latest.

The other three countries- Serbia and Montenegro, Bosnia and Herzegovina, and Albania, as potential candidates in the future are, in terms of EU integrations, rather far behind Macedonia, and particularly behind Croatia.

With respect to the stabilization and association process, Bosnia and Herzegovina is still at the beginning of negotiations, as well as Serbia and Montenegro. It is expected that both will finish negotiations during 2006, as well as for both countries to sign the Stabilization and Association Agreement. Albania has already begun negotiations to sign this agreement, but there have been no significant results up to this point.

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<sup>3</sup> Unemployment rates within the SEE countries are calculated through the implementation of different methodologies and thus data on unemployment rates cannot be completely comparable, despite the fact that these are the only available data.

<sup>4</sup> Main sources: ESI – “Breaking out of the Balkan Ghetto: Why IPA should be changed” June 2005; prof. dr Mojmir Mrak; “The Next medium-term Financial Perspective of the EU” April 2005 and “Division of the EU Funds for the Economic Development and connections” December 2004.

Generally, with respect to the EU integrations of Serbia and Montenegro, Bosnia and Herzegovina, and Albania, it should be pointed out that these three countries are currently in the position where Romania and Bulgaria were 13 years ago (see table 9.2).

*Table 9.2: The realistic scenario for EU accession of the Balkan countries and scenario of Romania and Bulgaria accession*

Bulgaria and Romania		Serbia and Montenegro, Bosnia and Herzegovina, Albania
1993	Association Agreement	2006
1995	Association Agreement, enters into force	2008
1995	Membership application	2008
1997	Candidate status	2010
2000	Opening negotiations	2013
2004	Closing negotiations	2017
2007	Membership	2020

Source: European Stability Initiative; ISSP

It is assumed that Serbia and Montenegro, Bosnia and Herzegovina, and Albania, if they sign the Stabilization and Association Agreement, would progress within the EU integration process as quickly as Bulgaria did. However, it is necessary to consider the more complex political situation in these three countries compared to the case of Bulgaria and Romania.

### 9.2.2 Financial Support within the “Instrument of Pre-Accession Assistance (IPA)”

In order to obtain financial support of the EU within the *Instrument of Pre-Accession Assistance (IPA)*, Balkan countries are divided into one of two categories, dependent on their status. The first category are those countries that have *candidate status for EU membership* and these countries are Croatia, Turkey, and Macedonia.<sup>5</sup> The second category are those countries that are *potential candidates* for membership - Serbia and Montenegro, Bosnia and Herzegovina, and Macedonia.

IPA defines five components: (i) **intermediate assistance and institutional building** to improve administrative capacities and judge the systems of the countries that should fulfill further conditions for accession; (ii) **regional and cross-border cooperation**; (iii) **regional development** to support structural programs and European funds for rural development and cohesion; (iv) **staff improvement** to provide structural funds programs; and (v) **rural development** to support agricultural development in rural areas.

Provision of pre-accession assistance for the countries of the Western Balkans beginning in 2007 should reduce the political risk of the EU in our region. With pre-accession assistance, the EU would retain the conditionality linked to the opening of membership negotiations, based on the Copenhagen criteria.

However, countries that are potential candidates for EU membership are not planned to receive the complete pre-accession assistance package, as was the case with the previous candidate countries. The EU strategy towards the Western Balkan countries as potential candidates for EU membership, implicit in the draft version of the IPA regulation does not support economic development of the region. Thus, according to this Strategy, and after

<sup>5</sup> Macedonia is expected to become an EU candidate in late 2005, or early 2006 at the latest. Thus, this country, as candidate one, is planned to receive financial support within the IPA fund beginning in 2007.

## Chapter 9. Regional Comparison

signing the Stabilization and Association Agreement, the scope of the potential candidate countries will be neither increased, nor will its quality be changed. The reason for this is that the EU will not be helping Serbia, Montenegro, Kosovo, BiH, and Albania to overcome social and economic problems and to put in place the structures for economic and social cohesion policies. The EU plans to be more focused on the strategy of stabilization and military reforms, and less on development and institutional changes.

The total sum budgeted for IPA assistance amounts to €14 billion for the period 2007 - 2013. The dynamics of the distribution is € 1.4 billion in 2007, €1.6 billion in 2008, € 1.7 billion in 2009, € 2 billion in 2010, € 2.3 billion in 2011, € 2.4 billion in 2012, and € 2.54 billion in 2013. Candidate countries are planned to receive € 11.4 billion; Croatia<sup>6</sup> will receive €840 million, Macedonia<sup>5</sup>- € 378 million, and Turkey - € 10.15 million. The sum proposed for the countries that are potential candidates for EU membership amounts to € 2.7 billion within the above-mentioned 7-year period ( see table 9.3).

Each of the above mentioned three candidate countries is planned to receive around € 27 per capita within the period from 2007 - 2013, while Turkey is going to receive approximately € 14 per capita in 2007, with a progressive increase annually until it reaches € 27 per capita in 2013.

By dividing the € 2.7 billion assistance within the IPA from 2007 to 2013 among the Western Balkan countries that are potential candidates for EU membership, based on number of citizens within these countries, it can be estimated that Serbia is going to receive € 1.2 billion, Montenegro € 108 million, Kosovo € 270 million, Albania € 485 million, and Bosnia and Herzegovina € 622 million (see table 9.3).

This assistance is going to equate to approximately € 14 per capita in 2007 up to € 27.4 per capita in 2013.

**Table 9.3 Planned assistance for potential candidates, 2007-2013 (in million €)**

Country	Population (in million)	2007	2008	2009	2010	2011	2012	2013	Total
Serbia	8.0	113	138	117	159	234	233	220	1,214
Kosovo	1.8	25	31	26	35	52	52	49	270
Montenegro	0.6	10	12	10	14	21	21	20	108
Albania	3.2	45	55	47	63	94	93	88	485
Bosnia and Herzegovina	4.1	59	71	60	82	119	118	113	622
<b>Total</b>	<b>17.8</b>	<b>252</b>	<b>307</b>	<b>260</b>	<b>353</b>	<b>520</b>	<b>517</b>	<b>490</b>	<b>2,699</b>
<b>Per capita</b>		<b>14.2€</b>	<b>17.3€</b>	<b>14.6€</b>	<b>19.8€</b>	<b>29.2€</b>	<b>29.0€</b>	<b>27.5€</b>	

*Izvor: European Stability Initiative; www.esiweb.org*

The bottom line is that if political elites of the EU want integration of the Western Balkans into the EU, they have to create a much more dynamic strategy towards the region. The countries of the Western Balkans that are at the beginning of negotiations for the stabilization and association, should be given similar treatment as Romania and Bulgaria received within the period from 1995 when they applied for membership through 1997 when they became candidate countries for EU membership. Furthermore, it would be good if countries of the

<sup>6</sup> If Croatia becomes an EU member prior to 2013, it will no longer be supported under this budget line, and its projected funding will be available to other pre-accession states.

region can access financial funds within the IPA immediately after signing the Stabilization and Association Agreement (SAA) and not after receiving their candidate status. This would provide the possibility for other forms of financial support because other donors could provide co-financing to supplement the IPA budget, which in the short term can provide functioning of institutions and other structures to aid in becoming a candidate country as fast as possible.

If the EU definitely changes its current strategy and focuses on several crucial issues in each potential candidate country and gets direct information on a regular basis from the offices of the European Commission, which should be established in the capital cities of the Western Balkan countries, than these countries would, after signing the SAA, possibly as soon as 2008 become candidate countries for EU membership and in 2009 they could open negotiations for EU accession. Several years after closing negotiations, EU membership would be expected to come. According to this, the “optimistic scenario” has the EU accession process taking approximately nine years after signing the SAA to complete, instead of 14 years, which is the previous and currently, the much more realistic scenario.

# **PART 2**



*COMMENT 1****STUDY REVIEW: TRENDS OF ECONOMIC DEVELOPMENT IN MONTENEGRO******Veselin Vukotić, PhD, ISSP******The outset retrospection:***

This study has been conducted for the purpose of the Montenegrin urban plan. What is the task of such a study -- a long-term relationship between economy and space, i.e. spatial allocation of resources. How does the given space (that is the map of the Montenegro) affect its development and how does development affect the space, i.e. devastation of the space (economy)? The task of this study, according to my perception, is to answer that question. The answer should be researched in the following:

1. Market economy
2. Liberalization and decentralization
3. European space integration

***The outset of the study:***

With correct use of the applied methodology, the achieved results can hardly be completely valid for the urban plan. Litigious in the outset are:

1. Basically, there is a request for a large public investment in the economic development
2. The essence of the economic system, which is being built in Montenegro, did not come to fruition
3. The relationship between economic development and natural resources in Montenegro is not in coordination.

The question is, “Where is the space in this study?”

**I The Government’s role**

A large role of the Government in the economic development is indicated. That means that the Government should affect distribution, i.e. allocation of resources in the space and allocation of the space for the purpose of economic goals.

Are there budget resources for that purpose?

Does the study propose that those funds should be obtained from the budget?

If those funds are to come from the budget, i.e. public consumption is 48%, does anyone think that the budget should be increased? How should it be increased?

Money is the main resource for steering economic development by the Government. Does this approach imply that Montenegro should oblige and increase its external debt?

If the budget money is a rare resource – then the study should be more emphasized on something that could be a stronger role of the Government – the infrastructure: roads, airports, harbors, etc. Road investments should be the Government’s priority. If there is the possibility of external borrowings, then it should only be done for the purpose of

building roads. Montenegro should be reduced. Today, the journey from Rožaja to Herceg Novi lasts from 7 to 8 hours and the impression of a "big" country is created. A highway would reduce this trip to just a few hours.

In Montenegro today, there is no long-term development, not to mention urban planning.

So, the first question is the origin of the money for the Government's role in economic development. If there is no money, and everything is determined by the market, how can spontaneous market forces be "regulated," from the aspect of economic protection and space organization? I think that philosophy and the method of urban plan implementation must be perceived differently. That is where the German experience is important. The Government will have to affect more through laws and institutions, rather than through money and investments.

*II Montenegrin economic system*, which is in the process of building its institutional framework, does not come to expression in the study, except in the measure of the author's negative attitude towards that system. However, that system exists and that system is getting built, and that is a fact. How should we regard these facts? Should we ignore them or respect them?

The first determinant of the new system is private ownership, as a pillar of the system. Through the system of privatization, it is already privatized 80%. The authors' assignment in this study is not to talk about privatization, but to look at the results and to start from there. The results are that there are almost no Government companies. Whether this is good or bad, or whether we approve or disapprove is not relevant for this project. Instead, our question focuses on, how an ownership structure established in this way will affect space utilization in Montenegro, its allocation, its devastation, etc. The issue is how to regulate the use of space when 80% is in private ownership, and the direction is toward complete privatization!

If the future of Montenegro is in private business – how should space be used? Should it be used, for example, for different industrial and business zones? That is a fact that should be more respected in the sense that privatization is looking for new instruments and control methods.

### Openness of the Economy

Is it possible, and if it is possible, how is it possible to affect the policy of space usage in the conditions of openness? If, for example, the number of people who buy private lots in Montenegro is that great, how can the space policy be affected? The demand for space is increased!

Even now, the space demand in Montenegro doesn't only consist of what the citizens of Montenegro have, but of the international demand as well.

Montenegro is opening as a destination! How to operate in such quick-tempered demand? Is the administrative liability of the municipalities, or the Republic, well allocated from that aspect today?

***Small open economy:***

Is there a way to manage economic flows in a country that has 650,000 citizens and GDP of 1.5 billion euros? No way! There can't be direct managing, but rather indirect through economic regulation.

***EURO:***

Is there a way to manage economic flows in a country that has "foreign" currency? No way, or very little! The Central Bank's part in this is much reduced, and in addition to that, so is the possibility of conducting economic policy in this area.

***Contract obeisance:***

Everything that has to do with ownership, especially with contracts, receives international treatment. The feasibility of local and republic authorities to "order" or "seize" the space is rapidly decreasing and has almost vanished.

***Public administration:***

Where is the concept of reducing Government administration and how would that affect space usage in this study?

***III With admission into the EU, Montenegro becomes part of the economic space integrity. How will that affect the space integration of Montenegro? The space of Montenegro is opening towards European space!***

***Some other warnings:***

1. *Should the entire space be planned today?*

Why shouldn't some of the space be left for the future generations? Why should it go for Jaz, Velika plaža or Ada today? Do we have information for the valorization of that space in the future context? Why shouldn't we wait and leave it to some future generation to utilize it in the spirit of its own time? The generations of today have enough workspace!

2. *Tunnel Sozina.* With the ability to drive through the tunnel Sozina, space integration of the South and middle regions of Montenegro will come. How will that spatial integrity affect economic development? How, for example, will the Lake of Skadar and the basin around it be valorized? Will the quick increase of lot purchases, especially by foreigners, affect the valorization quality of this space?

3. *Adriatic-Ionian main.* Regardless of all of the rejection from different lobbies within Europe, this main is certainly in the near future -- in fact, the larger part of it is already finished, all the way to Split. How should the space around the main and south of the main (by the shore) be treated, having in mind that the main passes over the mountaintops?

4. *Regional development.* The best way to achieve regional development is to support infrastructure construction in all parts of Montenegro. All of the politics based on

subventions and stimulations are untenable. Don't artificial infusions from the past prove that today? Why should we insist on this strategy that doesn't give results? In my opinion, it is more important to open one faculty in Northern Montenegro rather than to invest in factories. Those university-educated people will in turn open and develop more factories as compared to some "smart regional funds." Not to mention roads, services, etc.; development must be approached to prosper man, not the region. Let us pass from the collective to the individual! Let's create conditions for the individual to express himself instead of disabling him under the veil of fake concern over him!

### Trends of economic development

The opinion of economic development trends should be completely changed. Up to date, development and creation of the economic structure has been formed in a closed system in which Montenegro had a huge amount of money (for example, annual donations FNP were nearly 100 million dollars!). Economic thought that relies on such donations is long gone! That is why a new Montenegrin economic school has been raised, one that relies more on entrepreneurship, private capital, open markets, and efficient economic regulation.

Donations and help are gone! Logic of economic development that relies on external help, as well as on a great budget, is in the past. And that is the outset of the Montenegrin economic school!

In our opinion, KAP<sup>1</sup> is not the developmental direction of Montenegro anymore; although when the Government was building and creating, it was. Today, after privatization, KAP is in his owner's concern. KAP will work until his owner sees his interest. If the economic interest is lost, the Government will hardly have the money to keep it infused. If someone thinks that we need KAP, even when it wouldn't have economic justification, then he should recommend who would pay for it!

In my opinion, from the Government's aspect, the development trends are:

1. Space – this already is, and in the future will continue to be, the most valuable resource in Montenegro. That is why I see the main development trend relating to efficient space management. Within this should be included: deposits and minerals and natural gas, and their affect on space planning.
2. Energy (partially) – this creates an environment for attracting foreign capital.
3. Infrastructure (roads, airports, railroad) - This is crucial! Once the roads are good, entrepreneurs will do the rest! It is not the Governments concern anymore.
4. Research paper – this, as an investment in science and research is economic development.
5. Sport – this investment in the environment and infrastructure, which will, through European contests, valorize the human and natural potentials in Montenegro.
6. Culture - investment in this area will have a direct economic effect (for example, tourism), but also enormous indirect economic effects.
7. Art - doesn't Montenegro have that potential? Isn't that an economic resource?
8. Water – this becomes a bigger and bigger resource. What should the Government do to make this resource attractive for private investments?
9. Air - clean air is an economic resource.

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<sup>1</sup> Aluminum mill of Podgorica

10. Services - shouldn't an open and naturally attractive area of transit, such as Montenegro, be an **economy of services**? Not just services such as tourism and traffic, but also services of education, health, and municipal services. Wouldn't aid in opening regional centers in these areas be a great economic resource?
11. Software - Haven't the young brains in Montenegro already shown a predisposition to the abstract, which is demanded by the informatics society?

According to that, the classical perception of the economy and economic resources and the old classification of productive activities should be loosened.

All of the changes that are coming and those that have already begun, make the economic reality of Montenegro completely different than the one that was formed in the past.

That new vision must first be seen in space. For me, the key issue is how to expand the space of Montenegro in the economic sense? How to methodically parcel it between different activities (industry, agriculture) is not the problem, but how to expand it? We can expand it if all the economic resources of Montenegro are functioning towards the larger realization of products that are demanded abroad. Those are not just physical products that are "exported across the border," but first of all, services and products that will be sold to them in Montenegro itself; for example, when a foreign visitor consumes Nikšić beer in Budva, that is an export! Whoever doesn't understand what I am talking about, please ask yourself if the space of our shore is bigger when it is empty or when it is crowded with tourists?

And how much bigger is our space when our products are being sold in Europe physically? But, this is much harder! That is why investments in the environment for the development of service is crucial! In the short-term, this can be litigious, but it should be looked at with a vision of the next few decades. Didn't our ancestors look "forward" and send their kids to schools and universities even though they needed their kids to help with house and agricultural work?

In our opinion, the Government should create an attractive environment for foreign capital through the urban plan. Owners of the capital and entrepreneurs will decide what will be produced and how. Government space organization should be a motive for entrepreneurs and investors to invest in Montenegro! Therefore, the urban plan can't be a constraint, but should be a motive and incentive for those who invest. And the "urban plan" itself can't be degraded to a level where it determines what each factory will produce, where it will stand, etc.

A global environment, institutions, and laws are things that the government determines, and within that is freedom.

So, the government's job is to help to create a legal and physical and mental infrastructure. On the other hand, entrepreneurs, investors, and managers must use the infrastructure, and within it, realize their ideas and investments.

However, economic development depends on people who are ready to invest themselves and their knowledge and their capital in new attempts! And that is the major trend of the development strategy.

**COMMENT 2**

***RESTRUCTURING OF THE ELECTRICITY SECTOR – THE ROAD TO AN OPEN ELECTRICITY MARKET***

***Vesna Stojkovic , PhD, The Law Faculty in Podgorica***

***INTRODUCTION***

At the current moment, the trend of electricity development all around the world, or better – the factual status in the electricity sector, is composed of the accelerated reconstruction of conventional, centralized and totally regulated markets into deregulated open market structures. This will put stress on the market game. In modern, reconstructed electricity markets, the roles of production, transfer and distribution are totally changed and appear as substantive market subjects. Benefits that should be achieved by reconstructing the electricity companies/sectors are:

- Less costly electric power
- Competition in all areas of electric activity
- Effective planning and stimulation for the building of new capacities
- Minimization of business costs
- For the consumer – the possibility of choosing a supplier from among many and obtaining better, less costly service

At the end of the 80's, electric companies around the world began this process, forced by the need for increased efficiency in producing and supplying electric power. Great Britain led in Europe, followed by Spain, Scandinavian electricity, and then a range of other countries, while in other parts of world this process was first started in Argentina, Chile, etc. The process of deregulation is intensive in the USA as well, although the ownership structure of electric companies in this country was private even before deregulation. A common characteristic of reconstructing is the ambition to establish greater competition among the producers so that consumers have an expanded offer. These changes reflect to both ownership and managerial structures of electric power companies, so by following these processes we meet with the following terms:

- Deregulation
- Privatization
- Wheeling
- Reconstruction
- Liberalization

The main characteristics of the ES (Electricity Sector) – reconstruction can be summarized as follows:

- Introduction of competition into a region that is currently in a monopoly situation, thus breaking the monopoly.
- Vertical unbundling of the production functions, transfer, and distribution.
- Horizontal unbundling – forming more competitive generator companies.
- Understanding the fact that the electric power transmission network is a “natural” monopoly, and according to that fact, creating of such regulations that allow for equal approach and use of that network for everyone.

- Enable customers to choose from among many supply companies, simultaneously using the transform and distributive network.

EU country leaders have great hope in electricity market liberalization on a global level of European Union, as an undisputable fact is that a unique and open market of electricity is one of the main preconditions for creating a dynamic and strong economy, one that is totally able to compete with the economies of the USA and Japan. The process of change in the Electricity sector and the creation of a unique and free market of electricity officially began by enacting the Directive 96/92/EC in regards to the internal market of electricity, which was adopted in December 1996. After seven years of intensive development of this market, the Directive 2003/54/EC has been adopted. It changed the previous directive and prescribed acceleration of these processes. According to this Directive, until July 1, 2007, all electricity consumers in the EU region will be participants in a totally open market, and even all households belong there. So, in two years, the electricity market in the EU will be 100% open.

In the new, deregulated environment, many new, and so far unknown challenges, are occurring. The organization of complete: procedures for planning of electricity supply at the annual, monthly and daily level; the procedures of realization that supply to customers; providing of security and reliability of electric power system operation; providing of regulating functions of electric power system; electricity demand metering, accounting and billing; the allocation of responsibility for secure operation of overall power system, etc., are now totally different compared with the classical, centralized decision-making policy concerning the planning of electric power system operations, consumer supply, accounting and payment collection of consumed electricity.

### ***BASICS ABOUT THE ELECTRICITY MARKET***

The final development goal of the electricity market is total transparency of that market for all final consumers and absolute permeability and transparency for all potential suppliers of electricity so that the realization of the kind of consumption measuring and accounting system will be adequately correct and efficient, and again applicable for daily use.

Basically there are 4 structure models of the electricity sector with many variations in certain countries, which differ from each other based on the level of reached monopoly/competition, i.e. the possibility for consumers to choose the supplier, and those are:

- ***Monopoly model*** on all levels, whereby one country has a monopoly over the production, transfer and distribution, as well as the responsibility for the power supply of the consumers of (“his own”) territory. This model is of the classical structure, vertically spread electricity companies that we are already use to.
- ***Single buyer model*** is based on existing competition on the production level, but a monopoly on the level of transfer and distribution of electricity. The existence of a transfer system operator (TSO) is necessary.
- ***Large-scale competition model*** is based on open access to the transfer network, competition on the production level, but a monopoly exists over the buyers across the distributive companies and/or suppliers.
- ***Retail competition model*** is based on the existence of competition on the production level and direct access of all consumers to all suppliers, in other words, open access to the distributive and transfer network.

In the electricity sector of every country some of these model structures are certainly present, and the question that occurs after determining the model structure relates to the organization of the electricity market, whose legal frameworks and rules of functioning are typically regulated by the national legislation.

In every market there must exist some neutral, state promoted agency, or **Regulatory body**, that will define the regulation, i.e. the rules by which all market “players” must obey. Also, every market must behave in accordance with the regulations set forth in the previously adopted Law act – **Electricity market Law**, whose regulation is obliged to all, and in practice its appliance is elaborated by the control implementation of the previously mentioned Regulatory body. Within every market there should exist another obliged, neutral participant that is usually called a **Transform System Operator**, which takes care of the technical integrity of the electricity system, security of its operation, as well as its organization and/or account of the real- time electricity market ("*fine tuning*" or "*regulation market*"). Other market participants can fluctuate dependent on the different types of market organizations, all typical participants are:

- **Electricity producers** – generator companies
- **Independent suppliers** – those that supply energy on the market for final consumers - buyers
- **Qualified consumers** - those who can purchase electricity directly at the market, thanks to its quantity (consumption)
- **Final consumers** - those who buy electricity only for individual use
- **Network owners** (distributive and transfer) - those who are usually obligated to provide non-discriminative access to the network to all interested and licensed bidders, and to measure consumption and provide accounting data for all suppliers.

Without retracting into the description of a monopolistic organization in vertically spread National Electricity companies, we will address the organization, functioning and problems of the deregulated Electricity Sector. Under Electricity Sector, we imply a set of participants who offer their service and regulate their work on the open electricity market, which covers some sort of geographic area and is usually limited to the territory of a certain country, or multiple countries (if they are linked in a system of power level line).

Globally, in a deregulated atmosphere there are a few types of markets. With regards to the limited quantity of electricity that is purchased, or sold, or in other words, the variety of final consumers, we have:

- Large scale market
- Retail market

With regards to the time horizon, there are:

- Market for tomorrow
- Real-time market

With regards to "*goods*" that are traded, there are:

- Power market
- Adjutant service market

For now, regardless of the existing variety, two dominant models of large scale markets are established:

- Model POOL
- Model supply - demand



POOL based market can be:

- Obligatory POOL (i.e. England since 1990)
- Non-obligatory POOL (i.e. Spain, California)

Model supply-demand can be organized as:

- Bilateral market (ERCOT Texas, Germany)
- Stock exchange (Scandinavia)

In a market that is POOL type fully, consumers and producers bear their offers to the operative- POOL, which has the task of producing a preliminary plan of commitment in which production and consumption will be balanced, as well as to define the price in pool.

In an absolute bilateral market, participants arrange prices on their own. In order to fulfill their supply/delivery plan, network operators have to be informed, for control.

At the Stock exchange based market (power exchange), both producers and consumers launch their offers / bids , and on the one - hour time base ( sometimes even on the 15-minutes time base ), the price is set based on evaluations of MCP (Market Clearing Price) that are observed every hour , according to the cut - point of aggregated curves of total production and total consumption.

Today, there exists in every country some sort of hybrid market that is a combination of these two – the bilateral market and the stock exchange.

Now we will present some basic concepts on which the deregulated processes in electricity are based in European countries, as well as other countries.

### ***BASIC CONCEPTS FOR CREATING AN OPEN ELECTRICITY MARKET***

Basic concepts can be sorted into a few units:

1. **Necessary basis** for electricity
2. Clearly defined **key stimulating factors** on the electricity market
3. Assuring an **equal market game** for all participants
4. Clear delimitation of **market participants**
5. Basic **agreement structures**
6. Views and perspectives for adequate **electricity evaluation** in the following years

#### ***1. Basis for electricity trade***

One of the fundamental statements that should be clarified right away is the essential difference between the concept of "*sale*" and "*trade*", especially when we connect these two concepts with electricity.

Thus, *sale* is basically a simple process that happens between a seller that has an adequate quantity of a certain product and a buyer that wants to buy that product. The seller simply establishes the price at which he is ready to sell that product and the buyer can purchase it at that price. Either in a monopoly, or in a regulatory environment, the influence that either side has in this business is very small. If the seller is operating within a regulated business regime, he is not exposed to any risk. He has only to add a reasonable margin to the original (supply) price and he can form the selling price of his product that way.

Trade, however, is a different activity. An open market with many products and a large number of participants indicates trade. There is the concept of "*costs + margin*," which is totally exceeded by "*market price!*"

So, the *basics* for the existence of *trade* are:

- *Basic product*, which is clearly and understandably defined for all participants
- *Open access to the market* for the optimal number of potential buyers and sellers
- *Rules of market functioning* and full transparency in their appliance
- *Market permeability*, which is shown as more and more participants enter the market, with the existence of multiple versions of this product (which leads to the development of a series of new products and a larger and more complex market of products)

## 2. *Key stimulating factors of the electricity market*

In order to apply the above mentioned trade principles to the electricity market, it is very important to keep in mind the unique characteristics of electricity as a market product, which can be summarized as the following:

- For now, electricity cannot be accumulated in significant quantity; that is why the current consumption/production balance is necessary.
- Electricity is homogenous for all Electricity companies, so there is no way to pull apart and “mark” who produced which kWh.
- Electricity transfers through and uses an interconnected network in which all participants affect other participants by their activities.

From a technical point of view, it was inevitable that the interactive complexity of electricity led to centralized approach to management and control of production, transfer, distribution, and supply for the final consumers. It was the most efficient way of optimizing the operation of Electricity, while keeping the lowest costs. However, it is very difficult to expect a monolith, a centrally organized management of the electricity sector, to possess sufficient economic stimulations to really improve market performance and to lead to significant changes in the price of electricity. Only pressure of the market game itself can lead to the essential changes. This is the process of evolution, which leads to adjustments and survival of the best.

It is important, however, to understand that creating the market game and evolutionary variety that we pursue will lead to the high complexity level of a newborn market structure. Transition from a centralized, monopoly system to an open market structure cannot be half accomplished; it demands total reconstruction of the current structures, abdication of a long standing monopoly system, which will go very unwillingly, and the sharing of a huge portion of the market “cake” to many new players.

The widely accepted access for establishing a market environment in the area of electricity is to make accessible various factors that affect the trade of electricity and their matched economic mechanisms in the four most significant groups, and these are:

- **Capacities**

This element maintains a long-term strategic value measure of generator capacities. Capacity includes items such as the need for *strategic reserve* and economic evaluation of *lost production* due to the lack of available capacities. With regards to generator companies, capacity is presented upwards of fixed expenditures (operation, maintenance, credit obligation payback, etc.). Although we can consider capacities primarily as an element of market safety and work comfort, they also represent long-term market factors and have a

very important strategic role. Building new production capacities requires many years; from the initial market signal that a new capacity is needed to the beginning of its operation is indisputably a very long time, making it difficult to treat the *capacity* factor as an element that participates in the market. Since the capacity factor can be considered an element that is separated from the market, it is also viewed as a factor of long-term market policy.

- **Energy**

This element maintains the marginal product expenditures on the source and contains all operational, fuel, and maintenance expenditures as well. It is highly dependent on production technology. This is the primary area for a real economic market game in production.

- **Transmission and delivery**

The task of transferring electricity from the bus generator to the final consumer is naturally a monopoly. It is highly dependent on the efficient use of the transfer network that is supposed to be correctly projected and adequately maintained. Network operators must be strictly regulated and they should enable exploitation of the electricity transmission network in the most economic way. It is necessary that this operation be strictly separated from the production and sale of electricity, if a substantive, open, and transparent electricity market is wanted.

- **Supply**

This refers to the *supply* process to the final electricity consumers, *servicing* the various sets of consumers, as well as *projecting* the mechanism for price determination in order to balance, usually, complex supply expenditures with the will of final consumers to buy electricity under simple and non-discriminated tariffs. This is the area in which a natural market game can exist; however, if a supplier has a monopoly right (or franchise, i.e. license for supplying consumers in a certain region) to supply a certain set of consumers, than this activity must be strictly regulated.

### ***3. Equal market game for all participants***

The previously described steps and requests for opening an electricity market cannot be done all at once – in a snap. The gradual opening of the market, step-by-step, is predicted, and recommended, everywhere.

In order to bring a market to life, a large number of determinant factors should be ready for financial expenditures and risk. The first important step is to break apart the vertically spread electricity companies and many of the smaller market participants that operate in the above-mentioned key market areas (production, distribution and supply). This is a *necessary* step. Furthermore, new market participants should have a slight privilege in the beginning, in order to steady themselves on the market. Also, more than in any other market, the regulatory control should be strong, unchangeable and simulative. This is necessary because this market is connected to high capital and long term expenditures for building the object (generator capacities), and also because “old-timers,” as centralized, monopolized companies, will do their best to obstruct new participants’ entry. There is a ***Regulatory body*** that acts as an impartial, equal for everyone, state established agency; this agency is extremely important for providing the market game.

#### **4. Market participants**

In the functioning of an open electricity market, we can define the following participants:

- **Fuel supplier** - covers his own expenditures of producing and transporting fuel and cares to sell his product the best he can through to the final product
- **Generator** - covers his own fixed expenditures, and with regards to the conditions at the market, creates “added value” through the price at the sill of the electric plant
- **Wholesaler** - the clamp between producer and supplier
- **Supplier** - the one who pools final consumers
- **Transporter** - the one who provides transport services of a product to the final consumer

If a real electricity market is wanted, with a larger number of participants, which is opposite from the centralized concept, it is necessary to create a **market mechanism**. This mechanism would allow some independent producers to define their own product price, providing suppliers access to the flexible source of supplying, by using current prices or prices that would be defined at the market.

Generator companies in the market should be enabled to produce continually and suppliers should have enough energy (regardless the variable diagram of consumption), and the difference (imbalance) between consumption and production should be covered in every moment by an adequate market mechanism, for reasonable prices.

#### **5. Basic agreement structures**

Assuming that a clearly defined market exists, participants within it can make arrangements amongst each other. Thus, for example, a certain generating company may plan to build a new electric power plant, that will be in ownership of that generating company, but will pose as an independent producer of electricity at the free electricity market. Before taking on this endeavor, that generating company must be sure that it will succeed in providing at least the minimal revenue, enough to cover its fixed business costs (including the loan payback). In addition to that, this company would probably want to have realistic margins above these elementary costs in order to return its own investments.

The ideal goal of this generating company would be to be able to provide a guaranteed price, ideally, to be capable of giving that sort of guarantee for the entire production. This kind of contract is usually called the **PPA** (Power Purchase Agreement). Most PPA contracts are set up in order to split two key components "**capacity**" and "**energy**." Energy is basically transferred into marginal costs that are appropriate to electricity production, (i.e. the fuel price \* special fuel consumption).

In the broadest contract structure, fuel costs (i.e. gas) that are applicable to the already defined long-term contract for gas supply are included in the electricity price, and PPA effectively recovers investments costs through capacity (previously defined as one of the key factors):

***Gas costs --> Coefficient of usability of Generator --> Electricity cost***

If one identifies the power plant’s operational fuel (oil, coal, gas) as “**Raw electricity**”, i.e. as only one element in the chain of creating the final product, it gives one the possibility of creating various contract obligations, with the vital goal of **sharing business risk**.

## 6. Determination of the electricity price

*Short-term determination of prices* will reflect the inertia that is connected to the market competition, versus the centralized monopoly in which determination of prices is through the efficient regime of giving discounts (so the prices for final consumers can be momentarily reduced by an "decree") to provide a piece of the market for new participants. Using the example of the Norway electricity market [see literature 4.], we can see how long it took for the reflecting change of the Wholesale market to appear on the retail market. It is likely that the first strike of the market game, with the oscillating conditions in the market, will be realized as damage to the financial status (assets) of the participating companies or through certain kinds of market mechanism such as transmission network capacity auctions in which centralized (monopolistic) electricity companies are forced to relieve the piece of those capacities for the independent competitive market.

The primary obligation of the *long-term plan* (concerning electricity prices) of certain governments, is to provide various stimulating measures that will simplify things for new market participants, making it easier for them to accede to the building of new power plants and to rationalize such contract structures that improve the market game in order to return the capacities investment through the electricity price.

## CONCLUSIONS

Therefore, in order to arrive at an open market electricity structure, we can assume that the following steps are needed:

- Clear **market splitting**, with the creation of a wholesale market
- *Unbundling of the vertically structured* monopolistic companies
- Stimulating *new participants in larger number* at the market
- Forming *legal regulation of high quality*, but with significant facilities for new participants in the first years of existence

The theme of deregulating the electricity sector is still a new subject (at least to this part of Europe) with many unknowns and therefore unsolved problems. Some problems that appeared in to date organizations and exploitations of deregulated electricity markets are :

- achievement of complete electricity market opening for all consumers, regardless their installed power and annual consumption. Difficulties arose with regards to the efficient organization of the system for electricity consumption metering and the system of accounting for consumed electricity
- Problems of charging the electricity transit through international (inter-state) borders – **CBT (Cross Border Tariffication)**
- The congestion of the transmission network that prevent from electricity trading and measures for managing such problems - **CM (Congestion Management)**
- The appearance of local domination in the market
- “Non-technical” problems that representatives of the EU syndicate point out, i.e. there has been a serious loss of working places (employments) and the potential danger of establishing electric-financial control by a small number of suppliers in very broad market areas.

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*COMMENT 3****INSTITUTIONAL FRAMEWORK FOR NEW STATISTICAL SYSTEM IN MONTENEGRO – PROPOSED LAW ON STATISTICS AND STATISTICAL SYSTEM IN MONTENEGRO***

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***INTRODUCTION***

The transition process from a planned to a market oriented economy in Montenegro has initiated many changes in the economic system. Such a process has also influenced the statistical system in Montenegro. All participants in economic and social transactions have become more aware of the importance of accurate statistics and information.

Current conditions in the statistical system in Montenegro are characterized by numerous unreliable and inaccurate data, new methodologies and new standards that are insufficiently developed, relative isolation and weak coordination of participants in the system, unclear responsibilities of agencies for the quality of data, and a general lack of expert resources. This condition is the combined consequence of the disintegration of the earlier statistical system in SFRJ, of the changes in the economic system that have not been followed by changes in the statistical-IT system, and of the fact that in the overall reform process, this system was left aside.

However, during the last several years, progress has been achieved in this area: all participants in the system are trying separately to improve their work and to reform it, they are trying to solve problems independently, and all participants have international technical support. However, this approach to improving the statistical system often results with the problems that are mentioned. Thus, the Government of Montenegro was motivated to adopt a new **concept of statistical system in Montenegro**<sup>2</sup> in November 2003. This new statistical system is designed to satisfy the needs of all institutional sectors in Montenegro by providing needed information in regards to: analysis of the structure of the whole economy; analysis of certain aspects or parts of the economy; analysis of the development of the whole economy over time; analysis of the whole economy as compared to other whole economies.

In order to provide macro statistical information adequately, the statistical system must be organized to fulfill the following criteria<sup>3</sup>: international harmonization with other social and

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<sup>2</sup>Concept was created with expert support from the ISSP. Authors were Veselin Vukotic and Maja Bacovic

<sup>3</sup>In accordance with international standards, basic principles of organization of statistic system of a country are:

- a) Statistic offices have a task to provide information necessary to government, economy and public that are related to economic, demographic, social and ecologic situation in the country;
- b) Statistic offices have to observe professional, ethical and scientific principles regarding application of methodology and procedures for collection, processing, storing and presentation of statistical data;
- c) Providing objective interpretation of obtained statistical results;
- d) Statistic offices are authorized to comment on any misuse and misinterpretation of official statistical data;
- e) Data for statistical research can be collected from all types of sources. Statistic offices have a right to select a source of data that is optimal from the aspects of data quality, deadlines, costs, etc.
- f) Individual data possessed by statistic agencies and collected during statistic research, either related to physical or legal persons, are regarded as a business secret and must be kept confidential and used exclusively for statistic purposes.
- g) Work of statistic offices and overall statistic system must be legally regulated and rules must be made public.

economical statistic concepts, consistency, operatives, good foundation and stability, focus on the description of the economic process in monetary and simple terms, flexibility, and complex use.

A key regulation of the new concept is to focus on the construction of a SYSTEM, one that is composed of mutually connected and caused elements (statistical agencies- producers of data) that combine to form the totality. Construction of the system is possible with the establishment of IT, methodological, and legal connections, the main elements of the system:

- **Methodological connection** in terms of full application of international statistical standards and classifications. Any data that is a result of internal methodology and that is not in compliance with international standards and classifications cannot be entered in the system.
- **Legal connection** – The Law on statistics, and decrees based on it, regulate complete legal structure of all data producers.
- **IT connection.** An IT system is created that monitors the concept of the statistical system. The data producer is responsible for the formation of a database that is within his competency and he must make all data available to other participants as regulated by law. The data producer is obliged to make his database available to all other participants in the statistical system in the most efficient form. All other producers have the right, and obligation, to incorporate the source database into their database in compliance with the defined criteria and do not hold the right to form a new database produced by another producer in the system.

The statistical system is based on the following **key principles**:

- **Data is public property.** Pursuant to the Law on Statistics that shall be drafted in compliance with the concept of the statistical system in Montenegro, each producer is responsible for the quality of the data it produces. It is the producers' responsibility to collect statistical data for which it is responsible and to make it available to the system.
- **Data dissemination.** Statistical data becomes public (published) the moment it is entered into the database of the competent institution. Publishing data of other participants in the system does not imply responsibility for the quality of that data.
- *Users of data: Statistical data produced in the statistical system of Montenegro is considered public property as long as the data was obtained by institutions that are financed from tax revenue. Public property status implies free access and free of charge use.*

**In order to realize the concept, the first step is to define the legal regulation that has institutional character - defining the rules and principles through which it will be possible to create a statistical system in Montenegro.** The Government of Montenegro adopted the Proposal of Law on Statistics and Statistical System in Montenegro in March 2005 and sent it to the Parliament of Montenegro for further discussion. Key conceptual elements of the proposed Law are presented in the text below.

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- h) Statistical system of a country should be organized in a manner that provides coordination between individual statistical agencies and offices in the country.
  - i) Statistical system must be based on international standards and concepts, classifications and methods in order to provide consistency and international comparability.
  - j) Statistical offices should develop bilateral and multilateral cooperation with statistical systems in other countries, with the aim of enhancing research quality and results obtained.



**KEY CONCEPTUAL ELEMENTS OF THE PROPOSED LAW ON STATISTICS AND STATISTICAL SYSTEM IN MONTENEGRO<sup>4</sup>**

Adoption and implementation of the Law on Statistics and Statistical System in Montenegro are done with the goal of creating a functional system of statistics with a clear distribution of responsibilities and mechanisms of cooperation. The proposed Law is completely harmonized with EU standards in this area<sup>5</sup>.

This Law establishes basic principles on which modern statistical systems are based and puts special attention towards the principle of confidentiality that is connected with personal data.

The law defines the basic principles of official statistics in the Republic of Montenegro, organization of the statistical system and the principles on which it is based, the program of statistical research, the means of gathering, treating and storing statistical data, statistical registers, dissemination of statistical data, the means of providing confidentiality of statistical data, international statistical cooperation, and provides answers to other questions that are important for the functioning of a statistical system.

Statistics is based on the **principles** of relevancy, impartiality, reliability, transparency, timeliness, professional independence, rationality, consistency, publicity, and statistical confidentiality with personal data being used exclusively for statistical purposes.

The statistical system of Montenegro shall be **based** on methodological, legal and information technology consistency.

**Producers of statistical data are:** Monstat, Central bank of Montenegro, Securities Commission of Montenegro, Ministry of Finance, Custom Office, Public Revenues Office, Commercial Court Business registry, Secretariat for Development, and other bodies determined by the program. Statistical data producers will conduct activities prescribed by this Law in accordance with the methodology<sup>6</sup> that is defined in internal communication among producers in the System. *Statistical data producers are fully responsible for data collection, processing and dissemination of statistics from all sources.*

**Statistical activities** of data producers were defined by the Law, as follows:

- **Monstat** shall conduct the following activities:
  - development of a statistical system;

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<sup>4</sup> Law was prepared by a team consisting of representatives from statistical agencies and other state authorities, Institute for Strategic Studies and Prognoses, and supported by international experts financed through technical assistance to Montenegro

<sup>5</sup> EU standards are established with the following EU acts:

- Contract about EU, sixth part- General and Final decree articles 285 and 286
- Rule book of Council 322/97 from 17<sup>th</sup> February 1977 about statistics of Community, which arranges distribution of responsibilities between national and community organs responsible for implementing the law that regulates statistics
- Decision of Commission from 21<sup>st</sup> April 1997 that regulates the role of EUROSTATA with questions of producing statistics in Community (97/281/EC)
- Decision number 2367/2002/EC EU Parliament and Council from 16<sup>th</sup> December 2002 about the statistical program of the Community from 2003-2007
- Decision of Council of EU from 19<sup>th</sup> June 1989 that establishes a Committee for statistical programs of member states (89/382/EC)

<sup>6</sup> Methodology established by Government of Montenegro

- coordination, development and implementation of the program and reporting on program implementation;
  - establishing, updating and maintaining methodological bases and their harmonization in cooperation with other producers of statistics, and following-up on application of the same and providing instructions to other producers of statistics on how to apply the methodology;
  - prepare and implement statistical activities and fulfill international obligations within the scope of work determined by the program;
  - production of basic indicators and statistical aggregates within the scope of work determined by the program, usage of all accessible data sources, usage of administrative data sources and data obtained by the method of observation and follow-up that are gathered by all producers of statistics;
  - follow-up and implement control over quality of statistical results;
  - analysis and interpretation of statistical results;
  - introduce and maintain statistical registries and statistical database;
  - organize the sharing of results and methodological bases of statistics with other countries and international organizations, except in cases where the other producer of statistics is in charge of that, or unless otherwise prescribed by a special law.
- **The Central Bank of Montenegro** shall keep monetary, financial, insurance, balance of payments and payments with foreign countries statistics;
  - **The Securities Commission** of Montenegro shall keep statistics of capital markets;
  - **The Customs Administration** shall gather and control data on international trade in goods (custom tariffs and duties, import excise, except for goods subject to excise payment under the regime of delayed excise payment (installment), value added tax when importing goods, road toll in the case of transit of goods through the territory of the Republic of Montenegro, as well as administrative fees paid for goods in customs procedure;
  - **The Directorate of Public Revenues** shall keep statistics of fiscal revenues;
  - **The Ministry of Finance** shall keep statistics of fiscal expenditures and non-fiscal revenues;
  - **The Central Registry of the Commercial Court** shall keep statistics of economic entities (business organizations and entrepreneurs).
  - **The Republic Secretariat for Development** shall keep statistics for development and investments, and it shall publish the list of macroeconomic indicators.

In order to improve statistical culture and knowledge, and to make sure that all necessary statistics will be provided to users, the Government of Montenegro will establish a **Council of Statistical System**, which will be an advisory and expert body with the authority to make decisions on all strategic issues related to statistics and the statistical system in Montenegro.

The **Council**<sup>7</sup> provides **expert opinion and proposals** on: Program proposal; Annual work plan and proposal of report on work plan realization; decrees to establish new or change existing administrative sources of data; draft laws and decrees related to statistics or statistical activities; development and improvements to the statistical system and international cooperation; increase in educational level of statistical producers and users; and other issues relevant for statistical system operations and development. Additionally, the Council has the authority to evaluate statistical system functionality -- cases where the administrative source

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<sup>7</sup> The Council has 17 members, who represent all statistical agencies (data producers), science and research institutions and the NGO sector. The Council is appointed by the Government of Montenegro.

does not provide the requested data necessary for statistical purposes, as well cases where statistical producers do not work in accordance with the Law. The Council is **responsible** to define a list of macroeconomic indicators that will be published in cooperation with the Secretariat for Development, to decide on organization of census, to audit proposed statistical surveys and to abolish the decision to organize surveys and other infrastructural projects, to determine financial resources, and to make sure that international standards are applied.

Statistical activities will be based on the **Program**. The Program, proposed by the Ministry of labor and social protection, after Council's evaluation, will be adopted by the Government. All statistical data producers will participate in preparation of the Program. As the Program covers a five-year period, an **annual work plan** will be prepared in order to provide realization of activities defined in the Program.

Other than those listed, the Law defines issues on collection, processing and dissemination of data; statistical registries; international cooperation; and other standard elements of a legal act. The Law is fully based on **international standards and practice** in this field.

### **CONCLUSION**

The proposed Law is a good institutional base for development of statistics and a statistical system in Montenegro. Implementation of the Law will lead to a more efficient and organized statistical system, which will produce more accurate and timely relevant data to all institutional sectors. Additionally, the new law will bring lower costs associated with data production due to its network based organization and a reduction in transaction costs of production, processing and dissemination of data.

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**COMMENT 4**

***HOW THE POTENTIAL INCREASE IN MINIMUM WAGE WILL INFLUENCE THE MONTENEGRIN ECONOMY?***

***Ana Krsmanović, ISSP***

It is the custom in Montenegro to demand that the Government solve a variety of problems. Employment, wages, pensions, competition, investment, inequality, poverty, education, etc. are issues that are often put on the Government's agenda. The question is whether the government can or **should** solve all these problems. By minimizing the government's role in the economy, except for setting the rules of the game, the market forces will solve some of these problems.

The minimum wage is now on the agenda. The issue of an increase in the minimum wage has again been initiated by the Independent Alliance of Trade Unions. The Union request is to increase the minimum wage by 10%, or from 50€ to 55€. Since the first round of negotiations failed when the Government decided not to increase the minimum wage, the Union announced that they will continue to lobby for the minimum wage increase, and will do so more actively starting in September with the organization of strikes.

We have analyzed the impact that the minimum wage has on the economy and our suggestion is that it is a good time to change the rules on the labor market.

***1. THE CONCEPT OF MINIMUM WAGE***

The minimum wage represents a unit costs of unskilled labor, i.e. the price of unskilled labor for one hour, one week or one month. The minimum wage, as a concept, was introduced with the main goal of preventing the exploitation of the most vulnerable portion of the labor force, such as workers in the low paid labor intensive industries, females, and youth labor force.

In Montenegro, the minimum wage is more of a general concept. Minimum wage is defined as the price of 176 hours of unskilled labor. In addition to the minimum wage, the General Collective Agreement (GCA) defines minimum wage coefficients for all levels of education (skills). Thus, the Montenegrin definition<sup>8</sup> of the minimum wage assumes that all categories of workers are vulnerable, since there are different minimum wages for different levels of education. For example, an employee with a university degree, according to GCA, is entitled to a minimum wage of  $3.3 \times 50\text{€} = 165\text{€}$ , where 3.3 is the wage coefficient for this level of education and 50€ is a general (national) minimum wage.

Internationally, this is not the case. For example, in the United States, the federal minimum wage is a minimum price of labor for all and it is set at \$5.15 per hour, there are no differences based on the level of education and few differences based on occupation. Unlike the situation in Montenegro, normally, the minimum wage is not used as a parameter for

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<sup>8</sup> For more details on the concept of minimum wage, see MONET 13, comment "Minimum wage in Montenegro – a dangerous concept"

setting other wages in the economy; however, in some cases there is a link between the minimum wage and other wages, but this exists only for some activities and some countries.

Additionally, the national level minimum wage is not applied in all economies. For example, in Croatia the minimum wage compulsory to all employers (national minimum wage) was introduced in 1998. In the United Kingdom, the minimum wage concept was abolished in the Thatcher<sup>9</sup> era, while under Mr. Blair's mandate in 1998, the minimum wage was introduced as a national wage for the first time in the UK.

In Montenegro, the minimum wage is defined on a national level and it is compulsory to all employers in Montenegro.

## 2. INFLUENCE OF MINIMUM WAGE ON THE ECONOMY

Similar to a variety of other issues in the economy, there are different attitudes towards the goals and the impact of the minimum wage. On one side there are supporters of state interventionism, claiming that the minimum wage increases the standard of living, as well as employment (D. Card, A. Kruger<sup>10</sup>). On the other side, there are free-market oriented economists, claiming that the artificial increase in the price of one good causes a shrinking of demand for this good (D. Deere, K. Murphy, F. Welch<sup>11</sup>), so an administrative increase in the price of labor will reduce the demand for labor.

### Box 1. Negative and positive effects of the minimum wage

**Supporters of minimum wage** concept claim that minimum wages have following influence<sup>1</sup>:

- Reduce low paid work, which might be exploitative and unfair,
- Reduce dependency of the low-paid on welfare-state benefits,
- Stimulate economic growth by discouraging labor-intensive industries,
- Encourage students to stay in (or return to) school and thus to accumulate human capital.

**Opponents of the minimum wage** claim that minimum wages have following effects:

- Limits employment of low-wage earners, and increases unemployment in general
- Increases barriers on the labor market for people with little or no work experience or formal education.
- Increases labor cost, thus hindering economic growth,
- Lowers the supply of labor, and in that way, hinders economic growth,
- Increases the price of goods and services, since employers pass on employment costs in the form of higher prices,
- Decreases incentive for some low-skilled workers to gain skills,
- When implemented locally, it makes labor more expensive than in other areas, encouraging local businesses to relocate their operations elsewhere.

Empirical data in the US have showed that the minimum wage does decrease employment, especially among those that are meant to be protected by the minimum wage. According to Bruce Bartlett<sup>12</sup>, from 1948 to 1955, unemployment rates among black and white teenage<sup>13</sup>

<sup>9</sup> Ms. Margaret Thatcher was Prime Minister, from 1979-1990.

<sup>10</sup> Book: "Myth and Measurement: The New Economics of the Minimum Wage" - D. Card, A. Kruger, Princeton University Press 1995

<sup>11</sup> "Sense and Nonsense of Minimum Wage" - D. Deere, K. Murphy, F. Welch, Cato Review of Business & Government

<sup>12</sup> Senior fellow in the National Center for Policy Analysis

males were almost the same, 11.3% and 11.6%, respectively. After increasing the minimum wage from 75 cents to \$1, unemployment rose for both groups. By 1969, unemployment among black teenagers reached 22.7%, and for white teenagers 14.6%. The 27% increase in minimum wage that took place in 1990 and 1991, according to D.Deere, K.Murphy and F.Welch<sup>14</sup>, reduced employment by 7.3% for all teenagers. Later studies conducted in 1996 suggested that each 10% increase in minimum wage leads to a 2-6% decline in employment. According to all mentioned studies, an increase in the minimum wage in the US has had a strong influence on employment by reducing the number of low-paid employees, ultimately creating adverse effects as those planned.

Besides the influence on employment, an increase in minimum wage might also lead to higher inflation. Namely, since the price of one production input has increased artificially, i.e. the increase in wages did not happen due to an increase in productivity, this higher price will be effectuated in the higher price of output (products/services).

## *2.2. Effect of minimum wage increase on the Montenegrin economy*

Increasing the minimum wage in the Montenegrin economy has two direct impacts on the economy:

- Increase in the labor cost in general,
- Increase in the budget expenditures.

Indirect effects of the minimum wage increase are reduction of employment and increase in inflation.

Considering the minimum wage concept itself, in its general applicability, we will focus our analysis on the influences of the minimum wage on the overall labor market and economy. Unfortunately, there is no data that could identify its influence on individual categories of workers.

### *Effects of the minimum wage increase on the labor cost*

The influence of minimum wage on the labor cost in Montenegro is simple. Namely, as explained previously, there are actually 10 levels of minimum wage depending on the level of education. Therefore, an increase in minimum wage leads to an increase in the total labor cost. Our assessment<sup>15</sup> is that for roughly 10-15% of total employed persons, the national minimum wage is not used as a parameter in setting wages. Some of these companies have their own minimum wage levels that are higher than the national minimum, while others have higher wages, so they meet the requirements set in the GCA related to wage level. Thus, salary for roughly 85% of employed persons is dependent on the minimum wage.

During 2004, the Government of Montenegro decided to reduce the total fiscal burden on salaries, i.e. the Government announced a two-phase reduction in the rates of personal income tax and pension and health insurance contributions by 10% in total (or by 20% for the employers' share of contributions). This reduction has been fully in force since January 2005. By reducing the rates of taxes and contributions, the total labor cost for an employee with a university degree is reduced by almost 3%. The labor cost savings in this case is

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<sup>13</sup> According to the Bureau of labor Statistics data, minimum wage workers tend to be young -- almost half of these employees are under age 25.

<sup>14</sup> "Sense and Nonsense of Minimum Wage" - D.Deere, K.Murphy, F.Welch, Cato Review of Business & Government

<sup>15</sup> Based on salary information from big companies and the branch collective agreement.

equal to the annual salary of one additional employee, so the company could either increase employment or reduce the prices of their goods/services.

However, with a 10% increase in minimum wage, not only the effects of this reduction are fully diminished, but labor cost is further increased.

*Table 1: Effects of reduction in taxes and contributions and increase in minimum wage*

	Before reduction in taxes and contributions (€)	After 10% reduction in taxes and contributions (€)	% change	After 10% increase in minimum wage (€)	% change
	a	b	$c((b/a - 1)*100)$	d	$e((d/b-1)*100)$
<b>WAGE LABOR COST</b>	<b>333.1</b>	<b>322.3</b>	<b>-3.3</b>	<b>354.8</b>	<b>10.1%</b>
Minimum wage	50.0	50.0	0.0	55.0	10.0
Gross wage	270.5	270.5	0.0	297.6	10.0
Net wage	181.5	183.4	1.1	199.9	9.0
PIO employee contribution	32.5	32.5	0.0	35.7	10.0
Health employee contribution	20.3	20.3	0.0	22.3	10.0
Unemployment employee contribution	1.4	1.4	0.0	1.5	10.0
Personal income tax	34.9	33.0	-5.5	38.1	15.6
Housing allowance	1.9	1.9	0.0	2.1	10.0
Surtax on PIT	5.2	4.9	-5.5	5.7	15.6
Union contribution	0.5	0.5	0.0	0.6	10.0
Chamber of commerce contribution	0.9	0.9	0.0	1.0	10.0
PIO employer contribution	32.5	26.0	-20.0	28.6	10.0
Health employer contribution	20.3	16.2	-20.0	17.9	10.0
Unemployment employer contribution	1.4	1.4	0.0	1.5	10.0
<b>NON WAGE COST</b>	<b>37.5</b>	<b>37.5</b>	<b>0.0</b>	<b>41.3</b>	<b>10.1</b>
Meal allowance	25.0	25.0	0.0	27.5	10.0
Holiday allowance	12.5	12.5	0.0%	13.8	10.0%
<b>Total Labor Cost</b>	<b>370.6</b>	<b>359.8</b>	<b>-2.9%</b>	<b>396.1</b>	<b>10.1%</b>
<i>Annual cost per one employee</i>	<i>4447.6</i>	<i>4,317.6</i>	<i>-2.9%</i>	<i>4,752.7</i>	<i>10.1%</i>
<i>Annual cost per 40 employees</i>	<i>177905.4</i>	<i>172,703.1</i>	<i>-2.9%</i>	<i>190,106. 0</i>	<i>10.1%</i>

Source: Government of Montenegro, [www.vlada.cg.yu](http://www.vlada.cg.yu)

Calculations: ISSP

In order to show how the minimum wage increase will affect employment, we use, as an example, a company with 40 employees holding university diplomas. (This is a rather simplified explanation; however, it will show the nature of its influence). Due to a 10% increase in minimum wage, the labor cost increases by the same percentage, while net wages increase by 9%. On the company level, the increase in labor cost is equal to the annual wage of 3.8 employees, i.e. the company could potentially hire 4 new employees. Therefore, the increase in minimum wage lowers the possibility for new employment, in this case reducing potential employment by almost 4 persons. A more drastic effect would be felt if the company cannot afford to pay 10% more on labor, in that case, 3-4 employees will lose their jobs.

To summarize, in the case of a company with 40 employees, the government's increase in minimum wage will result in labor that is 10% more expensive. On the employees' side, the effects would be a 9% increase in net wage followed by, in the best case, a reduction of 4 potential jobs, or, in the worst case a reduction of 8 jobs (4 potential and 4 existing jobs).

*Effects of minimum wage increase on government expenditures*

Having in mind the applicability and nature of the minimum wage concept in Montenegro, it is inevitable that an increase in minimum wage will cause higher budget expenditures.

The public services sector<sup>16</sup> employs roughly 32,000 persons, from which more than two-thirds are employees in the education and health sector. Wages of these employees are directly financed from the state budget. The wages of employees in the education and health sector are directly linked to the minimum wage. Also, the public servants wages are linked to minimum wage, until the provisions of the Law on wages of public servants and clerks are applied. Namely the Law on wages and salaries of public servants and clerks introduces value points as a parameter for wage setting, instead of the minimum wage, which is currently used.

For the purpose of assessing the influence of a minimum wage increase on total budget expenditures in 2006, we have assumed that the budget plan, including the planned deficit, will be identical to that of 2005. Table 2 gives an overview of these changes.

**Table 2: Effects of a minimum wage increase on budget expenditures on wages for 2006, under assumption that the budget will be the same**

Type of expenditure	Planned amount	Amount after minimum wage increase	Difference	% Increase
	a	b	c	d((b/a-1)*100)
<b>Expenditures (in € million)</b>				
<b>1. Gross wages and salaries</b>	<b>158.58</b>	<b>173.39</b>	<b>14.81</b>	<b>9.34</b>
1.1. Net wages and salaries	90.25	94.81	4.56	5.05
1.2. Surtax on personal income tax	2.82	3.18	0.37	13.24
1.3. Personal income tax	18.93	21.35	2.32	12.28
1.4. Social security contributions	46.59	54.14	7.55	16.22
<b>2. Other benefits to employees</b>	<b>15.45</b>	<b>16.80</b>	<b>1.35</b>	<b>8.75</b>
2.1. Meal allowance	9.01	9.91	0.90	10.00
2.2. Housing allowance	1.08	1.08	0.00	0.00
2.3. Winter allowance	0	0	0.00	0.00
2.4. Transportation allowance	0	0	0.00	0.00
2.5. Summer allowance <sup>17</sup>	4.90	5.40	0.49	10.00
2.6. Temporary activities allowance	0.02	0.02	0.00	0.00
2.7. Allowance to parliament members	0.30	0.30	0.00	0.00
2.8. Other allowances	0.54	0.54	0.00	0.00
<b>3. Total cost of employees (1+2)</b>	<b>174.44</b>	<b>190.64</b>	<b>16.20</b>	<b>9.30</b>
<b>4. Planned budget deficit</b>	<b>25.60</b>	<b>41.80</b>	<b>16.20</b>	<b>63.10</b>
<b>4. Planned budget deficit as % of GDP</b>	<b>1.60</b>	<b>2.50</b>		

Source: Budget Law 2005

Calculations: ISSP

<sup>16</sup> Public services sector includes state administration, health and education.

<sup>17</sup> Actual budget plan for this category is €1.4 million, which obviously does not include all employees financed from the budget. This number was obtained by multiplying €150 (€160) by 32753, which is our estimation of employees financed from the budget. This estimation is obtained using a simple formula, amount allocated to meal allowance we have divided by 11 to get total amount per month and by 25 to get the number of employees receiving this compensation.



Since the Union has announced more pressure on the Government beginning in September, let's assume that the increase will happen in the fourth quarter of 2005. If the Government agrees to increase the minimum wage in October, it will cost roughly €4.2 million, or €2.9 million if we consider that public servants will not be affected with this increase.

Increasing the minimum wage by 10% will cost the Government €16.1 million from the central budget, or if we take into account only the education and health sector, €11.5 million. The question is, how will this increase be financed? Furthermore, under the assumption that the 2006 budget will be the same as 2005, the minimum wage increase will cause an increase in the budget deficit of 63.1%, or in Euros, it will increase from €25.6 million to €41.8 million. In terms of GDP share, the budget deficit will increase from 1.6% of GDP to 2.5% of GDP.

#### What the historic data show?

Our previous simplified explanation is based solely on economic logic. For the purpose of assessing the true impact of minimum wage, based on historical data from the Macro-model for Montenegro, we have extracted some data-series and generated equations shown in box 2.

The observed period from 1994 to 2004, is characterized by a constant increase in minimum wage up to 2002, when the minimum wage was set at 50€ per month, and since then, it hasn't changed. According to results obtained by this analysis, the effects of a minimum wage increase on employment are not immediate; it takes two years for effects to show themselves. On the other hand, an increased minimum wage increases labor cost and also increases the level of tax burden on wages, which is sooner effectuated on employment. Therefore, since an increase in minimum wage immediately increases the tax burden, the negative effect of the increased tax burden on employment is felt after just two quarters.

**BOX 2. How the minimum wage influences employment and inflation**

Table 3. Link between employment and minimum wage

Dependent Variable: LOG(EMPLOYMENT)				
Method: Least Squares				
Date: 05/24/05 Time: 12:06				
Sample(adjusted): 1996:1 2004:4				
Included observations: 36 after adjusting endpoints				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	12.02578	0.021447	560.7249	0.0000
TAX(-2)	-0.094868	0.013965	-6.793281	0.0000
MINPL(-8)	-0.002395	0.000377	-6.356445	0.0000
R-squared	0.635024	Mean dependent var		11.86567
Adjusted R-squared	0.612904	S.D. dependent var		0.025587
S.E. of regression	0.015919	Akaike info criterion		-5.362931
Sum squared resid	0.008363	Schwarz criterion		-5.230971
Log likelihood	99.53276	F-statistic		28.70846
Durbin-Watson stat <sup>1</sup>	1.239523	Prob(F-statistic)		0.000000

Source: MMCG, Calculations: ISSP

Note: EMPLOYMENT – overall official employment, TAX – tax burden on wages, MINPL – minimum wage

Table 4. Link between minimum wage and inflation

Dependent Variable: IMC				
Method: Least Squares				
Date: 05/26/05 Time: 07:58				
Sample(adjusted): 2000:1 2003:4				
Included observations: 16 after adjusting endpoints				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-179.0497	47.98844	-3.731101	0.0025
MINPL(-2)	2.649173	0.177569	14.91913	0.0000
ZAPTRA(-4)	0.002686	0.000657	4.091215	0.0013
R-squared	0.958332	Mean dependent var		132.9021
Adjusted R-squared	0.951921	S.D. dependent var		24.42303
S.E. of regression	5.355198	Akaike info criterion		6.361373
Sum squared resid	372.8159	Schwarz criterion		6.506233
Log likelihood	-47.89098	F-statistic		149.4945
Durbin-Watson stat	1.410925	Prob(F-statistic)		0.000000

Source: MMCG, Calculations: ISSP

Note: IMC – retail prices index, ZAPTRA – employment in tradable sector, MINPL – minimum wage

A 10% increase in minimum wage (assuming that the tax burden remains the same) will lead to a 1.2% reduction in employment over a two-year period. With the high unemployment rate (over 20%) in the Montenegrin economy, boosting employment is the goal; the minimum wage increase can only boost unemployment.

The general level of prices is also impacted by the level of minimum wage, i.e. inflation. Table 4 shows inflation explained by employment in the tradable sector and minimum wage. A 10% increase in minimum wage (assuming that employment in the tradable sector remains the same) increases the inflation rate by 10%. If, hypothetically speaking, inflation in Montenegro is 5%, six months after increasing the minimum wage it will be 5.5%.

And in the end ...

If the goal of an increased minimum wage is to improve the living standard of citizens, we can now say that this will not happen. Let's assume for a moment that this is true, that the Montenegrin government has an easy job, it can decide to increase the minimum wage to 1000€, and everybody will have higher salaries, living standards will be improved, and everybody will be happy. It would also follow then that many other problems could also be solved; for example, the pension fund deficit would not be a problem because on higher salaries, higher contributions are paid and the PIO generates more revenue. There is a saying, if it sounds too good to be true, it probably is.

On the other hand, businesses, by hiring more expensive labor will have to charge more for their goods and services, thus pushing prices up. The Montenegrin economy will enter into a cycle of wage and pension growth – price growth – wage and pension growth – price growth, etc. while the living standard of citizens would remain the same, if not become worse. Another reaction to an increased minimum wage could be decreased employment, which again generally decreases the standard of living.

Intervening on the labor market cannot solve the social issues. As we mentioned, a decreased role of government on the labor market could lead, through reduced fiscal burden, to the generation of new employment, based on the labor cost savings or to lower prices if companies choose to reduce their prices and become more competitive.

The concept of minimum wage reduces the negotiating powers of workers and seriously limits the freedom of contracting. Also, the minimum wage concept supports the shadow economy, which is damaging from an employee point of view as it provides no savings for the future and no healthcare or other benefits, and also bad from the government's perspective as it results in a loss of fiscal revenues.

The Government, or anybody else, should not determine the price of labor. This price should be set on the market, between the members of the workforce (supply side) and the employers (demand side).

**COMMENT 5**

**WORLD TRADE ORGANIZATION AND AGRICULTURE**

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**I INTRODUCTION**

The World Trade Organization (WTO) is an international organization, which was established in 1995 when it replaced the General Agreement on Tariffs and Trade (GATT). GATT was originally issued in 1948, when 23 countries ratified the agreement of reduced tariffs. All regulations in the framework of GATT and WTO have been reformed through multilateral negotiations about trade – well known as Round. The objectives of these negotiations were: to recuperate rules about guiding international trade on a fair and equal basis and to acquire agreement on reduced barriers for international trade. Since 1948, GATT went through eight rounds of negotiations. One of the eight was the Uruguay Rounds, and during that negotiation, the World Trade Organization was established.

The objective of WTO is to promote open door trade, and with that objective assured, to annihilate import tariffs and other barriers. WTO operates on the promotion of: process globalization, expansion of multinational companies, and trends toward common liberalization of the different profiles of international trade.

WTO enforces and controls current agreements of open door trade, settles trade disputes between governments of WTO member countries, and organizes trade negotiations. The WTO has three main objectives that ratify WTO agreements:

1. Make the trade process easier between WTO members,
2. Pro-negotiations insure further liberalization of trade and
3. Reconstitute fairly settled trade disputes.

Decisions of the WTO are final and all members must respect that. However, members do have the right to implement trade sanctions to countries that have broken the rules of that organization.

The World Trade Organization has developed very quickly, and today there are 148 member states that comprise about 97% of the total world trade.

**II WTO AGRICULTURAL POLICY**

Eight conferences and WTO rounds on tariff rates have taken place from 1947 to 1994 (Dillon Round, Kennedy Round, Tokyo Round, conference in Geneva, and more). In the beginning, negotiations were conducted according to the principle “product by product,” after which the principle “position by position” was applied. Trade of agricultural production was regulated for the first time in the WTO Uruguay round, and that’s why this round is considered the most important for the agricultural sector.

### *Uruguay round*

The Uruguay round was launched in Punta del Este, Uruguay, on September 20<sup>th</sup> 1986 and was concluded on April 15<sup>th</sup> 1994, when the final document was signed.

Agriculture, as one of the most sensitive issues, was “unreachable” until the Uruguay Round because participating countries (“contracting parties”) were negotiating on the regulation of industrial goods’ trade. The large number of exemptions on multilateral trade rules, which existed in the agricultural sector, created a widely accepted opinion that this area could not be regulated with the strict international rules, because that would have caused far-reaching social and economic disturbances. In the meantime, tensions and conflicts in international trade became stronger every day.

Protectionist agricultural policy, which was applied in many developed countries, caused a growth of consumers and producers’ prices. All protectionist measures, whether they were tariffs or non-tariff barriers (special fees, quantity import restrictions, export restrictions), as well as different support measures (subsidies, guaranteed purchase of surpluses), came under attention within the Uruguay round. The main goal was the gradual reduction of these mentioned measures.

Despite the fact that negotiations went through many crises, thus endangering their successful completion, final agreement is considered one of the most important achievements in the whole Round. International trade rules and discipline were applied in the agricultural sector for the first time thanks to the Uruguay round. Above all, the negotiations resulted in an established framework for long-term reform in trade of agricultural products and domestic agricultural policies.

One of the results of the Uruguay round is the Agreement on Agriculture, which is a foundation for regulation of this area. The trade rules for agricultural products were tightened, resulting in increased predictability and stability of this sector, both for exporting and importing countries. This agreement is a decisive step towards stronger market orientation in agriculture.

In addition to the Agreement on agriculture, two documents influence agriculture and its regulation: Sanitary and Phytosanitary Measures Agreement and the Agreement on Subsidies and Compensatory (Countervailing) Measures.

### *Agreement on Agriculture*

The essence of the Agreement on Agriculture is a classification of all agricultural policy measures, which are subject to reduction and multilateral control, in three main groups:

- Market access, ie. tariff concessions;
- Domestic support ie. subsidies for producers; and
- Export stimulations.

The new rule for market access in agricultural products, which was introduced by the Agreement on Agriculture, is called “tariffication,” meaning the converting of all other types of non-tariff protection measures to tariffs. Tariffs obtained this way, including tariff rates and non-tariff duties on agricultural products’ import, were subject to reduction and consolidation. Developed countries would reduce the tariffs by an average of 36%, in equal steps over the next 6 years (1995-2000), while developing countries would make 24% tariff

## Comments

cuts over the following 10 years (1995-2004). Additionally, the minimal reduction of tariff rates for each product should have been 15% for developed countries and 10% for developing countries. Underdeveloped countries, on the other hand, were not obliged to reduce their tariff rates.

*Table 1. Reduction of tariff rates*

	<b>Developed countries 6 years: 1995 - 2000</b>	<b>Developing countries 10 years: 1995-2004</b>
Average reduction rate for all agricultural products	- 36%	- 24%
Minimal reduction rate per product	- 15%	- 10%

*Source: www.wto.org*

In addition to this, tariffication required maintenance of the existing market access possibilities and establishment of so-called minimal tariff-quota access in cases when market access was less than 3% of domestic consumption. These minimal tariff-quota access rates should increase by 5% over the Agreement implementation period.

However, the Agreement contains articles on special temporary protection measures, which could be implemented in cases where the price of imported products, in domestic currency, is below a certain level, or in cases of sudden import growth. Such measures can be implemented as additional protection, but in a transparent and completely predetermined way.

In order to facilitate implementation of the tariffication process in particularly sensitive situations, a clause on "special treatment" has been introduced into the Agreement. Special treatment allows a country to keep import restrictions during the implementation period, but they are subject to strictly defined conditions. After six years of extension, a country would have to take additional duties.

Special and differential treatment, which should be implemented in developing countries as a common element of all obligations taken in the Uruguay Round, is contained in all parts of the Agreement on Agriculture. These clauses refer to the primary agricultural product, which is traditionally the main subject of trade on the list of a developing country, which cites this clause.

Domestic support programs, which are part of the Agreement on Agriculture, include a wide spectrum of measures. Goals of these measures include the growth of agricultural production on one side and the growth of farmers' revenues on the other, as well as to provide incentive for the rural population to engage in agricultural production. Programs implemented to achieve these goals vary, ranging from direct support through guaranteed prices for agricultural products to subsidizing inputs to reduce production costs.

The Agreement on Agriculture differentiates between domestic support measures, which are harmful for trade, and those that have minimal or no impact. Domestic support measures that directly impact prices of agricultural products and those that subsidize input prices are known as "Amber box" measures in WTO terminology. The Agreement contains clauses to reduce these measures. In the case of import duties, a previous calculation of the AMS-Aggregate Measurement of Support is required, through a specific mechanism. Values obtained this way are subject to a 20% reduction for developed countries, and a 13%

reduction for developing countries. The implementation period is, as in the case of import duties, 6 years for developed (1995-2000) and 10 years for developing countries (1995-2004).

*Table 2. Reduction of domestic support measures*

	Developed countries 6 years: 1995 - 2000	Developing countries 10 years: 1995-2004
Reduction of Aggregate Measurement of Support	- 20%	- 13%

Source: *www.wto.org*

Measures of support for agricultural producers who have minimal impact on trade ("Green box" measures) are not subject to reduction. These measures include public government services such as research, disease and pest control, food security and infrastructure services; direct payments to farmers that impact growth revenues but have no impact on the price of production; aid for structural adjustments; and payments made directly to farmers under environmental and regional assistance. In addition to these, certain government measures are not subject to the reduction according to the Agreement such as: programs to limit production ("Blue box" measures); certain government assistance programs to encourage agricultural and rural development in developing countries; other small scale support ("de minimis") when compared with the total value of the product or products supported.

The Agreement on Agriculture does not prohibit export subsidies in agriculture, but its reduction by a certain percentage over the period of implementation is required. Subject to this requirement are domestic subsidies that are approved depending on export results and those that are financed from the budget or funds provided through a certain government decision (for example using funds collected from import duties on agricultural products to subsidize export of agricultural products). An important decision criterion is the source of funds, not the redistributing body, which subsidizes export.

According to the Agreement, mentioned export subsidies would not expand and their level would be lowered compared to the average of the base period 1986-1990. This means a reduction to both the expenditures for subsidies and to the quantities of subsidized export. Reductions would be conducted in equal portions over the implementation period. Developed countries agreed to cut the value of export subsidies by 36% over six years starting in 1995, and the predicted reduction is 24% over 10 years for developing countries. Additionally, developed countries agreed to reduce the quantities of subsidized exports by 21% over six years, while developing countries will decrease this percentage by 14% over 10 years.

*Table 3. Reduction of subsidies*

	Developed countries 6 years: 1995 - 2000	Developing countries 10 years: 1995-2004
Value of subsidies	- 36%	- 24%
Quantity of subsidies	- 21%	- 14%

Source: *www.wto.org*

### ***Other agreements that influence agriculture***

*The Agreement on the Application of Sanitary and Phytosanitary Measures* contains measures that provide food safety for protection of human health (food safety measures), protection of animal health (sanitary measures) and protection of plant health (phytosanitary measures), if these measures influence international trade. Before the agreement to implement the sanitary and phytosanitary measures, many rules on food safety, plant and animal health have been regulated on technical standards and rules. According to the Agreement on the Application of Sanitary and Phytosanitary Measures, participating countries ("contracting parties") should apply sanitary and phytosanitary rules only to the extent necessary to protect human, animal or plant life and health; all sanitary and phytosanitary regulations must be based on science; implementation of these rules must not restrict international trade and they should not arbitrarily or unjustifiably discriminate between countries where identical or similar conditions prevail.

*The Agreement on Subsidies and Countervailing Measures* defines three categories of subsidies: prohibited subsidies; actionable subsidies (which can be subject to legal disputes); and non-actionable subsidies (which cannot be subject to legal disputes). This agreement regulates the usage of subsidies and determines which measures countries can undertake in regard to the subsidies' effects. The Agreement predicts legal disputes between countries within WTO, according to certain procedures, and requires either withdrawal of the subsidy or elimination of its negative effects. Countries could also conduct additional research and introduce additional tariffs (well known as "countervailing") on subsidized products, which endanger domestic producers. The Agreement on Subsidies and Countervailing Measures refers to agricultural and industrial products, except for the case when subsidies are in accordance with the Agreement on Agriculture.

### ***III WTO AND DEVELOPMENT COUNTRY (EU; USA; CANADA AND JAPAN)***

After the Uruguay round of negotiations there was a significant reduction of custom tariffs in the world. However, custom policies of developed countries (Canada, European Union, USA and Japan) are still marked with high tariffs in certain sectors (special custom peaks) and custom escalation<sup>18</sup>.

About 10% of the custom scale of the mentioned countries is still above 12 *ad valorem* after complete enforcement of the Uruguay round and the general scheme of preferential. Custom peaks in these countries range from 350% to 900% for important export products, especially for food and clothes. About one-fifth of USA custom peaks, around 30% of Japanese and EU, and one-seventh of Canadian custom peaks are over 30%. The most important areas with great frequency and high custom rates are agricultural products, especially: meat, sugar, milk, cheese, butter and wheat, and tobacco products. By applying tariffs with the earlier quantitative restrictions, with duties and other measures of non-tariff restrictions, the custom rates have risen, in most cases, to above 30%. The EU is applying additional charges on poultry meat, eggs and sugar. The food industry in the EU comprises 30% of all custom peaks, ranging from 12% to 100%. In several cases there are additional charges that are meant to protect the processing industries from the high prices of agricultural import inputs.

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<sup>18</sup> Under the term "custom escalation" we mean the rise of custom tariffs correlated with the higher processing phases of the product. Custom escalation is often called as the effective rate of protection



The USA, Japan, Canada and EU comprise about 75% of world production, and among them, there is a constant feud about the conquest of new markets, both within the territories of developed countries and on the markets of less developed countries. These countries give different types of subsidies and tax cuts to its producers, by which they reduce the price of the product that is then sold in other countries.

**Box 1*****WTO has approved European trade sanctions against the USA***

WTO has ended many court cases related to imposing various direct or indirect trade barriers.

In August of 2002 the WTO judged that the EU can implement trade sanctions in the amount of four billion dollars against the USA because of tax-cuts that are received by American companies. This reparation is twenty times larger than the any other reparation that the WTO has ruled in any court case. The EU has calculated this amount on annual trade losses that the EU15 have suffered because of the tax-cuts that are given to domestic companies in the USA.

*Source: www.voanews.com*

***The Doha Round***

Besides the fact that developed countries gain new markets, they have an even greater impact in the harm they are inflicting on the markets (economies) of less developed countries. In November of 2001 WTO member states met in Doha, the capital of Qatar, in order to make the Doha Development Agenda. The aim of the meeting was to create a system of trade rules that would be fairer to the developing countries. The Doha round was the first attempt to influence the reduction of agricultural subsidies and protections that exist in the developed countries. In September of 2003 in Cancun, the summit of WTO was dedicated on the implementation of agreements from the “Doha round” of negotiations. The summit was focused on four main areas – agriculture, industry goods, trade of services, and the code of new customs. The negotiations did not succeed because the rich and poor countries could not reach an agreement, especially on the issues of agriculture<sup>19</sup>. For the failure of the negotiations, the main countries to blame are the EU and the USA, the countries with the highest subsidies in the world, and the countries that have not met the agreements from the Doha round. On the other hand, the developing countries did not want to sign the agreement proposed by the developed countries as they considered the agreement to favor the rich WTO member states.

The developing countries have hinted that they would guarantee intellectual property rights and access to the markets for products and services, but only if they could gain access to the markets of the developed countries. Many developing countries considered that they made concessions during the Uruguay Round of Agreements, but have not been reciprocally awarded with access to the markets of agricultural markets. At the ministerial meeting in Cancun, the developing countries set agricultural liberalization and reduction of agricultural subsidies of rich countries as a precondition for any type of agreement. These countries have been especially critical of the Common Agricultural Policy of the EU, which amounts for nearly half of the expenses of the EU, and the high subsidies that the U.S. gives to farmers, especially cotton producers<sup>20</sup>.

<sup>19</sup> *At the meetings, the developed countries have admitted that with the subsidies and agricultural protection they prevent the access of the agricultural products from the less-developed countries to their markets.*

<sup>20</sup> *Cheap cotton from the USA is flooding the world markets, the prices are dropping, and in that way the cotton from the African fields is impossible to sell on the world market for a real price.*

In August of 2004, 147 WTO member states agreed in Geneva to reduce agricultural subsidies in the amount of one billion USD, to open markets for industrial products, and to resume discussions regarding world trade liberalization. After five days of negotiations, the WTO member states agreed to implement a framework within which the agreements on the liberalization of world trade within the Doha round, after the failure of its implementation in Cancun, would continue.

With this adopted agreement, the deadline for the cancellation of the export subsidies, which harm the most third-world agricultural producers, is being set. Key WTO member states, among them, the USA, EU, Brazil and Japan, agreed to abolish export subsidies, which were for a long time the principal demand from the developing countries, as well as to reduce the number of products protected by high barriers.

The USA agreed to diminish its export credits and some of the subsidies it provides to the cotton producers, as well as to cut the subsidies for corn, wheat, rice and Soya by 20% in the first year. These subsidies are now worth around \$19 billion. In return, the rich countries have gained more favorable access to the markets of developing countries, especially for industrial goods<sup>21</sup>.

The expectations are that all of the points of this agreement from Geneva will be met before the ministerial agreement of WTO in December 2005 in Hong Kong.

#### ***IV MONTENEGRO AND WTO***

The stage of development of Montenegro imposes that all development policies should be followed in light of joining the EU and WTO. These memberships should result after many Agreements on Free Trade. The process of signing Agreements on Free Trade presents a much better answer to high protectionism than protection through customs, paid by citizens and enterprises. Membership in the Free Trade Clubs implies the absence of custom protection.

Currently, the customs in Montenegro are lower than those in the EU; however, if the levies, customs during the season, and other non custom barriers were converted in customs according to WTO rules, the overall level of customs in Montenegro would be higher. The average agricultural tariff in Montenegro, after converting levies in custom rate, doesn't exceed 20%, but membership in the EU requires that this rate be between 10-12%. Negotiations with either the EU or WTO, in the field of agriculture, are generally very hard, because of its complexity.

Montenegro has begun WTO accession negotiations<sup>22</sup>. The accession negotiations are conducted through three phases. The first phase in the accession process is the application of different documents that describe the current situation in the field of international trade. Montenegro has provided part of that documentation and is now awaiting a response from the WTO member states. The second phase is negotiations within the working group for WTO accession in Geneva, where it is decided whether the Montenegrin regulation and practice meet the WTO criteria. And the third phase is the preparation of documents that are comprised of the entire custom regulation and the tariffs for all products. Having in mind that WTO acknowledges customs as the only legitimate instrument for the protection of domestic production, the basic request is to convert all non-custom barriers into a unique

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<sup>21</sup> *The experts of the World Bank estimate that the Doha Round, with the intensification of trade, will remove five hundred million people from poverty.*

<sup>22</sup> The process of the accession negotiation of Montenegro to the WTO began on the 15th of February 2005

custom rate and then determine the initial level of protection of the domestic economy, which will be the basis for further negotiation.

If Montenegro seeks full membership, the custom protection must be reduced. These reductions will directly affect the domestic economy.<sup>23</sup> After all, customs liberalization increases competition on the domestic market, resulting in a poorer short-term position for domestic producers. Thus, only products those are competitively priced and of high quality will be able to subsist on a global market. Additionally, referring to the very low level of domestic production compared to the very high necessity of public expenses, other measures of protection that are used in developed countries (support for undeveloped areas, new investments and technologies, endangered households etc.) are not available.

## V CONCLUSION

Developed countries, as well as developing countries, insist on reciprocal liberalization, the "I'll open my market, only if you open yours" principle doesn't make economic sense. Every country feels better in the conditions of an open market even if its partners are protectionists. Economic costs of tariffs and other trade barriers almost always pay the country that applies them, not its trade partners. Probably, it is politically impossible to open third world markets to European products and services without a quid pro quo principle (something for something). Practically speaking, the developed world has to reform their subsidies (main obstacle) in agriculture in order to improve liberalization in global trade.

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<sup>23</sup> The accession process started on February 15th, 2005.

