MONET

MONTENEGRO ECONOMIC TRENDS

July 2004

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).

***The Institute's mission is** "to provide research that will contribute to Montenegro's economic transformation and to change the current mindset, as well as to train today's young people how to function successfully in the new environment."*

Major projects:

- o Macroeconomic reform in Montenegro
  - **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

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Events

January 2004

21. ***Treasury bills issue.*** *Government in Montenegro issues 28-day-treasury bills in the amount of € 12 million.*

26. ***Montenegroberza adds four more companies to its listing.*** *Montenegroberza adds shares of HTP Berane to its A list, while shares of Brskovo, Mjesovito and Guming to its B list.*

28. ***€ 13 million for new workplaces.*** *The Government of Montenegro and six Montenegrin commercial banks sign contracts for business support loans worth € 13 million. This credit line is designed to stimulate employment and to finance projects in agriculture and tourism.*

February 2004

03. ***Hotel Splendid sold.*** *Company "Hotel Group Montenegro Stars," from Kotor, purchased Hotel Splendid. The new owner paid € 2,425,000 for the hotel and he should, within the next three years, invest € 4.7 million.*

04. ***Treasury bills issue.*** *Government in Montenegro issues 56-day-treasury bills in the amount of € 4.5 million.*

09. ***Tender for Beranka announced.*** *The Agency for Reconstruction and Foreign Investments of Montenegro announced tender for sale of approximately 80% of the shares of the Factory for production and processing of paper – Beranka, from Berane.*

10. ***Tender for Livnica announced.*** *The Agency for Reconstruction and Foreign Investments of Montenegro announced tender for sale of approximately 87% of the shares of Livnica Nikšić.*

17. ***New tender for Željezara.*** *The Agency for Reconstruction and Foreign Investments of Montenegro repeated tender for sale of 57.9% of the shares of Niksic's Holding Company, Zeljezara.*

26. ***Agro budget – € 9.2 million.*** *According to the announcement of the Montenegrin Ministry of Agriculture, Forestry and Water Management, the agro budget for 2004 amounts to € 9.2 million.*

28. ***Tender for three Hotels announced.*** *The Commercial Court from Bijelo Polje, together with the Ministry of Tourism, announced tender for sale of Hotels: Jezera, Zabljak, and Planinka, owned by the company SKI Center Durmitor.*

March 2004

03. ***Treasury bills issue.*** *The Government of Montenegro issues 56-day-treasury bills in the amount of € 4.5 million.*

08. ***Tender for sale Beranka prolonged.*** *The Agency for Reconstruction and Foreign Investments of Montenegro prolonged the tender for sale of approximately 80% of the shares of the Factory for production and processing paper – Beranka, from Berane.*

12. ***Treasury bills issue.*** *The Government of Montenegro issues 56-day-treasury bills in the amount of € 5.5 million.*

20. ***Tender for sale Hotel Podgorica.*** *The Agency for Reconstruction and Foreign Investments of Montenegro announced tender for sale Hotel Podgorica owned by the UTIP Montenegro.*

22. ***Increase of petrol price.*** *The price of "super" petrol and "unleaded" petrol increased by 2 cents per liter. The new price of "super" and "unleaded" petrol is €0.88 and €0.89, respectively.*

23. ***New Laws adopted.*** *The Parliament of Montenegro adopted three new Laws: Law on Railways, Law on Political parties, and Law on Restitution of Disposed Property Rights and Repatriation.*

24. ***Law on Civil Procedure and Law on Executive Procedure adopted.*** *The Law on Civil Procedure abolishes the institution of the collective jury and introduces an institution of a judge as an individual, while the Law on Executive Procedure should facilitate the process of carrying out executive procedures.*

Executive Summary

First section

In first quarter of 2004, various sectors of Montenegrin economy exhibited different trends.

Industrial production registered negative annual dynamics as a result of deep falls in processing industries and mining and quarrying as well as electricity, gas and water supply. The total number of tourists in 2003 was 10.5% higher than in 2002. In January 2004, the total number of tourists declined by 30.9% compared to the same month in 2003. The number of domestic tourists declined on an annual basis by 32.1%, while that of foreign guests dropped by 26.7%.

Total employment in Montenegro in the first quarter of 2004 registered a decreasing trend. Namely, employment in the first quarter of 2004 was 3.9% lower than in the first quarter of 2003. When compared to the same months of last year, the number of employed was lower by 3.6%, 4.8% and 3.3% in January, February and March 2004, respectively. Average wages and salaries in the first quarter of 2004 increased.

In the first quarter of 2004, the average annual inflation continued its falling trend, reaching a quarter average of 5.5%. Monthly CPI changes in the first quarter of 2004 were very low: 0.1% in January, 0.2% in February and 0.1% in March. RPI exhibited similar dynamics to that of the CPI, continuing a mild declining trend.

Budget revenues experience seasonal fluctuations caused by the lower economic activity. Cumulative budget revenues for the first quarter amounted to €67.1 million or 94.24% of the plan (26.24% higher than in the same period last year). Thus, total expenditures in 2004Q1 amounted to €72.4 million, which represents about 64% of the planned level, but this amount is 17% higher when comparing with the previous year.

In Q1 2004, monetary sector in Montenegro was characterized by an increase of the total deposits. Total loans registered positive annual growth rates in the analyzed period as well.

Increase of the total number of transactions, negligible decrease of the total turnover and growth of the stock exchange indices were among the tendencies dominating the capital market in Q1 2004.

The current account deficit in Montenegro in 2003 amounted to US$ 114 million (around 8.0% of GDP) and nominally declined by 26.2% compared to 2002. Total revenues rose by 11.4% compared to 2002, whilst total expenditures of the current account in 2003 nominally increased by 4.2% compared to 2002.

Second section

Bank research

In November 2003 ISSP conducted research in banking sector of Montenegro. This research is related to the business environment and business barriers in this sector. This research included commercial banks with the research being oriented towards enterprises and their perspective of banking.

The characteristics of the private pension insurance

Analyzing the development of the pension system over time, we have concluded that private pension insurance was established before state pension insurance. Saving for old age was a part of the occupational plan that companies provided for the loyalty of their workers. Such types of contracted savings exist today and represent a constitutional part of the company employment policy. In order to understand private pension insurance, this paper analyzes the components of such systems and explains their basic characteristics.

Foreign Trade Law and Free Trade Zones Law in Montenegro

In 2004, two Laws regarding foreign trade were adopted and one of them implemented - the Foreign Trade Law and the Free Trade Zones Law. Both laws should provide the appropriate legal framework for further liberalization of the Montenegrin economy as well as improvement of its international competitive position. This paper presents comments of these laws.

Law on Investment Funds

Financial market reform and its development is one of the key elements of the total reform program in Montenegro. Implementation of the privatization process requires restitution and normal performing of a capital market with its full infrastructure and legislative framework. The Government of Montenegro adopted a Law on Investment Funds Amendment, in May 2004. This chapter comments the Law and gives suggestions and arguments for its adoption and implementation.

PART 1

Table 1.1 Major Developments in the Real Sector

	GDP		Industrial Output						Tourism			Retail trade turnover (nominally)	
			Total		Processing Industries								
	1989 = 100	Annual change in %	2000=100	Annual change in %	2000=100	Annual change in %	Aluminum production (ton)	Electricity generation (in MWh)	persons	annual change in % *	share of foreign tourists in total in %	index 1999= 100	annual change in %*
1990	89.0	-11.0	194.8										
1991	70.0	-21.3	169.0				102,256	2,963,675					
1992	61.0	-12.9	136.0	-19.5			89,165	2,312,621					
1993	39.0	-36.1	77.3	-43.2			38,104	1,694,769					
1994	39.0	0.0	70.1	-9.2			10,574	1,997,483					
1995	46.0	17.9	69.2	-1.4			26,071	1,504,302					
1996	57.0	23.9	102.9	48.7			51,178	3,102,091					
1997	61.0	7.0	104.5	1.5			80,600	2,276,868					
1998	64.0	4.9	105.3	0.8			76,737	2,713,936					
1999	58.0	-9.4	96.8	-8.0			80,936	2,711,929				100	
2000	59.8	3.1	100.0	3.3	100.0		95,526	2,698,019	448,187		17.8	271	170.9
2001	59.7	-0.2	98.0	-2.0	101.6	2.3	108,123	2,492,993	555,040	23.8	20.8	369	36.1
2002	60.2	0.8	98.7	0.7	103.9	1.3	116,482	2,194,516	541,699	-2.4	25.1	352	-4.5
2003	60.5	0.5	100.9	2.4	101.8	-2.1	120,212	2,586,485	598,539	10.5	23.6	413	17.3
2000-Q1			101.8					952,727	38,745		16.0	145.0	
2000-Q2			91.0					504,224	95,661		20.3	213.7	
2000-Q3			97.2					403,666	277,003		16.3	357.0	
2000-Q4			110.0					837,402	36,778		18.8	368.0	
2001-Q1			103.6	1.8			26,060	952,441	35,067	-9.5	20.0	282.7	95.0
2001-Q2			94.5	3.8			26,610	524,536	97,744	2.2	22.3	335.3	56.9
2001-Q3			87.0	-10.4			27,778	267,701	387,023	39.7	20.1	471.9	32.2
2001-Q4			106.7	-3.0			27,675	748,315	35,206	-4.3	20.6	385.5	4.8
2002-Q1			88.0	-15.1			26,619	507,743	33,292	-5.1	20.9	305.8	8.2
2002-Q2			89.0	-5.8			29,513	265,271	118,958	21.7	25.5	334.3	-0.3
2002-Q3			101.0	16.1			30,105	501,282	352,718	-8.9	26.9	398.6	-15.5
2002-Q4			116.7	9.4			30,245	920,220	36,731	4.3	25.6	370.0	-4.0
2003-Q1			108.5	23.3	104.4	3.7	29,744	1,010,097	26,913	-19.2	21.7	366.8	19.9
2003-Q2			87.9	-1.2	105.9	-6.4	29,988	377,521	123,180	3.5	27.5	392.4	17.4
2003-Q3			98.1	-2.9	99.2	-4.5	30,176	458,240	420,910	19.3	25.0	454.4	14.0
2003-Q4			106.8	-8.5	108.7	0.1	30,304	740,627	27,536	-25.0	30.3	438.3	18.5
2004-Q1			106.6	-1.7	108.9	3.5	30,168	840,947					
Jan-02			77.31	-16.0		-5.6	7,949	186,203	10,450	-9.3	18.4	307.0	15.3
Feb-02			88.13	-17.2		-1.4	8,644	131,239	11,648	6.3	22.1	285.6	3.1
Mar-02			98.53	-12.8		1.3	10,026	190,301	11,194	-11.1	22.2	324.8	6.5
Apr-02			93.01	3.2		14.4	9,682	110,477	15,584	22.1	24.7	321.2	0.7
May-02			79.71	-21.6		-4.0	10,088	36,512	34,190	29.9	24.3	335.5	1.9
Jun-02			94.30	2.2		2.8	9,743	118,282	69,184	18.0	27.4	346.2	-3.1
Jul-02			104.20	24.5		9.6	10,187	171,070	151,284	-6.5	21.1	417.6	-8.3
Aug-02			92.53	5.2		-11.6	9,995	136,702	137,230	-17.2	25.2	431.9	-14.4
Sep-02			106.41	18.2		-0.6	9,923	193,510	64,204	8.0	34.2	346.2	-24.0
Oct-02			116.52	17.4		4.0	10,216	289,604	21,921	39.2	26.3	385.5	-3.5
Nov-02			114.89	10.0		7.8	9,840	284,397	6,826	-30.5	26.9	360.5	-3.0
Dec-02			118.68	1.6		-0.6	10,189	346,219	7,984	-17.2	23.5	364.1	-5.6
Jan-03			99.74	17.2	81.3	13.1	10,217	337,645	9,519	-8.9	22.3	351.9	14.7
Feb-03			113.00	27.9	117.6	-2.3	9,238	371,125	9,520	-18.3	18.7	368.1	28.9
Mar-03			112.66	14.3	114.4	0.2	10,289	301,327	7,874	-29.7	24.1	380.3	17.1
Apr-03			82.47	-11.3	92.5	-16.6	9,903	125,751	13,792	-11.5	24.8	380.3	18.4
May-03			79.91	0.4	107.1	-5.9	10,258	86,870	37,457	9.6	33.8	396.4	18.2
Jun-03			101.41	7.5	118.0	3.2	9,827	164,900	71,931	4.0	23.9	400.5	15.7
Jul-03			100.09	-3.9	96.3	-5.2	10,190	183,360	182,814	20.8	18.8	432.8	3.6
Aug-03			98.79	6.9	96.3	2.3	10,213	143,300	169,966	23.9	20.7	477.3	10.5
Sep-03			95.53	-10.1	105.0	-10.6	9,773	131,580	68,130	6.1	35.6	453.1	30.9
Oct-03			103.55	-11.1	119.1	1.7	10,135	170,262	13,723	-37.4	34.8	428.8	11.2
Nov-03			102.52	-10.8	95.9	-3.6	9,881	222,064	7,436	8.9	31.4	436.9	21.2
Dec-03			120.67	1.6	111.1	2.2	10,287	348,301	6,377	-20.1	22.3	449.3	23.4
Jan-04			99.67	-0.1	80.2	-1.4	10,274	275,727	6,578	-30.9	23.7	397.6	13.0
Feb-04			109.04	-3.5	115.5	-1.8	9,588	340,680					
Mar-04			111.55	-1.1	131.0	14.9	10,305	224,540					

1. REAL SECTOR

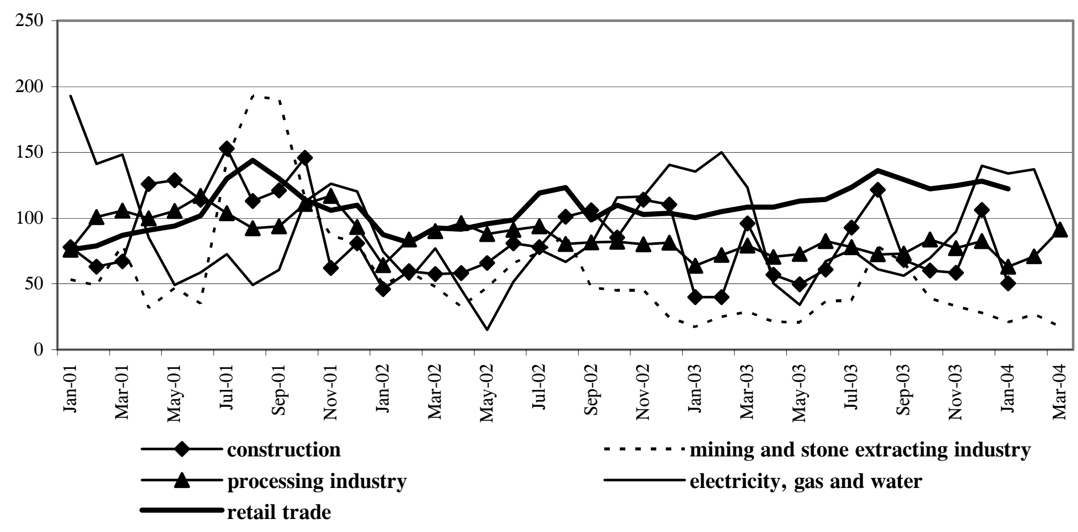
- *Average industrial production in the first quarter of 2004 was 1.7% lower than the average industrial production in the same period of 2003.*
- *Average electricity production in the first quarter of 2004 was 10% lower than in the same period of 2003.*
- *Average aluminum production in the first quarter of 2004 increased by 1.4% compared to the same period of 2003.*

In the following chapter of MONET 17, we present the most recent developments in the sectors of industrial production, tourism, transport, trade, forestry and construction in 2003 and the beginning of 2004. Due to the lack of data, several sectors (health care, education, financial services and services to firms) of the economy are not included in the analysis, and hence, it is difficult to determine the prevailing aggregate trends in the real sector. However, the following analysis comprises the most important sectors, which when combined, account for approximately 55% of the GDP. General trends in the real sector during 2003 were positive in industrial production, forestry, transport and catering, while construction and retail trade exhibited negative trends.

In the first quarter of 2004, industrial production registered negative annual dynamics as a result of deep falls in processing industries (January-February) and mining and quarrying (March) as well as eletricity, gas and water supply (February-March). In late 2003, negative annual dynamics prevailed in, road transport of goods and persons, railway and sea transport of goods, as well as retail trade, but most of them turned positive in January 2004. Positive growth rates were registered for forestry and catering in the late 2003. Annual dynamics of activity in construction was negative in late 2003 but turned positive in January 2004.

Summing up 2003 in the non-industrial sectors, we can say that the average level of activity in forestry was almost exactly the same as in 2002, while construction experienced a severe plunge of 13%. All transportation services were at lower levels than in 2002, with the exception of railway transportation of persons, which remained constant. Higher activity was registered in catering, which grew in real terms by 11.4%, while retail trade decreased by 11% (in real terms) and the construction sector fell by 13%. The following graph presents developments in the dominant sectors in Montenegro:

Graph 1.1: Situation in the certain sectors of the real economy (2000=100)



Source: Monstat

Table 1.2. Industrial production: disaggregated indices of major industries

	share in the index in	2001	2002	1-12.2003		1-3.2004	10.2003	11.2003	12.2003	01.2004	02.2004	03.2004
	2000	2000			1-12.2002							
INDUSTRY TOTAL	100.0	99.3	99.9	99.7	102.4	98.3	88.9	89.2	101.60	99.9	96.50	98.90
MINING AND STONE EXTRACTING	7.6	88.5	95.1	71.6	101.4	91.60	86.00	72.50	113.50	121.5	107.40	59.90
PROCESSING UNDUSTRY	67.8	101.6	103.9	101.8	97.9	104.50	101.70	96.40	102.20	98.6	98.20	114.90
ELECTRICITY, GAS AND WATER PRODUCTION	24.6	93.9	87.7	106.5	117.5	88.80	60.80	78.00	100.50	100.0	92.40	72.10
MINING AND STONE EXTRACTING	7.6	88.5	95.1	71.6	101.4	91.60	86.0	72.5	113.5	121.5	107.40	91.60
RAW MATERIALS EXTRACTION	2.8	78.0	119.1	89.2	85.4	81.70	87.6	70.3	85.4	118.9	121.20	81.70
OTHER RAW MATERIALS EXTRACTION	4.8	94.6	81.1	61.3	115.0	109.80	85.00	74.30	213.00	145.5	91.70	109.8
Metal ores mining	3.4	96.3	96.6	70.4	88.3	122.70	83.90	74.20	290.80	165.7	96.80	122.7
Other ores and stone extraction	1.3	90.3	41.9	38.5	217.8	60.20	94.90	74.00	101.80	117.5	60.30	60.2
PROCESSING UNDUSTRY	67.8	101.6	103.9	99.5	97.9	104.50	101.7	96.4	102.20	98.6	98.20	104.50
MANUFACTURE OF FOOD PRODUCTS, BAVERAGES AND TOBACCO	9.0	104.6	91.8	90.7	101.40	117.00	69.6	69.80	112.80	167.8	104.20	117.00
Manufacture of food products and baverages	7.1	100.1	90.0	98.1	109.50	108.60	62.50	86.10	104.00	141.5	91.00	108.60
Manufacture of tobacco products	1.9	121.9	99.1	62.8	73.00	148.20	107.90	22.20	176.30	856.7	158.10	148.20
MANUFACTURE OF TEXTILE AND TEXTILE PRODUCTS	2.4	72.1	81.5	61.2	75.20	101.10	64.40	128.10	59.00	56.6	62.70	101.10
Manufacture of yarn and fabrics	0.6	94.1	70.5	42.9	80.70	28.90	269.30	122.50	119.90	112.8	30.40	28.90
Manufacture of wearing apparel and fur	1.8	64.9	85.0	67.1	73.80	117.10	42.50	129.80	54.70	54.4	71.70	117.10
MANUFACTURE OF LEATHER AND LEATHER PRODUCTS	0.4	73.6	57.3	40.5	60.4	-	82.5	56.1	43.0	_	-	-
WOOD PROCESSING AND WOOD PRODUCTS	3.6	78.2	54.8	26.3	80.4	185.90	226.9	103.9	111.4	112	219.40	185.9
MANUFACTURE OF PAPER; ISSUING AND PRINTING	1.8	107.2	98.4	62.1	59.2	81.10	68.4	89.7	44.0	76.4	86.00	81.10
Maufacture of cellose, paper and paper processing	1.0	89.8	99.1	27.5	26.5	61.40	34.1	95.8	20.6	52.7	79.40	61.40
Issuing, printing and reproduction	0.8	129.7	97.7	106.7	101.8	87.70	110.4	87.8	90.3	83.6	87.70	87.70
MANUFACTURE OF COKE AND OIL DERIVATES	0.1	111.1	63.8	8.5	12.5	-	83.1	-	150.0	-	-	-
MANUFACTURE OF CHEMICAL PRODUCTS AND FIBERS	1.9	99.9	105.5	71.8	78.5	97.60	163.2	111.8	56.7	112.7	97.40	97.60
MANUFACTURE OF RUBBER AND PLASTIC PRODUCTS	0.5	72.9	91.9	55.0	51.0	39.80	57.1	25.8	75.3	55.4	44.00	39.80
MANUFACTURE OF PRODUCTS OF OTHER NONMETAL MINERALS	6.5	107.2	112.9	110.6	100.3	96.30	98.6	121.4	96.8	92.6	98.10	96.30
MANUFACTURE OF BASE METALS AND METAL PRODUCTS	39.3	109.7	115.2	117.0	102.2	104.30	105.8	96.6	106.6	95	99.00	104.30
Manufacture of basic metals	37.6	111.2	116.8	118.5	102.1	103.90	107.2	97.6	104.6	92.8	99.10	103.90
Manufacture of metal products, except machines	1.7	75.4	97.9	102.0	104.7	121.50	78.3	68.7	177.1	2985.7	98.40	121.50
MANUFACTURE OF MACHINERY AND DEVICES, OTHER	1.8	12.5	52.3	30.1	77.1	120.70	60.3	137.8	310.2	467.9	66.1	120.70
MANUFACTURE OF TRANSPORT EQUIPMENT	0.4	144.0	174.0	167.9	95.8	124.10	209.4	84.2	113.1	86.2	143.9	124.10
PROCESSING INDUSTRY, OTHER	0.1	39.6	63.3	11.6	33.1	221.80	37.4	32.0	100.3	-	-	221.80
ELECTRICITY, GAS AND WATER PRODUCTION	24.6	93.9	87.7	106.5	117.5		60.8	78.0	100.5	100.0	92.4	88.8

1.1. PRODUCTION

The total production index in Montenegro consists of the indices of industrial production, forestry, and construction. Industrial production increased in 2003 (compared to 2002), but annual growth rates turned negative in 2004. However, the processing industry, as the main segment of industrial and total production, had a positive annual growth rate in March 2004. According to the available data on forestry and construction in 2003, activities in the forestry sector were at the same level as in 2002, while they decreased by 13% in the construction sector. As a result, total production in 2003 was at nearly the same level as in the previous year. In January 2004, total production was 1% lower compared to the same month in 2003.

1.1.1. Industrial production

The average industrial production in 2003 was 2.4% higher than in 2002. However, in the first quarter of 2004, the average industrial production was 1.7% lower than in the same period of 2003.

Three major industrial sectors

The processing industry, which represents 67.9%[1] of total industrial production, decreased by 2.1% in 2003 compared to 2002, while in the first quarter of 2004 it was 4.5% higher than in the same period last year. Annual growth rate of the processing industry in March 2004 was 14.9%, while it was -1.4% and -1.8% in January and February 2004, respectively.

Positive trends were registered in several sub-sectors of the processing industry in 2004. The industry *food products, beverages and tobacco* (8.2% of total industrial production) increased its production by 17% in the first quarter of 2004 compared to the same period of the previous year.

In addition, one of the major sub-sectors of the processing industry, "*basic metals and metal products manufacturing*" (45.1% of total industrial production), increased its production by 4.3% compared to the same period in 2003. The sub-sector "*Wood processing and wood products,*" which accounts for 1.5% of total industrial production, increased its average production by a whopping 85.9% in the first quarter of 2004 compared to the same period in 2003. However, several other sub-sectors within the processing industries sector experienced decreased production. Average production of the sub-sector "*chemical products and fibers manufacturing*" (1.5% of total industrial production) declined in the first quarter of 2004 by 2.5% compared to the same period in 2003, while production within the "*Manufacture of paper; issuing and printing*" (1% of total industrial production) declined by 18.9%.

The second major industrial sector, *electricity, gas and water,* which accounts for 24.9% of total industrial production, saw its average production decline by 11.2% in the first quarter of 2004 compared to the same period of the previous year. The annual growth rate of its production was also negative in March 2004, amounting to –27.9%.

[1] Data based on the share of sales in 2003, used in official statistics in 2003.

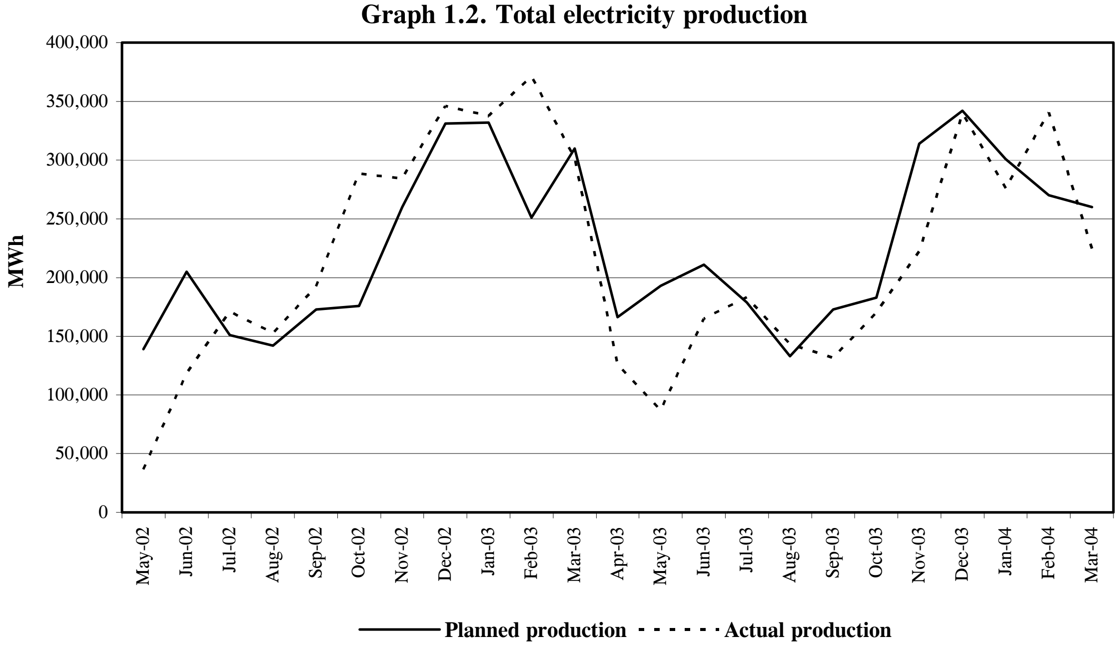
The mining and quarrying industry, which accounts for about 7.2% of total industrial production, declined an average of 8.4% in the first quarter of 2004 compared to the same period in 2003. Average annual growth of its production in March 2004 was negative as well, amounting to –40.1%.

Leading industrial producers

The Power Company of Montenegro (Elektroprivreda Crne Gore), one of the most important industrial producers in Montenegro, decreased its electricity generation by 10% in the first quarter of 2004 compared to the same period in 2003. Electricity generation in March 2004 was 25.3% lower than in the same month of the previous year, while in February and January it was 8% and 18.3% lower respectively.

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

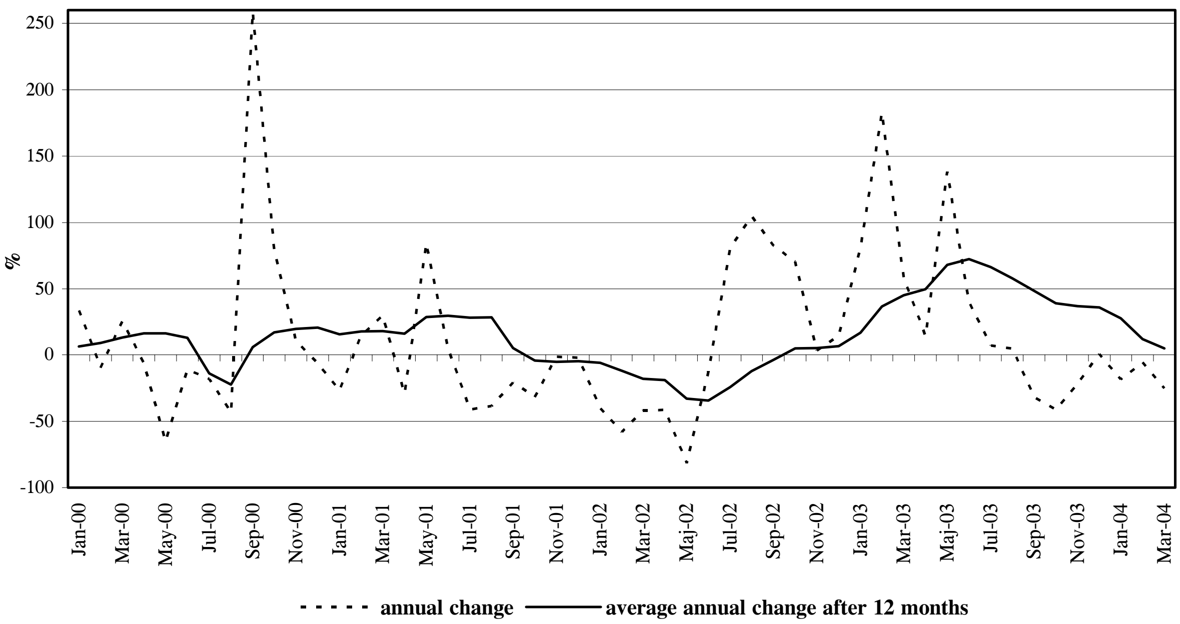
Graph 1.2. Total electricity production



Source: The Power Plant of Montenegro (EPCG)

The total actual production of the three plants in the first quarter of 2004 exceeded the planned level by 1.2%. Individually, the actual production of the *Thermal Plant Pjevlja* was 38.9% under the planned level due to the fact that this plant did not work in March because of the inability to deliver coal from the coalmine (due to severe weather conditions), while total actual production of the *Piva Hydro Plant* was 30.1% above the planned level during the first three months of 2004, and production of the *Perucica Hydro Plant* exceeded the planned level by 24.4% in this period. In March 2004 alone, actual production of the *Piva* Hydro Plant exceeded the planned level by 28.5%, while actual production of the *Perucica* hydro Plant was 60% above the planned level.

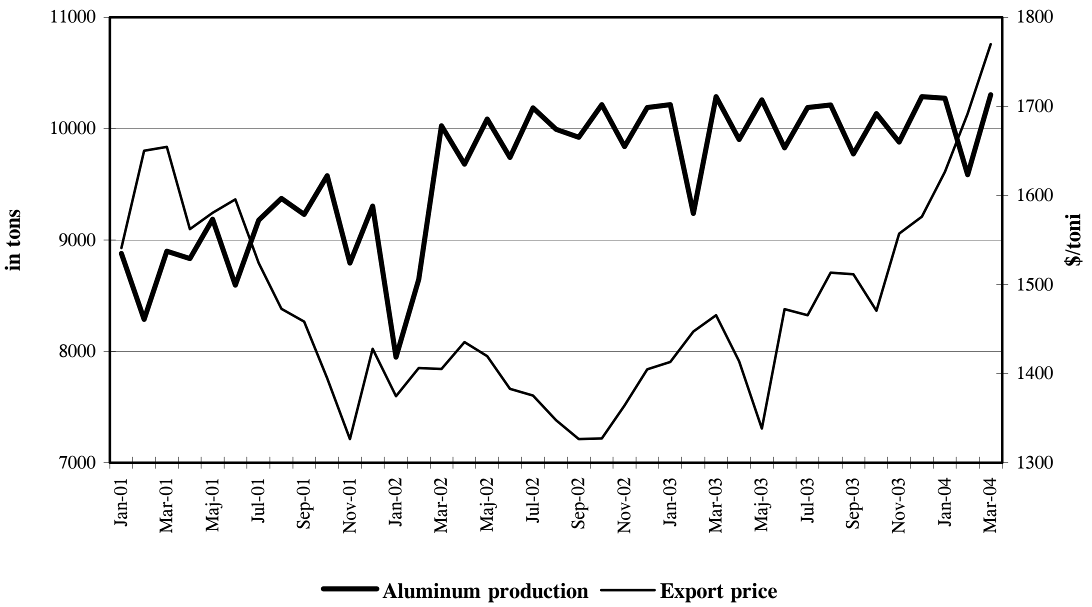
Graph 1.3. Dynamics of electricity production



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

During the first quarter of 2004, production of the Aluminum Combine Podgorica ***(KAP)*** increased by 1.4% compared to the same period in 2003. In March 2004, aluminum production was 0.16% higher than in the same period of 2003.

Graph 1.4: Aluminum production and exports prices



Source: KAP

Graph 1.4 presents monthly dynamics of aluminum production since January 2001, as well as prices at which KAP exported its aluminum. Aluminum production, as the graph presents, increased in March 2004 after falling in February. Furthermore, and in line with the global trend of a rapid growth in metal prices, the average monthly aluminum price has been going up particularly quickly in recent months and has reached the level of 1769.9$/ton in March 2004.

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

	Index value	2000	2001	2002	1-12.2003		10/2003	11/2003	12/2003	01/2004
	Base period	1999				1-12.2002	10/2002 =100	11/2002 =100	12/2002 =100	01/2003 =100
Production	Total	102.5	101.5	101.5	101.0	100.5	88.13	89.66	100.85	98.94
	Industrial production	103.3	101.2	101.9	104.2	102.4	88.9	89.2	101.6	99.9
	Forestry	121.5	104.5	94.0	93.7	100.2	131.0	125.7	120.2	114.0
	Construction	160.0	177.6	198.9	168.2	87.0	70.3	51.2	96.4	109.0
Transport	road (goods)	84.0	100.0	97.0	78.4	80.9	122.1	110.4	57.9	84.0
	road(persons)	102.6	72.8	65.6	53.4	81.5	81.9	88.7	91.9	102.3
	sea (goods)	79.7	41.4	2.1	0.1	5.0	45.6	51.5	67.4	122.0
	railway (goods)	84.0	83.2	106.4	89.4	84.0	68.2	99.3	126.5	154.8
	railway (persons)	103.0	110.2	98.1	98.1	100.0	39.4	64.1	74.4	71.0
Retail trade	current prices	131.0	144.1	136.9	130.1	95.0	111.2	121.2	123.4	113.0
	deflated by CPI	107.4	96.9	79.3	108.0	89.0	104.6	113.9	116.2	107.4
Catering	current prices	124.0	186.0	221.3	255.9	119.0	50.5	101.9	86.0	101.0
	deflated by CPI	101.6	125.1	128.2	212.6	111.4	47.5	95.7	81.0	96.0
CPI		122.0	148.73	172.7	120.4	106.8	106.3	106.4	106.2	105.2

Source: Monstat Monthly Statistical review, no. 8/2001, 4/2002, 9/2003, 10/2003 and 3/2004.

1.1.2. Forestry and Construction

Monstat's data on forestry and construction are the only available data that present activities in these sectors, and they are based on a rather limited sample of firms that are active in forestry and construction.

Forestry

Production in the forestry sector remained constant in 2003 as compared to 2002. In January 2004, the annual growth rate of forestry production was 14%.

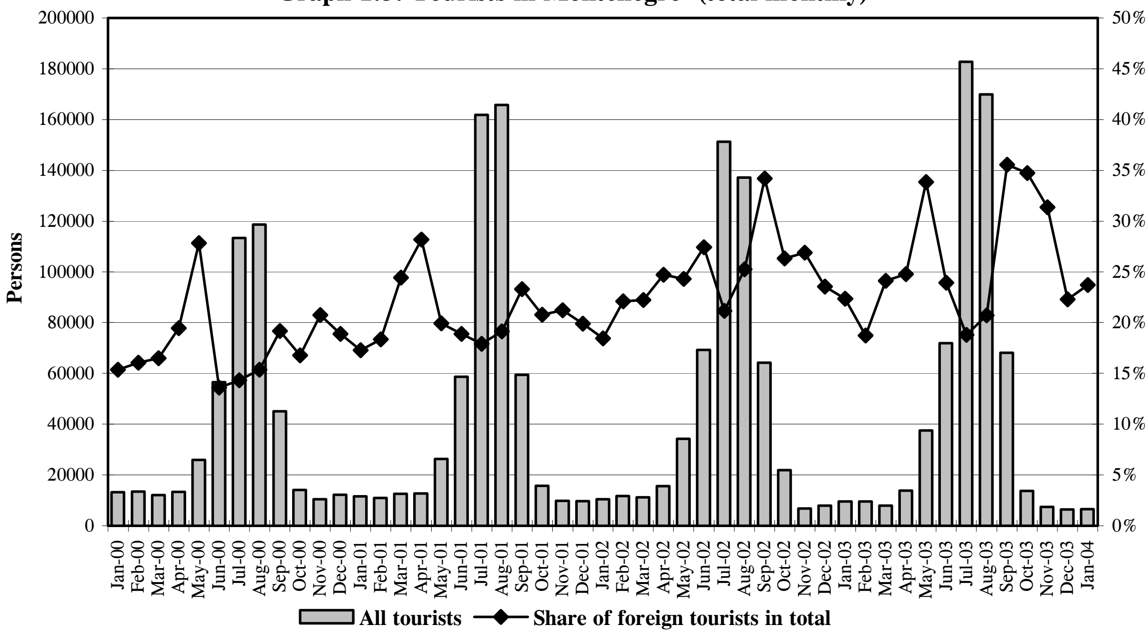
Construction

Construction activities in 2003 were 35.9% lower than in the previous year. In January 2004, the annual growth rate of construction activities was positive, amounting to 9%.

1.2. TOURISM

The total number of tourists in 2003 was 10.5% higher than in 2002. The share of foreign tourists in the total number of tourists in 2003 was 23.6%, which represents a fall of 0.5 percentage points compared to 2002. The number of domestic tourists in 2003 was 12.7% higher than in 2002 (see graphs 1.5 and 1.6). In January 2004, the total number of tourists declined by 30.9% compared to the same month in 2003. The number of domestic tourists declined on an annual basis by 32.1%, while that of foreign guests dropped by 26.7%.

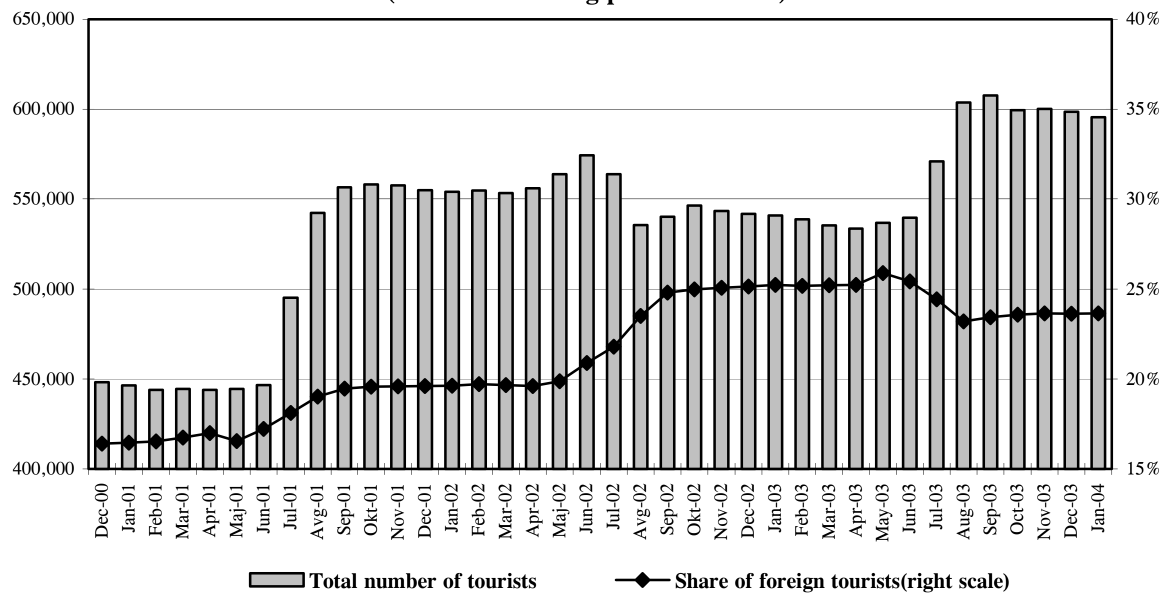
Graph 1.5. Tourists in Montenegro (total monthly)



Source: Monstat

The number of tourists cumulated over the previous 12-month period is presented in graph 1.6. The graph points to the relative stabilization of the annual number of tourists in the 4th quarter of 2003 and into January of 2004; the number of tourists is about 50,000 more than compared to the corresponding period of the preceding years. However, the share of foreign tourists was lower in 2003 by several percentage points, varying by month.

Graph 1.6: Annual visits of tourists in Montenegro
(cumulated during past 12 months)

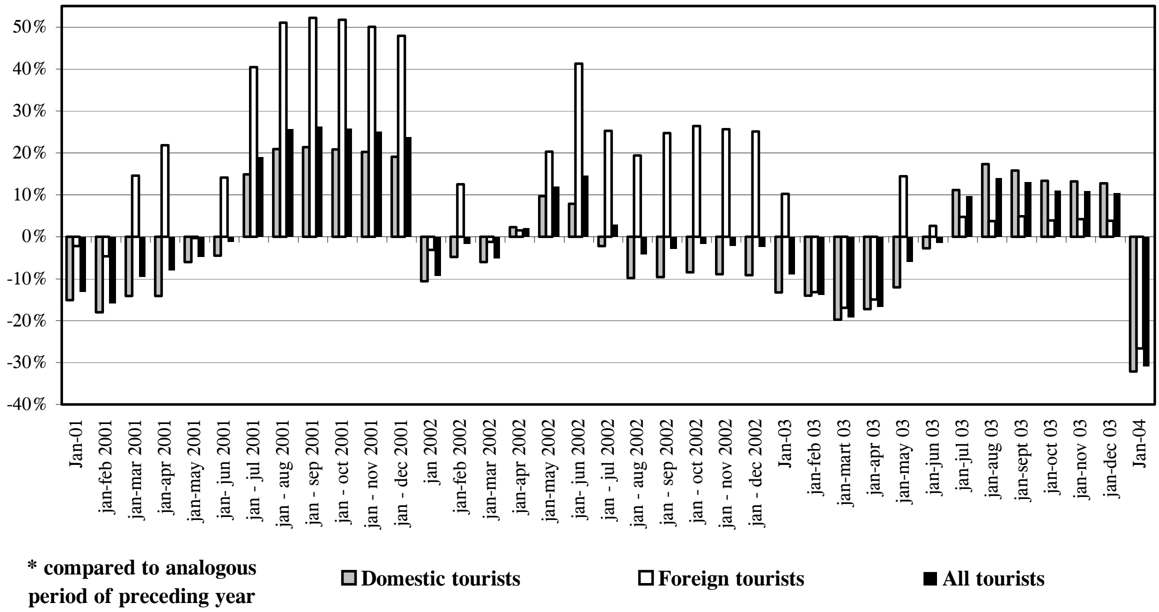


Source: Monstat

The growth rates of tourism, cumulated since the beginning of the respective year are presented in graph 1.7. Data for the period January-December 2003 indicate that the total number of domestic tourists in 2003 increased by 12.7% compared to the same period in 2002, while the number of foreign tourists in this period increased by 4.9%.

Tourism revenue earned from domestic tourists increased by 42.3% while revenue from foreign tourists increased by just 20% in 2003, compared to the previous year.

Graph 1.7. Annual growth rates of number of tourists*



Source: Monstat

1.3. OTHER SECTORS OF SERVICES

Transport

In 2003, almost all forms of transportation services registered a decrease in activities; the only exception being the railway transport of passengers, which maintained a constant level as in the previous year. The largest decline occurred in the sector of sea transportation of goods, which fell 20-fold in 2003 to represent just 5% of what it represented in 2002. Road transportation of goods decreased by 19.1% while road transportation of passengers declined by 18.5%, compared to 2002. In 2003, railway transportation of goods decreased by 16%.

In January 2004, transportation activities were at higher levels than in January 2003, except for railway transportation of passengers (29% lower) and road transportation of goods (16% lower). Road transportation of passengers was 2.3% higher than in January 2003, while the analogous figures for railway transportation of goods and sea transportation of goods were 54,8% and 22%, respectively (see table 1.3).
Revenue from the export of transportation services, as evidenced in the Balance of Payments statistics, increased by 31.2% in 2003 compared to 2002.

Retail trade

In 2003, the average level of real[3] retail sales services was 11% lower than in 2002 (or 5% lower in the case of nominal retail sales). The annual real growth rate of retail sales was 7.4% in January 2004, while in nominal terms it was 13%.

Catering

The average real level of catering in 2003 was 11.4% higher in 2003, while the analogous figure in current prices rose by 19%, compared to 2002. On an annual basis, the real growth of catering in January 2004 was negative, amounting to –4%, while the nominal growth was 1%.

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[3] Deflated by CPI

[1] Data for 1991 and 2003 are census data. Data from 1992-2002 are ISSP estimates based on the average yearly growth rate of the population between two successive censuses. Data from 2003 census are not final and total number of inhabitants is a total number of inhabitants that are in the country. This methodology respects European standards in presentation of population in one country. Comparable to it is a number 591,269 from the 1991 census. So, earlier used data of 616,632 inhabitants in 1991 from Statistical Yearbook 2002 is shown according to methodology that is not comparable to new census, so the ISSP will in future use this new manner for presenting data

Table 2.1. Labor force and unemployment

	Population (mid -year) without migrations[1]	Total employed persons (all sectors)	Number of unemployed (2)	Unemployment rate %	Unemployment rate % (estimate)	Unemployment rate ISSP survey* %
	Official data			ISSP estimate based on official data	ISSP	
1991	616,632	144,045	58,144	28.8	21.6	
1992	621,763	134,205	64,632	32.5	23.6	
1993	626,214	130,901	62,818	32.4	22.4	
1994	630,441	128,835	58,210	31.1	21.8	
1995	635,002	125,090	59,045	32.1	22.2	
1996	639,114	124,264	60,225	32.6	21.9	
1997	642,719	120,604	63,995	34.7	23.5	
1998	646,618	117,745	68,373	36.7	25.7	
1999	650,053	115,349	75,303	39.5	27.3	
2000	653,825	113,818	83,583	42.4	27.8	
2001	657,233	114,076	81,561	41.7	24.8	
2002	660,051	113,743	80,865	41.5	23.7	
2003	672,556	111,852	71,679	39.0	21.4	
2002-Q1		113.715	81.085	41.6	23.7	
2002-Q2		113,785	81,541	41.7	23.4	
2002-Q3		113,877	80,935	41.5	25.1	
2002-Q4		113,593	79,898	41.3	23.4	
2003-Q1		112,587	76,275	40.4	23.4	
2003-Q2		112,173	72,744	39.3	21.7	
2003-Q3		112,338	66,964	37.3	20.3	
2003-Q4		110,312	70,732	39.1	21.1	
2004-Q1		108,185	71,123	39.7	22.6	
Jan-02		*113,594*	*80,385*	*41.7*	*23.9*	
Feb-02		*113,597*	*81,360*	*41.7*	*23.9*	
Mar-02		*113,953*	*81,510*	*41.8*	*23.8*	*19.6*
Apr-02		*114,180*	*81,961*	*41.8*	*23.8*	
May-02		*113,461*	*81,622*	*41.6*	*23.7*	
June-02		*113,715*	*81,041*	*41.5*	*23.5*	
July-02		*114,422*	*81,166*	*41.6*	*23.5*	*13.7*
Aug-02		*113,684*	*80,830*	*41.6*	*23.4*	
Sep-02		*113,526*	*80,809*	*41.4*	*23.4*	
Oct-02		*113,676*	*80,183*	*41.3*	*23.2*	*20.7*
Nov-02		*113,679*	*79,894*	*41.2*	*23.5*	
Dec-02		*113,425*	*79,616*	*41.5*	*23.5*	
Jan-03		*112,673*	*76,584*	*40.3*	*22.6*	
Feb-03		*112,771*	*76,077*	*40.5*	*22.5*	
Mar-03		*112,317*	*76,165*	*40.4*	*22.6*	
Apr-03		*112,132*	*74,896*	*40.0*	*22.3*	
May-03		*111,738*	*73,250*	*39.6*	*22.0*	
June-03		*112,648*	*69,735*	*38.2*	*21.0*	
July-03		*112,905*	*66,951*	*37.2*	*20.3*	*17.0*
Aug-03		*112,647*	*66,277*	*37.0*	*20.2*	
Sep-03		*111,461*	*67,664*	*37.8*	*20.4*	
Oct-03		*110,911*	*71,023*	*39.0*	*21.2*	
Nov-03		*110,387*	*72,547*	*39.7*	*21.6*	
Dec-03		*109,639*	*68,625*	*38.5*	*20.6*	
Jan-04		*108,562*	*69,573*	*39.1*	*22.2*	
Feb-04		*107,359*	*71,419*	*39.9*	*22.7*	
Mar-04		*108,634*	*72,378*	*40.2*	*22.8*	

Source: Monstat, Employment Office of Montenegro and ISSP

Methodological note:

- ***Population (mid-year) without migrations*** *is an ISSP estimate based on vital statistics. The starting point is a census data for 1991 and population for each subsequent period is obtained by adding the difference between births and deaths in respective periods as reported by the Monstat.*
- ***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 obtained by combining data from Monstat, Federal Labor Force Survey and ISSP Household Survey. These data are used to estimate the number of employed persons per household, number of households, average number of households, as well as the official number of employed and unemployed. In this way we obtain the number of employed and unemployed in the economy and the rate is calculated using the standard abovementioned formula.*
- ***ISSP Survey unemployment rate*** *has been obtained from the ISSP Household Income Expenditures Surveys and is, based on the answers to the following questions: During the previous week, did you work, or were you involved in any gainful activity, for money or in-kind compensation (at least one hour)? Although you did not work in the previous week, do you have a job? Did you look for a job in the past 4 weeks? Then, using the standard formula the rate is calculated.*

CHAPTER 2. EMPLOYMENT

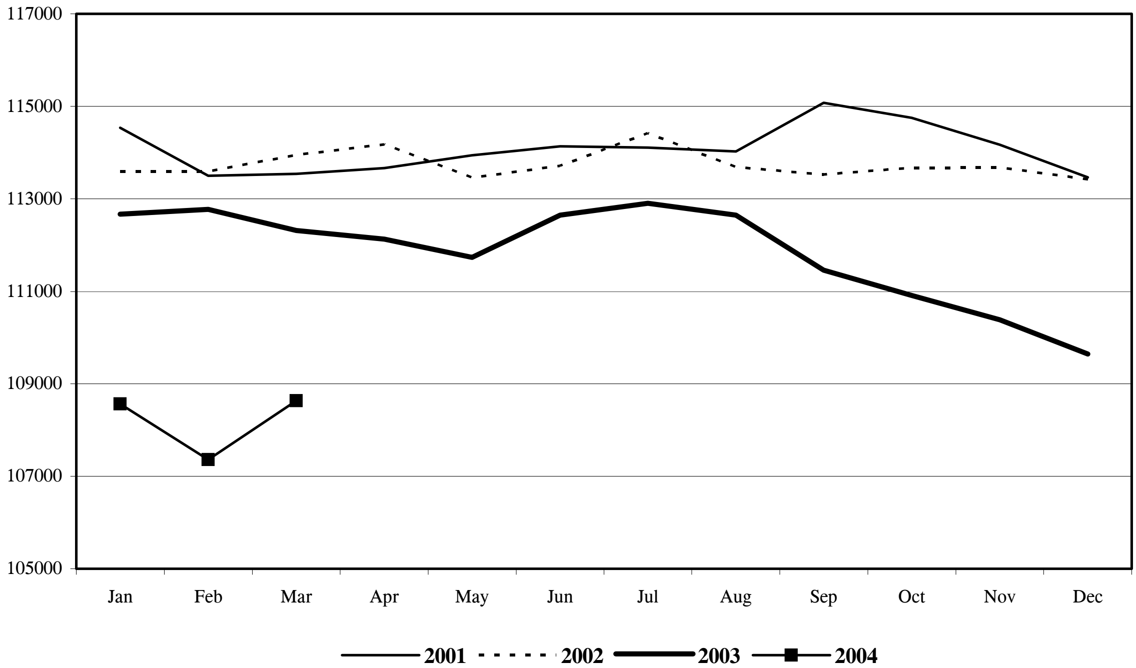
- *According to official data, employment in Montenegro, after a constant decline since July 2003 began to increase in March 2004*
- *The average number of unemployed in the first quarter of 2004 was 0.6% higher compared to the fourth quarter of 2003.*
- *According to the Survey of Employers on Employment, which was carried out by the Employment Office, 33% of employers plan to increase employment in 2004.*

2.1 EMPLOYMENT AND UNEMPLOYMENT

According to the official data, employment in Montenegro declined in the first two months of 2004, and then started to increase in March. The number of employed persons in January was equal to 108,562 while in February, just 107,359 were employed (or 1,200 persons less). March showed a slight increase to 108,634 total persons employed. When compared to the same months of last year, the number of employed was lower by 3.6%, 4.8% and 3.3% in January, February and March 2004, respectively.

If we observe quarterly averages, employment in the first quarter of 2004 was 3.9% lower than in the first quarter of 2003 and 1.9% lower than the average employment in the fourth quarter of 2003.

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

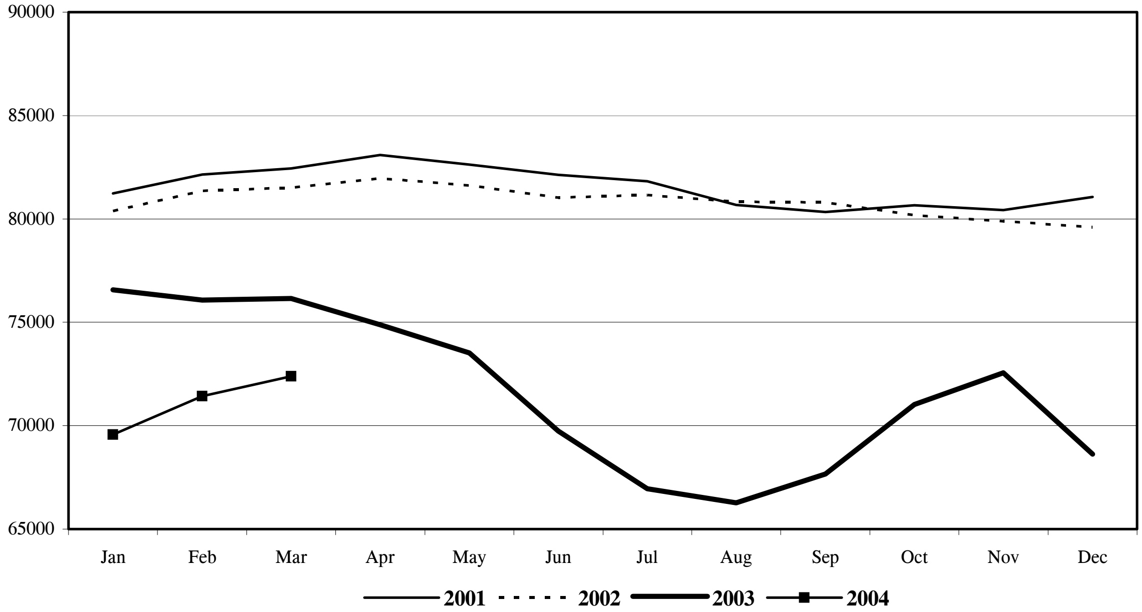


Source: Monstat

In the same period, the number of unemployed persons increased and in March 2004 it was 5.5% higher than in December 2003. Overall, the average number of registered unemployed in the first quarter of 2004 was 0.6% higher than in the previous quarter (Q4-2003). However, if we observe annual changes, the number of unemployed persons was lower in the first three months of 2004 compared to the same months last year, by 9.2% in

January, 6.1% in February and 5% in March. So, in the first quarter of 2004 compared to the first quarter of 2003, the average number of unemployed persons fell by 6.7%.

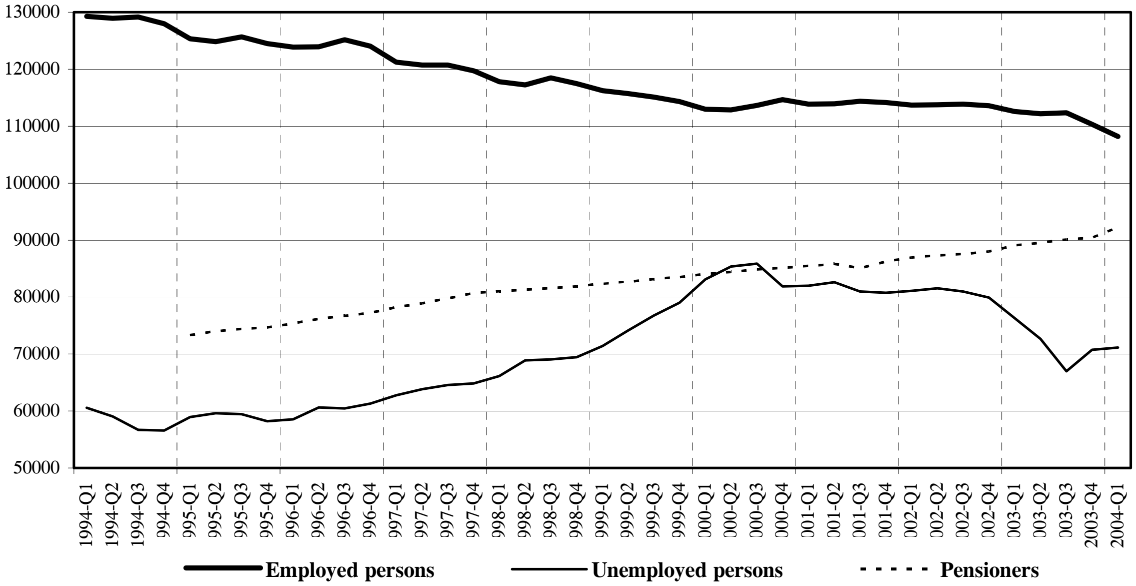
Graph 2.2: Number of unemployed persons (2000-2003)



Source: Employment Office of Montenegro

As shown in graph 2.2, an increase in the number of unemployed persons in the first quarter is typical (seasonal effect), with the exception of 2003, when the Employment Office started a stricter execution of the Employment Law[2] in terms of requiring unemployed persons to register regularly, to take mandatory trainings, etc. The number of unemployed persons usually goes up until April and then declines during the remainder of the year.

Graph 2.3: The official number of employed, unemployed persons and pensioners (1994Q1-2004Q1)



Source: Monstat, Employment Office of Montenegro and ISSP
Note: data are quarterly averages

[2] Employment Law regulates the definition of an unemployed person, as well as rights that unemployed persons have along with the conditions that have to be fulfilled in order to qualify as unemployed such as regular reporting, taking trainings when summoned, accepting an offered job, etc.

The number of pensioners continues to increase. In the first quarter of 2004, it was 1.9% higher compared to the previous quarter (Q4-2003), which is significant compared to the 0.7% average quarterly increase in the number of pensioners in 2003 and the 0.5% increase in 2002. Although no clear seasonal pattern has emerged with respect to the number of pensioners, in the past there have been years in which quarterly increases in the number of pensioners were highest in the first quarter of the year.

2.2. EMPLOYMENT OFFICE'S SURVEY OF EMPLOYERS ON EMPLOYMENT

In October 2003 the Employment Office conducted a survey among employers related to employment in 2003 and employment trends in 2004. The survey included total sample of 10,440 employers (companies) from all over Montenegro, which represents nearly 50% of registered employers (companies and entrepreneurs) in the country. From this sample a total of 9,749 companies responded to the survey (i.e. answered questionnaires).

In the survey, companies were divided into five groups according to the number of employees (see table 2.2). The largest number of companies (45.1%) employs between 1 and 5 workers. This category is followed by individual entrepreneurs (one-employee companies), which make up 35.5% of the surveyed companies.

Table 2.2. Structure of surveyed companies according to the number of employees

	One employee	Between 1and 5 employees	Between 5 and 10 employees	Between 10 and 50 employees	Over 50 employees	Total
Number of companies	3,465	4,394	803	737	350	9749
%	35.5%	45.1%	8.2%	7.6%	3.6%	100.0%

Source: Survey of Employers on Employment, Employment Office of Montenegro, January 2004

In addition to data on the size of companies in terms of employment, the survey helped to obtain particularly interesting data related to redundant labor in companies, as well as companies' plans for 2004 in terms of new hires.

Among all surveyed companies, just 5% indicated problems with redundant labor. Among those, the majority of cases (55.8%) report that this problem is a consequence of the reduction in company activity while the inappropriate structure of employees was quoted as the second most important reason.

Table 2.3. Redundant labor in companies according to reasons and potential solutions

	%
Reasons	
1. Restructuring of production	9.4
2. Reduction in the volume of production /services	558
3. Inappropriate structure of employees	15.4
4. Other	19.4
Potential solutions	
A) Severance payment	20.2
B) Early retirement program	14.5
C) Employment with other employer	16.3
D) Pre-qualification, retraining, etc.	5.9
E) Status not solved	28.5
F) Other	14.6

Source: Survey of Employers on Employment, Employment Office of Montenegro, January 2004

Among all companies with the problem of redundant labor, those in the manufacturing industry are most likely to voice this concern (41.3%), followed by trade (23%), hotels and restaurants (13%) and transport, storage and communications activity (10.2%). The problem is significantly less important in other sectors.

Table 2.3. Redundant labor in companies according to company's activity

Activity	%
Agriculture, hunting and forestry	3.1
Fishing	0.0
Mining	2.5
Manufacturing	41.3
Electricity production	0.4
Construction	1.9
Trade	23.0
Hotels and restaurants	13.0
Transport, storage and communications	10.2
Financial intermediation	0.1
Real estate	0.6
Public administration	0.9
Education	1.6
Health and social work	0.6
Communal and other services	0.7
Private households with employed persons	3.1
Exterritorial organizations and bodies	0.0

Source: Survey of Employers on Employment, Employment Office of Montenegro, January 2004

On the other hand, 33% of surveyed employers stated that they have plans to increase the number of employees in their company in 2004. Employers cite the expansion of economic activity in their firms, i.e. increased volume of production or services, as the main reason for this increase.

Table 2.4. Overview of employers that plan to increase the number of employees by activity

Activity	%
Agriculture, hunting and forestry	1.58
Fishing	0.34
Mining	0.31
Manufacturing	13.86
Electricity production	0.15
Construction	4.22
Trade	44.61
Hotels and restaurants	13.08
Transport, storage and communications	4.87
Financial intermediation	0.43
Real estate	6.32
Public administration	0.59
Education	1.52
Health and social work	1.98
Communal and other services	6.11
Private households with employed persons	-
Exterritorial organizations and bodies	-

Source: Survey of Employers on Employment, Employment Office of Montenegro, January 2004

Table 2.4 shows employers that plan to increase employment according to the type of activity. Obviously, the largest increase in employment is expected in the services sector – among all companies that plan to increase employment, 44.6% are engaged in trade, 13.08% are in hotels and restaurants, 4.87% in transport, storage and communications, 6.11% in the communal services, and 6.32% in activities related to real estate. Unfortunately, this survey does not provide the analogous structure according to ownership type.

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)
			Official data IN DINARS					**ISSP estimates IN DINARS**	
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	42,0		873,0	32,0
1996	243,0	1349,0	689,7	659,0	600,0	37,0		1826,0	31,0
1997	332,0	1801,4	922,5	879,0	738,0	38,0		2445,0	31,0
1998	453,0	2503,8	1276,1	1228,0	1073,0	37,0		3391,0	31,0
1999	663,0	3159,3	1227,3	1932,0	1581,0	34,0		4356,0	19,0
			IN EUROS					**IN EUROS**	
2000	37,0	150,9	55,5	96,4	83,5	38,0		218,0	19,0
2001	42,0	176,2	68,5	108,0	97,0	39,0	174,0	249,0	19,0
1-6/2002	42,0	185,8	72,9	112,9	106,0	41,0		262,5	19,0
2002-Q1	46,0	178,5	69,7	108,9	103,0	42,0		254,2	19,0
2002-Q2	46,0	193,1	76,2	116,9	108,0	39,0		270,9	19,0
Jul-01	40,9	174,4	68,0	106,3	101,0	38,0		245,4	19,0
Aug-01	40,9	176,9	67,0	109,9	101,0	37,0	171,0		250,4
Sep-01	40,9	182,5	71,1	111,5	101,0	37,0		255,3	19,0
Oct-01	46,0	181,5	70,6	111,0	101,0	42,0	175,0	258,0	19,0
Nov-01	46,0	182,5	71,1	111,5	101,0	41,0		259,1	19,0
Dec-01	46,0	183,6	71,6	112,0	101,0	41,0		260,3	19,0
Jan-02	46,0	166,5	65,0	101,7	101,0	45,0		239,7	19,0
Feb-02	46,0	181,3	70,7	110,6	104,0	42,0		257,5	19,0
Mar-02	46,0	187,8	73,3	114,5	104,0	40,0	186,0	266,2	19,0
Apr-02	46,0	194,0	78,3	115,7	104,0	40,0		270,1	19,0
May-02	46,0	191,0	74,5	116,4	110,0	40,0		274,4	19,0
Jun-02	46,0	194,5	75,8	118,7	110,0	39,0		273,4	19,0

New personal income tax system

	Minimum wage	Average wages and salaries of employee	Total contributions and taxes	Average wages and salaries taxes and contributions	Average pension (paid)	Ratio min. wage/ Average wages and salaries after 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
2002-Q3	50,0	263,2	97,8	165,4	112,0	30,3		353,9	15,2
2002-Q4	50,0	282,0	104,6	177,5	112,0	28,2		377,4	15,6
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	283,8	101,7	182,1	120,0	27,5		378,6	14,0
Jul-02	50,0	251,3	94,0	157,2	112,0	31,8	208,2	338,4	14,9
Aug-02	50,0	267,6	98,7	168,9	112,0	29,6		360,1	15,3
Sep-02	50,0	270,8	100,8	170,0	112,0	29,4		363,1	15,4
Oct-02	50,0	277,5	103,0	174,5	112,0	28,7	204,2	371,7	15,5
Nov-02	50,0	278,9	103,6	175,3	112,0	28,5		373,3	15,5
Dec-02	50,0	289,6	107,0	182,6	112,0	27,4		387,2	15,7
Jan 03	50,0	242,5	88,0	154,5	112,0	32,4		327,1	13,4
Feb-03	50,0	198,9	72,2	126,7	113,0	39,5		272,7	11,8
Mar-03	50,0	259,2	91,6	167,6	113,0	29,8		350,5	13,9
Apr-03	50,0	276,4	100,4	176,0	113,0	28,4		369,4	14,4
May-03	50,0	273,3	99,3	174,0	113,0	28,7		365,5	14,3
Jun-03	50,0	273,1	98,6	174,6	113,0	28,6		365,9	14,3
Jul-03	50,0	275,5	97,8	177,7	113,0	28,1		370,5	14,3
Avg-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
Okt-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

*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 wages and salaries 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, till now there have been 8 surveys. **Total labor cost includes average gross wage/average wages and salaries, employer part of contribution and taxes and other benefits.*

CHAPTER 3. WAGES AND SALARIES

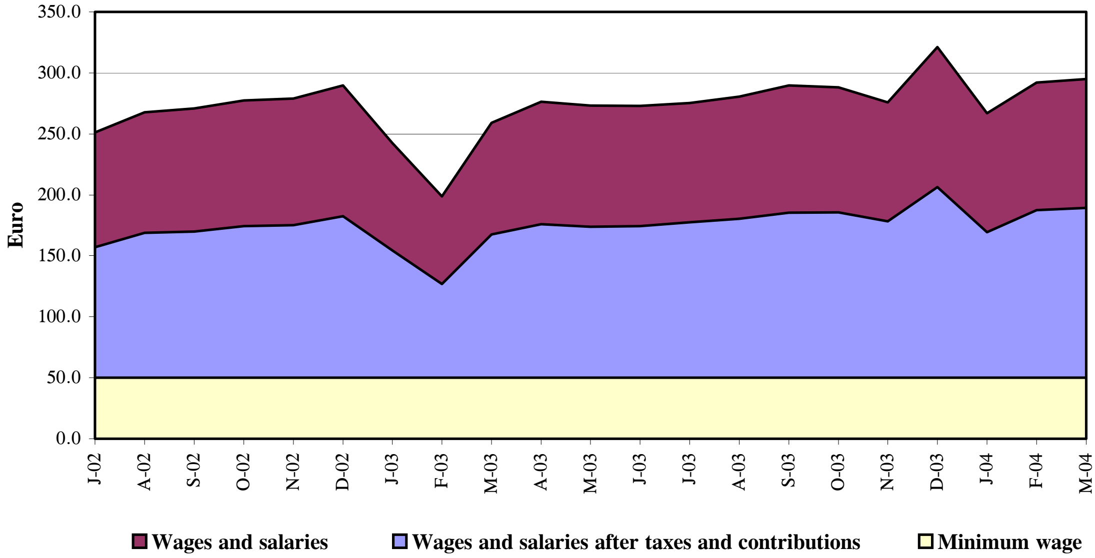
- *The average wage and salary in the first quarter of 2004 amounted to 283.9€, which is 21.5% higher than in the same period last year.*
- *The Government of Montenegro announced a 20% reduction in the personal income tax rates and a 20% reduction of the contributions for health and pension insurance that are paid by employers.*
- *The Law on Wages of Public Servants and Clerks was adopted.*

3.1. WAGES AND SALARIES

The average wage in the first quarter of 2004 amounted to €283.9, while the average net wage and salary after taxes and contributions was equal to €182.1. As in previous years, January was marked by a significant seasonal fall in wages: net wages and salaries were, on average, 17% lower compared to the previous month. As stated several times in Monet, this seasonal effect is a consequence of the methodology that Monstat uses[1].

If we observe annual changes, average wages and salaries in the first quarter of 2004 were almost 22% higher than in the same quarter last year, with annual growth rates at 10%, 48%, and 13% in January, February, and March, respectively. These high annual growth rates are not a consequence of a particularly strong growth of wages in the first quarter of 2004 but rather the result of the so-called 'statistical-base effect', i.e. low wages in early 2003 due to significant decreases in wages in the first two months of 2003 (wages fell by 15% and 18% on a monthly basis in January and February 2003, respectively). Actually, the average wages and salaries in the first quarter of 2004 are 4.3% lower than the previous quarter.

Graph 3.1: Wages and salaries, wages and salaries after taxes and contributions and minimum wage (July 2002-March 2004)



Source: Monstat and ISSP calculations

[1] Data on wages paid in a given month are usually collected in the beginning of the following month. Because wages due for a given month are usually paid in the beginning of the following month, the average wage paid in December actually represents the wage for November, and due to the holiday season in late December and January, the majority of employers pay December wages at the end of December rather than in the following month. Therefore, in January, a smaller portion of salaries remains to be paid. Hence, monthly data on wages are marked by an exceptional rise in December followed by a deep fall in January.

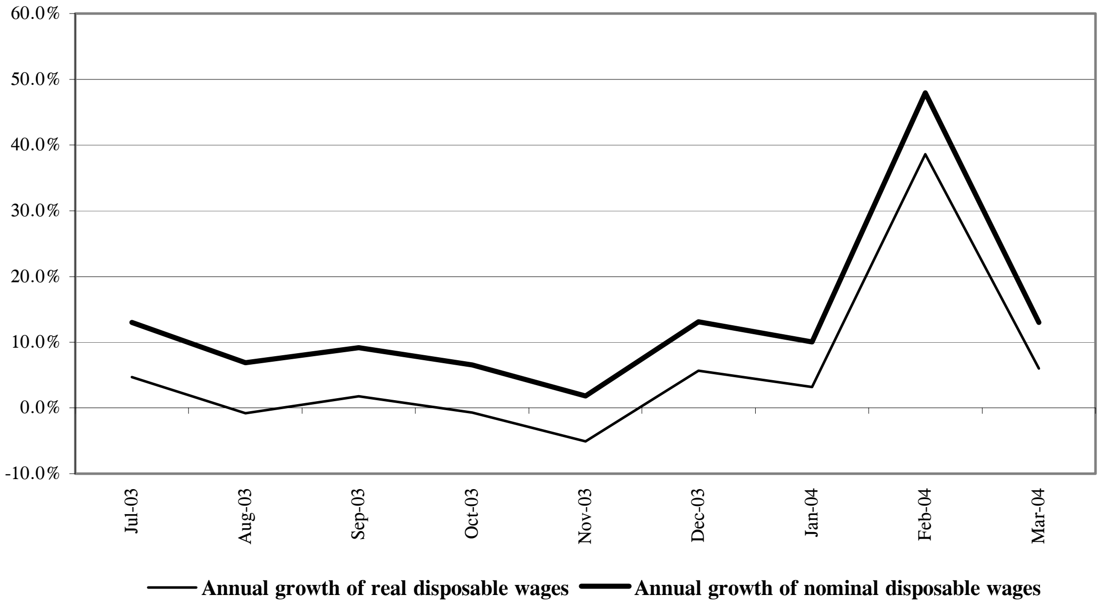
[6] Gross wage includes only contributions that employee pays.

The graph makes clear that wages and salaries have had an increasing trend for several months.

The minimum wage has remained at the level of €50 per month and there are no indications that it will be increased soon.

With respect to real wages and salaries, after taxes and contributions, significant nominal wage growth coupled with falling inflation have resulted in a positive and increasing annual growth since December 2003. This growth reached a record high in February 2004, at 60% (mostly due to a significant fall in February 2003) and was followed by a moderate 6% in March 2004.

Graph 3.2. Annual growth of nominal and real disposable wages



Source: Monstat and ISSP calculations

The positive growth trend of real wages and salaries, present since late 2003, is expected to prevail during the remainder of the current year provided that no unexpected inflation shocks occur and nominal wages maintain the existing (increasing) trend.

3.2. ANNOUNCEMENT OF PLANS TO REDUCE THE TAX BURDEN

The Government of Montenegro has decided to reduce the tax burden of employers by cutting taxes on wages. This decision is based on the Economic Reform Agenda, which encourages the creation of a more favorable business environment for business development.

The Government has already sent proposed changes and amendments of the Personal Income Tax (PIT) Law, the Pension Law and the Health Insurance Law to Parliament. According to the Government's plan, the reduction of the tax burden will be implemented in two phases – the first phase will be implemented by September 2004 and the second phase will begin in September 2004; overall, the plan would reduce the tax and contribution rates on wage by 20%. In the first phase, the PIT rates should be lowered by 10% implying that the existing rates of 17%, 21% and 25% would be replaced by new rates of 15%, 19% and 22% (see table 3.2). Regarding the contribution rates, the anticipated reduction is related only to rates paid by employers (i.e. the portion of contributions that employers are obliged to pay). The cumulated reduction in total contributions in both phases will be equal to 20%, although the reduction in employers' contribution rates will be much higher. The reduction in the second phase will also amount to 10%.

Table 3.2: Proposed changes in tax and contributions rates

	Monthly level of income in €	**Change in the tax system**	**Contribution to PIO Fund**	**Contribution to Health Fund**
Current state	0-65€ 65-218€ 218-381€ Over 381€	0% 0+ 17% on amount over 65€ 26€ +21% on amount over 218€ 60€ + 25% on amount over 381€	Employee 12% Employer 12% Total 24%	Employee 7,5% Employer 7,5% Total 15%
Until September 2004 **10% reduction**	0-65€ 65-218€ 218-381€ Over 381€	0% 0+ 15% on amount over 65€ 23€ +19% on amount over 218€ 54€ + 22% on amount over 381€	Employee 12% Employer 9,6% **Total 21.6%**	Employee 7,5% Employer 6% **Total 13.5%**
From September 2004 **20% reduction**	0-65€ 65-218€ 218-381€ Over 381€	0% 0+ 14% on amount over 65€ 21€ +17% on amount over 218€ 49€ + 20% on amount over 381€	Employee 12% Employer 7,2% **Total 19.4%**	Employee 7,5% Employer 4,5% **Total 12%**

Source: Proposal of Changes and Amendments of Personal Income Tax Law, Proposal of Changes in Pension Law, Proposal of Changes in Health Insurance Law, Parliament of Montenegro (www.skupstina.cg.yu)

In the second phase, from September 2004, tax and contribution rates should be 20% lower than the original level. According to the anticipated reduction, tax commitments on a net wage of 200€, or gross 306€, would be 23% lower.

Also, along with these changes, the Government plans to abolish the Regulation on Adjusting Taxable Income with the Retail Price Growth.

In addition to the announced tax cuts, the Government plans to include tax relief for employing new employees in the Personal Income Tax Law. This tax relief was introduced last year by the Decree on Tax Relief for New Employees and was in force until May 1, 2004. According to new provisions, companies that, within a business year, will hire new employees for a contract of at least two years will be allowed to reduce their tax base by the amount of gross salaries paid to these employees, augmented by the employer's portion of social contributions[6]. This tax relief can be used in a one-year period (one yearly gross wage of newly hired employees plus the employer's portion of contributions can be deducted from the tax base) and cannot exceed the tax base.

However, the introduction and application of the relief is problematic. Namely, the World Bank and other international financial institutions are strongly against introducing any change in the tax or contribution rates, justifying their position by their negative impact on the state budget revenues and by questioning its sustainability.[7] The World Bank has threatened to stop three approved loans if these laws were to be introduced. "The World Bank's dealings with Montenegro illustrate how World Bank officials use their power to advance their own interests, not those of the country that they are presumably trying to help. In fact, the mere presence of the World Bank and other international financial institutions

[7] Ministry of Finance has estimated the negative effect on the budget in the amount of €22.5 million, from which €1.6 million would be a direct budget loss, €9.3 million a loss of the Fund PIO and €11.6 million a loss of the Health Fund. According to the Ministry, this deficit could be financed through a more efficient collection of excise taxes, higher excise on cigarettes as well as further rationalizations and savings measures in the public spending sector.

(IFIs) severely undermines any serious domestic effort to implement reforms …”[8] The World Bank loans are important for Montenegro, but at the same time some policies that the World Bank and other IFIs impose on the country can be viewed as hindering economic reforms and thwarting the development of a free market economy. Regardless of the opposition of these institutions, the Government of Montenegro has announced that it will implement the new tax law. Recently, the Ministry of Finance has agreed to cooperate with the WB experts on finding a tax reduction scheme acceptable to both sides.

3.3. LAW ON WAGES OF PUBLIC SERVANTS AND CLERKS

On April 21, 2004 the Parliament of Montenegro adopted two laws related to public administration reform – the Law on Public Servants and Clerks and the Law on Wages of Public Servants and Clerks. These two laws should contribute to a more efficient and professional public service. The Law on Public Servants and Clerks will not be commented on in this chapter, but we will present a short overview of the main provisions of the Law on Wages of Public Servants and Clerks.

The Law on Wages of Public Servants and Clerks will be applied as of January 1, 2005. According to this law, the wage of servants and clerks is composed of a fixed component, a wage supplement, and a variable component.

Table 3.3. Wage coefficients and salary grades for public servants and clerks

Salary grade	Coefficient	Salary grade	Coefficient
1	8.00	19	4.20
2	7.50	20	410
3	7.10	21	4.00
4	6.70	22	3.85
5	6.30	23	3.70
6	5.50	24	3.60
7	5.40	25	3.50
8	5.30	26	3.40
9	5.20	27	3.30
10	5.10	28	3.15
11	5.00	29	2.90
12	4.90	30	2.75
13	4.80	31	2.65
14	4.70	32	2.55
15	4.60	33	2.45
16	4.50	34	2.35
17	4.40	35	2.25
18	4.30	36	1.55

Source: Law on Wages of Public Servants and Clerks, www.skupstina.cg.yu

A fixed part of the wage is calculated based on thirty six wage grades to which corresponding wage coefficients are attributed (table 3.3). Grades are determined according to the position, the complexity and responsibility of a job, as well as work conditions (see table 3.4 for the distribution in the salary grades). The fixed component of wages is calculated by multiplying a coefficient for a certain wage grade by the unit value of the coefficient, similar to the calculation with the use of the minimum wage where the unit value of the coefficient is equal to a minimum wage (coefficient 1=1 x minimum wage, coefficient 3.3 = 3.3 x minimum wage). The Government will set the unit value of the coefficient for a month.

[8] Ana Isabel Eiras – “ The World Bank Interferes with Montenegro’s Reform”, Executive Memorandum, Heritage Foundation, www.heritage.org/research/internationalorganizations/em926.cfm

The wage supplement is granted to an employee for more difficult working conditions, such as night shifts, working during state and religious holidays, overtime work, etc.

The variable component is related to and determined by the quality of work. It will be paid once a year and will be determined through the end of February for the previous year. The amount of this component is equal to the average wage that an employee received during the last year (recipient employees would receive a 13th wage). The total amount of funds for the variable wage component cannot be higher than 10% of the total amount allocated in the budget for the fixed portion of servants' earnings.

Table 3.4. Division into salary grades

Servants	Clerks	Positions	Salary grades from	Salary grades to
Heads of bodies and services		Head of the administrative body President of the Offence Committee	1	-
		Head of service	2	-
Managing and other appointed persons		Secretary of the Ministry Deputy Minister	3	-
		Deputy head of the administrative body Judge in the Offence Committee	4	-
		Deputy head of a service President of regional body for offences	5	-
		Judge in the regional body for offences	6	_
I grade	I grade	Adviser to a head, chief inspector, chief authorized person	8	6
		Independent adviser I, inspector I, authorized person I, independent clerk I	10	8
		Independent adviser II, inspector II, authorized person II, independent clerk II	12	10
		Independent adviser III, inspector III, authorized person III, independent clerk III	14	12
II grade	II grade	Senior Adviser I, senior clerk I	17	15
		Senior Adviser II, senior clerk II	19	17
		Senior Adviser III, senior clerk III	21	19
III grade	III grade	Adviser I, clerk I	24	22
		Adviser II, clerk II	26	24
		Adviser III, clerk III	28	26
	IV grade	Clerk IV	31	29
		Clerk V	33	31
		Clerk VI	35	33
	V grade	Clerk	36	-

Source: Law on Wages of Public Servants and Clerks, www.skupstina.cg.yu

This law should ensure that the system of compensation of public servants and clerks is designed to reflect the quality of work and accomplishments and that compensation will not be determined exclusively by position. In some measure, this law is a good step in the direction of making the public administration a more attractive employment opportunity to skilled and competent personnel.

To what extent this law will be successful in achieving these goals remains to be seen. One of the most positive changes in the law will certainly be the dismantling of the link between the minimum wage and the wage of public servants. In the old system, wages were calculated by multiplying the wage coefficients by the minimum wage and the new law will abolish this rigid scheme.

Table 4.1. Prices

	Consumer prices index (Cost of living))[1]						RPI Total, official			Producer prices changes	
	CPI Total, official			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 %
PRICES IN DINARS											
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	
DM (until December 2001) and EURO (from January 2002)											
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	114.5	14.5
2002	142.0	0.7	16.8	15.7	18.7	19.5	147.6	3.1	17.4	119.7	4.5
2003	151.6	0.50	6.8	3.9	9.3	7.3	159.4	0.5	7.7	127.8	2.9
2002-Q1	136.6	1.1	19.6	18.5	18.9	31.2	142.1	1.1	25.0	122.17	7.1
2002-Q2	142.7	1.5	19.4	19.7	18.5	19.7	148.9	1.3	20.4	122.56	5.8
2002-Q3	143.5	0.1	16.3	15.3	20.0	13.9	151.1	0.4	15.2	120.50	4.0
2002-Q4	145.2	0.3	11.8	9.5	17.7	13.1	152.8	0.3	8.7	121.16	2.9
2003-Q1	146.7	0.1	7.3	4.5	7.5	4.8	158.2	0.4	8.9	121.61	-0.7
2003-Q2	152.4	0.5	6.7	3.1	10.4	5.1	161.1	0.2	8.2	128.15	4.5
2003-Q3	153.0	0.2	6.6	3.9	11.7	10.5	161.9	0.1	7.1	129.33	0.2
2003-Q4	154.3	0.3	6.3	4.2	7.3	9.0	162.0	0.0	6.7	132.09	7.5
2004-Q1	155	0.1	5.5	3.9	8.1	7.7	161.9	0.1	7.1	130.9	7.6
Mar-03	146.9	0.2	6.5	0.0	0.7	0.7	154.8	0.7	8.1	123.1	-0.7
Apr-03	151.6	3.2	7.7	2.3	5.5	0.6	159.8	3.2	9.8	127.8	3.8
May-03	151.8	0.2	6.1	3.0	13.2	7.6	160.1	0.2	8.6	127.7	2.9
Jun-03	153.7	1.3	6.6	4.0	12.6	7.0	160.7	0.3	8.1	128.9	6.7
Jul-03	152.5	-0.8	6.9	4.0	12.2	11.5	161.2	0.3	8.3	129.2	0.2
Aug-03	152.8	0.2	6.7	4.0	11.9	10.3	161.3	0.1	8.0	129.2	0.0
Sep-03	153.6	0.5	6.3	3.7	11.2	9.7	161.8	0.3	7.4	129.7	0.4
Oct-03	154.0	0.3	6.3	4.1	10.2	9.5	162.0	0.1	7.1	130.9	7.0
Nov-03	154.2	0.1	6.4	4.3	6.0	9.0	162.0	0.0	6.8	132.1	7.3
Dec-03	154.7	0.3	6.2	4.2	5.8	8.4	162.0	0.0	6.7	133.3	8.2
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

Sources: Price indices published by Statistical Office of Montenegro
Table presents end-of-period values for monthly data and average period values for quarterly and annual data.
Currencies: DIN till 1999, DM from 2000 till 2002 and € from 2002.
Since MONET 15 we have used year 2000 as a base for CPI and RPI (2000=100)

- *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.*

[1] Cost of Living is the official name of Consumer price index (CPI) in Montenegro

4. PRICES

- *Consumer and retail price inflation decreased in the first quarter of 2004*
- *The cost of the Food consumer basket slightly decreased in the first quarter of 2004*
- *Producer prices increased more than retail prices at an annual level*
- *Inflation forecast interval for the next 12 months: 2.5%-4.3%*

4.1. CONSUMER PRICE INDEX (CPI)

In the first quarter of 2004, the average annual inflation continued its falling trend, reaching an average of 5.5% (compared to 6.3% in the fourth quarter of 2003). However, within the quarter, annual inflation exhibited increasing annual dynamics: 5.2% in January, 5.4% in February and 5.8% in March. Various measures of inflation in the first quarter of 2004 are presented below:

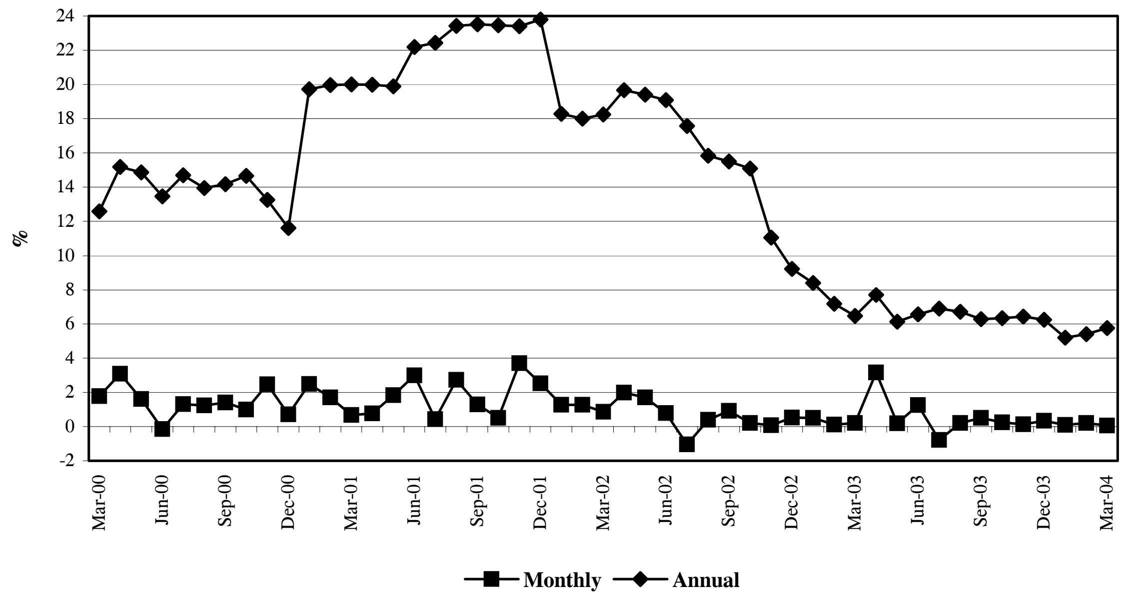
Inflation in Q1 2004

	Annual change[2]	"Average on average"[3]		Average annual[4]	Average monthly[5]
		Compared to the same quarter last year	Compared to the previous quarter		
CPI	**5.8%**	5.8%	0.52%	5.5%	0.1%

Source: Monstat

Monthly CPI changes in the first quarter of 2004 were very low: 0.1% in January, 0.2% in February and 0.1% in March.

Graph 4.1 CPI inflation



Source: Monstat

[2] "**Annual change**" represents a ratio of index in observed month and the same month in the previous year. In this case it is the change of index in March 2004 compared to the index in March 2003. This way of measuring inflation is also called "end-of-period-inflation"

[3] **"Average on average"** represents ratios of an average of indices in the observed period to an average of indices in the previous period (previous quarter or the same quarter of the last year)

[4] **"Average annual inflation"** represents arithmetic average of indices of annual change in the observed period.

[5] **"Average monthly inflation"** is calculated by applying geometric averages for 3 months of observed period.

The Retail Prices Index (RPI) exhibited similar dynamics to that of the CPI, continuing a mild declining trend. The annual rate of change of retail prices was lower than consumer prices, reaching 5.5% in March 2004. Retail prices registered inflation of 5.7% in January and 5.2% in February at the annual level.

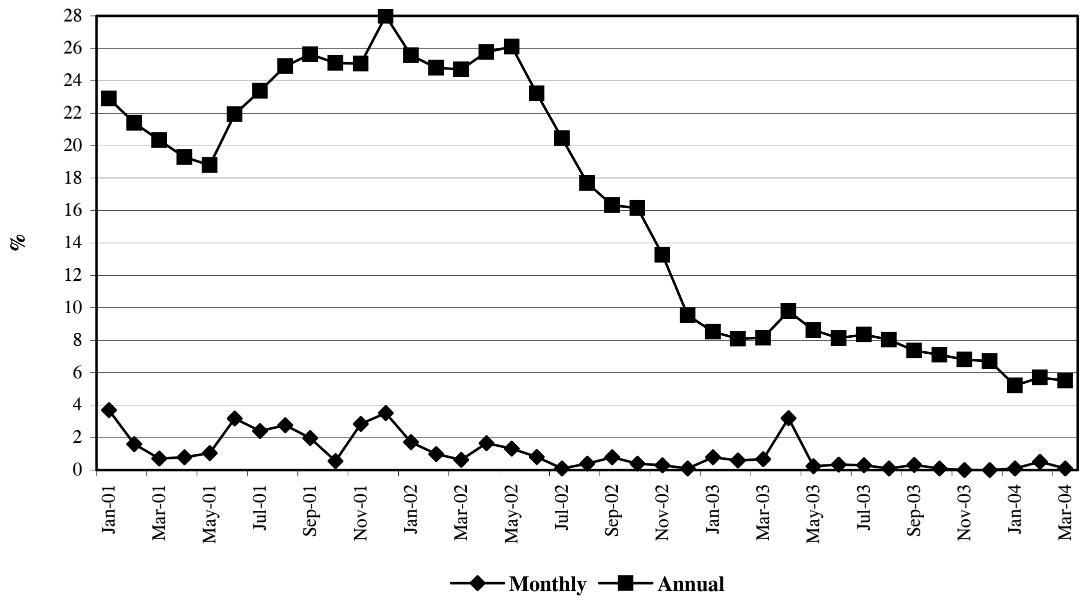
RPI in Q1 2004

	Annual change	"Average on average"		Average annual	Average monthly
		Compared to the same quarter last year	Compared to the previous quarter		
RPI	5.5%	5.8%	0.47%	5.5%	0.2%

Source: Monstat

Monthly inflation of retail prices was 0.1% in January, 0.5% in February and 0.1% in March 2004.

Graph 4.2 RPI Inflation



Source: Monstat

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 2003	100	58.10	6.80	8.23	11.20	5.25	4.80	5.62
Consumption Weights in 2004	100	57.56	7.34	8.23	11.16	5.25	4.8	5.66
2003								
Jan	8.4	7.8	4.88	13.8	4.09	9.99	31.6	2.2
Feb	7.17	6.4	4.62	13.83	3.5	9.08	30.07	2.86
Mar	6.46	4.71	4.54	14.39	3.38	8.59	26.9	6.08
Apr	7.69	5.02	3.23	10.59	15.66	9.07	27.62	7.18
May	6.12	3.16	1.41	9.58	15.74	8.6	25.18	5.14
Jun	6.56	4.39	0.32	10.41	15.18	5.68	24.54	4.52
Jul	6.90	4.38	0.25	9.89	17.19	5.42	23.72	7.43
Aug	6.70	4.38	-0.04	9.52	16.20	5.34	22.55	7.55
Sep	6.28	4.11	-0.08	7.91	16.24	5.69	18.29	7.64
Oct	6.33	4.60	-0.11	6.70	16.13	5.23	18.25	6.75
Nov	6.42	4.79	-0.18	6.28	16.20	5.11	18.42	6.14
Dec	6.23	4.67	-0.13	7.30	16.14	4.20	15.51	5.54
2004								
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

Source: Monstat

The inflation measurement in Montenegro still relies on a consumer basket that consists of 365 products and services; this basket is based on the household budget survey that was conducted in 1997. At the beginning of 2004, the weight structure of the consumer basket was adjusted to reflect relative price changes[6]. The changes of the main CPI aggregates are as follows:

- The weight of Food, Tobacco and Beverages was reduced from 66.9% to 64.9%,
- The weight of Goods without food, tobacco and beverages was increased from 24.9% to 26.7% and
- The weight of Services was increased from 8.22% to 8.41%.

However, even with these corrections, the structure of the consumer basket does not properly reflect the actual structure of expenditures within Montenegrin households. This will not be possible until the new household budget survey is conducted. Thus, currently the official CPI index has to be considered a highly inaccurate measure of inflation in Montenegro.

The annual change of **Food prices** in the consumer basket (weight reduced to 57.6%) was below that of the total index at 3.9% in January, 4.3% in February and 4.8% in March.

[6] Instead of conducting a new household budget survey, the Monstat adjusts weights according to relative price changes in the previous year. The weights of products and services whose prices rose more than the CPI are adjusted upwards while those whose prices rose less than the CPI are adjusted downwards.

However, increase of total CPI dynamics from January to March 2004 was influenced by Food price changes. A very significant annual inflation of 20.7% was registered in March for vegetables, mostly due to potato prices that increased by 63% on an annual level (weight of potatoes is 1.82%). In the same month, the annual dynamics of dairy product prices amounted to a high of 12.5%, while fish prices were at 5.7% and meat at 2.2%. Most food products registered a decline in price during March of 2004 on a monthly basis, but some products experienced seasonal price increases: vegetables 4.2% in January and 2.6% in February and fruit 1.6% in March. Prices for cereal products registered an increase on a monthly basis (0.5% in January and 0.1% in February and March). The prices of dairy products increased on a monthly basis as well, in February 0.5% compared to January.

Tobacco and Beverage prices continued to have a strong dis-inflationary effect on total CPI in the first quarter of 2004, thanks to their negative growth rate. On a monthly basis, with an insignificant beverage price increase, those two product groups exhibited stable prices.

The prices of **Clothing and Footwear** maintained their pro-inflationary impact on the total index with an annual rate change of 6.9% in March 2004. On a monthly basis, these prices increased as well. Monthly increases were a bit smaller in the case of clothes (0.1% in January, 0.3% in February and 0.04% in March), while footwear prices continued to increase more rapidly, by 1% in January, 0.5% in February and 0.7% in March.

The annual dynamics of **Accommodation** prices were at a lower level in the first quarter of 2004 compared to 2003. A significant increase (49%) was registered in the monthly price changes for the service of wood cutting for fuel, while refrigerator prices increased by 1.6% in March 2004.

The annual price growth of **Hygiene and Personal Care products** continued to decline. On an annual basis, drug prices decreased by 0.5% in February and 0.1% in March. The most significant increase in this category is hardly worth mention at just 0.1% -- hygienic products showed a monthly price increase in February.

The category **Education and Culture** continued to exert a significant pro-inflationary effect on the total indicator. This impact intensified additionally in the first quarter. Annual inflation in this period rose from 9.5% in January to 11.9% in March. Among monthly rates of change, the highest is for education service prices, which increased by 0.3% in January and 6.3% in February.

The annual inflation of **Vehicles, Transport and Telecom Services** registered a significant decline compared to other categories. The dynamics of prices of products and services from this category fell from 4.5% in January to 1.2% in March on an annual basis. The reason for the decline could be the exceptionally high price hikes in March of last year. Oil prices increased by 1.6% in March compared to February (gasoline 1.2% and diesel 3%). The cost of vehicle services increased by 0.33% in March compared to the previous month. The most significant price decrease was registered in the prices of taxi services, which declined by 6.2%.

In summarizing the individual impact on inflation of various products and services in the first quarter of 2004, we would like to point out those categories such as vehicles, transport and telecom services had a dis-inflationary effect on the total index, while accommodation, education and culture, as well as clothes and footwear had a pro-inflationary effect. Thus, the beginning of 2004 continues trends that were apparent in 2003.

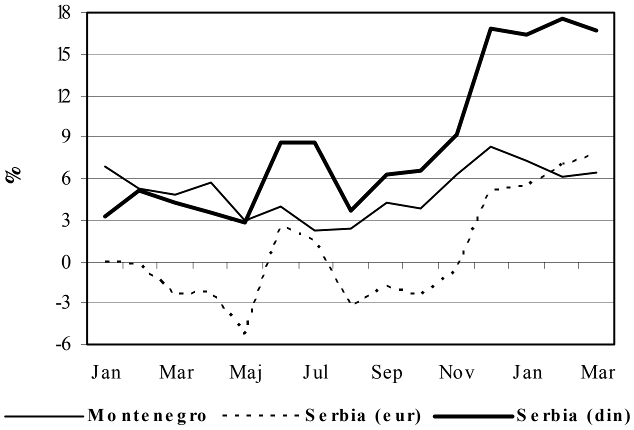
4.1.3. COST OF THE FOOD CONSUMER BASKET (FCB)[7]

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

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2003	240.06	242.10	241.72	246.01	257.92	263.57	252.86	260.00	264.15	262.06	258.73	258.74
2004	257.73	257.08	257.11									

Source: Monstat

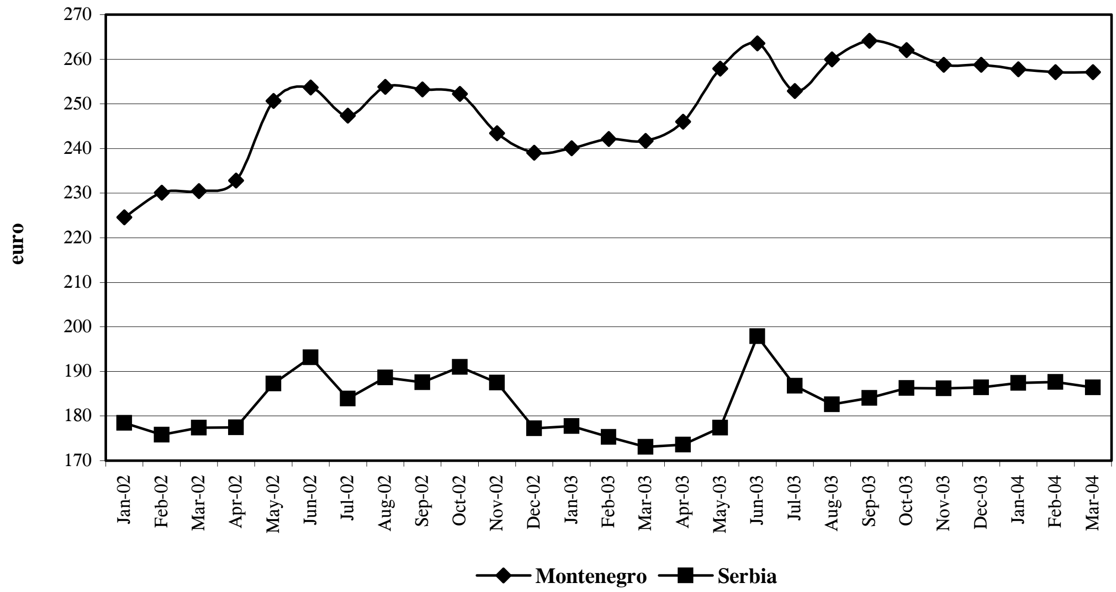
Graph 4.6. Food Consumer Basket (annual change)



Source: Monstat and Federal Statistical Office

The total cost of a food consumer basket for a four-member family amounted to €257.1 in March 2004. On a monthly basis, its value decreased in January and February and was stable in March. The annual inflation of the FCB cost exceeded inflation of the CPI food category by 1.3 percentage points in March 2004. Most fresh vegetable and fruit products experienced price decreases at the end of Q1 2004 (March 2004 compared to March 2003), including: cauliflower 46%, cleaned nuts 34%, pears 31%, cabbage 26%, spinach 19%, and apples 18%, while the prices of potatoes and onions have increased by 65% and 72% respectively. In March 2004 the most significant annual price increases from the basket were registered for the products of beef liver 18%, domestic cheese 18% and flour and bread around 14%.

Graph 4.5. Cost of consumer basket in Montenegro and Serbia



Source: Monstat and Federal Statistical Office

[7] The food consumer basket consists of a group of basic food products in the quantities appropriate 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.

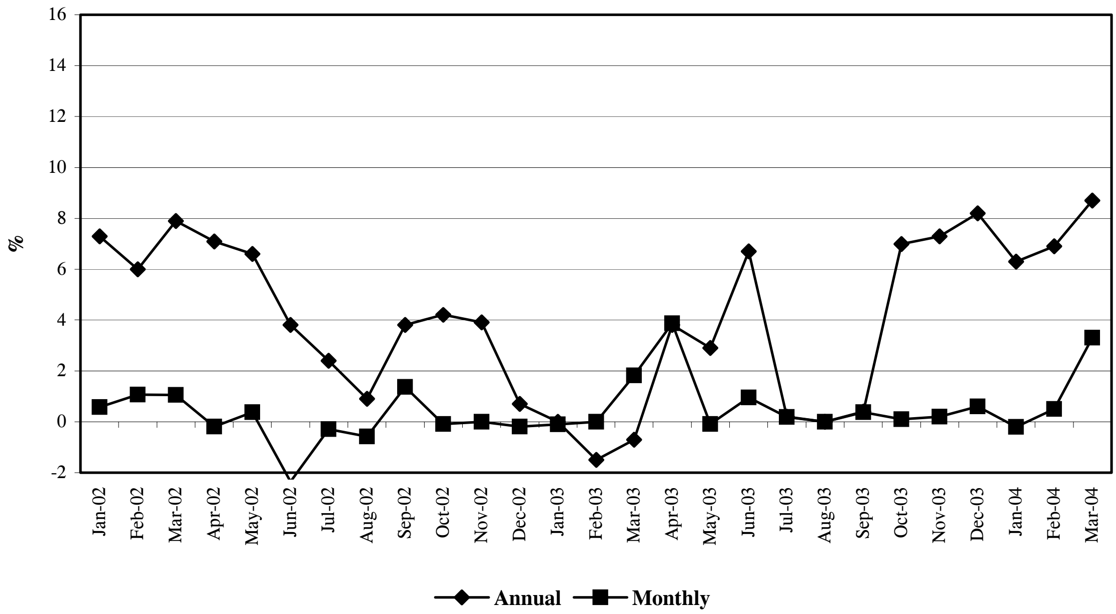
The comparable food consumer basket cost amounted to €186 in Serbia, which is 38% cheaper than in Montenegro. In the first quarter of 2004, FCB cost increased on an annual level by 17% in dinar currency and 8% in euros[8]. The higher annual rate of change in dinars as compared to euros is a result of the dinar's depreciation. For the first time since the beginning of its calculation, the annual inflation in euros of the food consumer basket was higher in Serbia than in Montenegro – this occurred in February and March of 2004.

4.2. PRODUCER PRICES

4.2.1. PPI Inflation

Inflation in the producer and wholesaler sector, measured by the annual rate of change of the Produced Price Index (PPI), declined to 6.2% in January then increased to 6.9% in February and to 8.7% in March 2004. On a monthly basis, producer prices fell by 0.2% in January, and then increased 0.5% in February and registered a significant increase of 3.3% in March.

Graph 4.7. PPI inflation



Source: Monstat

4.2.2 PPI disaggregated changes

The increased inflation of producer and wholesaler prices above the inflation of retailer and consumer prices was caused by a hike of prices in the processing industries, which increased from 4.2% in January to 7.2% in March 2004, on an annual basis. Such a significant increase was a consequence of monthly inflation of basic metals production and metal products by 9.7% (in line with world trends) and furniture production by 3.2%. Additionally, prices of food, tobacco and beverage products increased by 1.9% in February compared to the previous month. Annual inflation of this product group increased from

[8] Ratio euro/din is end of period data. The source is web site of National Bank of Serbia (www.nbs.co.yu)

16.8% in December 2003 to 21.1% in March 2004. Those product groups had a significant impact on the increase of the total index.

Prices in the electricity sector (a very important component of the total index) have registered high annual dynamics of 23.6% consistently since April 2003. Prices in the mining industry continued to fall in January, down 2.2%, while in February and March they stood unchanged at an annual level. Annual change of construction material prices fell by 0.6% in January and 0.7% in February and March.

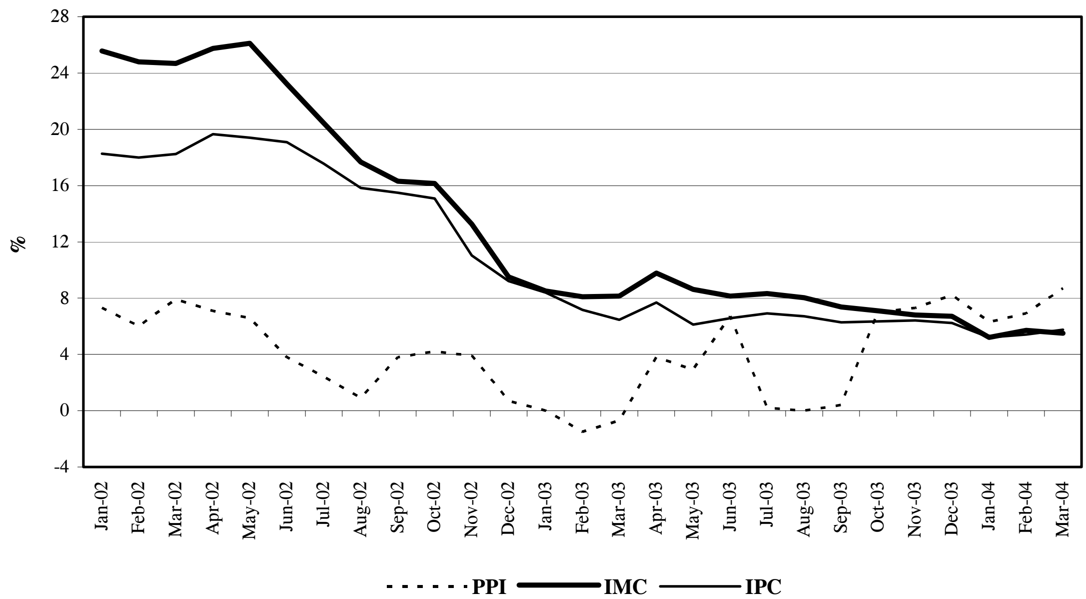
The chemical and textile industry registered a zero rate of monthly inflation in the first quarter of 2004. On an annual basis, chemical production prices fell by 0.3% in all three months of the first quarter of 2004, while annual dynamics of textile production prices was 0.2% in January and 0.1% in February and March 2004.

Thus, two very important groups of products in the producer and wholesale sector – electricity and food, tobacco and beverage – exerted inflationary pressures on total PPI in the first quarter of 2004. Prices of other groups had a dis-inflationary effect.

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

Graph 4.10 shows annual rates of change of consumer, retailer and producer price indices. Trends present in late 2003 prevailed in the first quarter of 2004. The PPI continues to exhibit the highest dynamics of all indices while the CPI and RPI came very close to each other. Inflation in producer prices increased from 6.3% in January to 8.7% in March 2004, while inflation of consumer and retail prices fluctuated within a range 5.2-5.8% in the first quarter of 2004.

Graph 4.10. PPI, RPI and CPI - annual changes



Source: Monstat

4.4. FORECAST

Actual developments of CPI inflation in Q1 2004 suggest that inflation followed the optimistic scenario described in the previous issue of MONET. Actual inflation at the end of March 2004 amounted to 5.76%, while our optimistic forecast predicted a rate of 5.95%.

As usual, we provide inflation forecasts for both an optimistic and a pessimistic scenario. The different assumptions made for each of these two scenarios follow[9]:

The optimistic scenario of inflation developments in the next 12 months (April 2004 – March 2005) assumes:

- The Goods category changes:
    - Monthly changes of consumer prices a bit lower than in 2003. One-off shocks related to electricity price increase and VAT introduction in April 2003 are ignored in the forecast for 2004.
    - The fall of world price of oil of 0.1% on a monthly basis during the observed period.
- Customs tariff rate increase for 56 strategic agriculture products in October.

The pessimistic scenario of inflation developments in the next 12 months (April 2004 – March 2005) assumes:

- The Goods category changes:
    - The consumer prices increase faster in 2004 compared to 2003 with the exception of inflation shocks produced by electricity price increase and VAT introduction in April.
    - The oil prices increase of 0.2% on a monthly basis during the forecasted period.
    - Electricity price increase of 15% in November.
- Custom tariff rate increase for 56 strategic agriculture products in August.

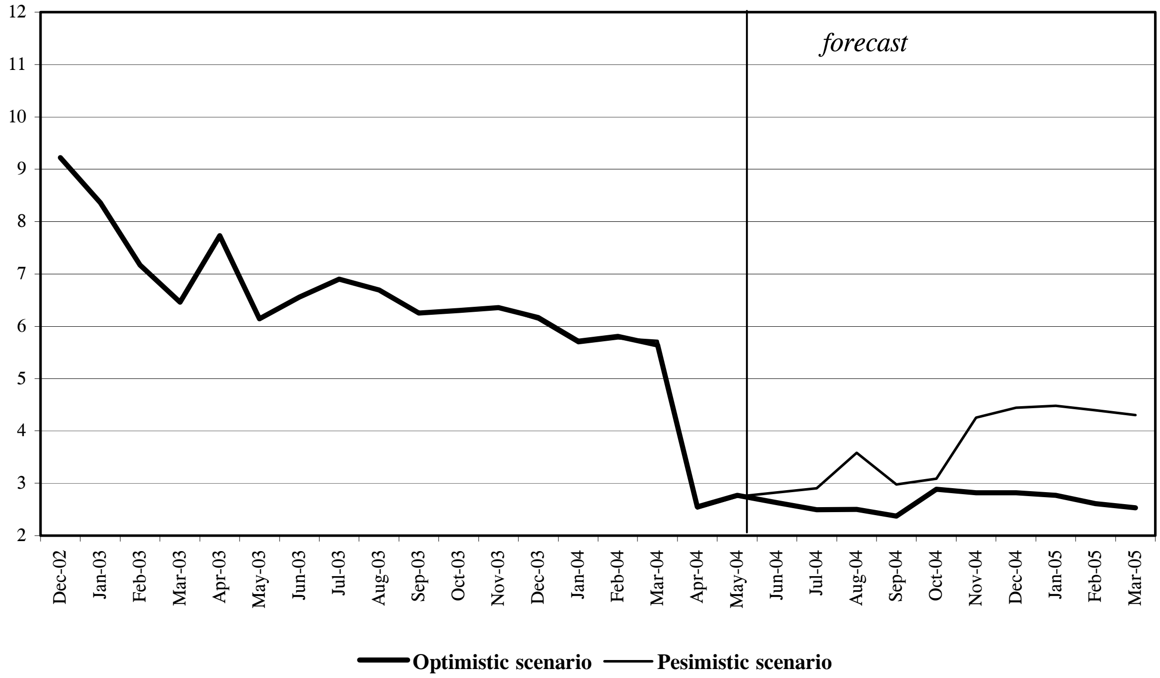
The resulting **projected inflation in the next 12 months ranging from 2.5% to 4.3% in 2004** is shown in Graph 4.11.

According to the optimistic scenario, the inflation rate in the remaining 3 quarters of 2004 and the first quarter of 2005 is projected to amount to: 2.6% in Q2 2004, 2.4% in Q3 2004, 2.8 % in Q4 2004 and 2.5% in Q1 2005.

According to the pessimistic scenario, the inflation rate in the remaining 3 quarters of 2004 and the first quarter of 2005 is projected at: 2.8% in Q2 2004, 3.0% in Q3 2004, 4.4% in Q4 2004 and 4.3 % in Q1 2005.

[9] Although Prices chapter is related to the first quarter 2004, we input actual monthly and annual changes of CPI for April and May 2004 in the inflation forecast. The inflation rate for the rest of the forecasted period is projected.

Graph 4.11 Inflation forecast for the next 12 monhs



Source: ISSP

5. BUDGET

- *The Government of Montenegro, in May of 2004, adopted decrease contribution on pension and disability insurance and contribution for health insurance in the total amount of 10%*
- *Cumulative budget revenues for the first quarter amounted to €67.1 million and are for 26.24% higher than in the same period last year.*
- *Total expenditures in the first quarter of 2004 amounted €72.4 million, which is 17% higher in comparison to the previous year.*

5.1. LAW ON BUDGET CHANGES AND AMENDMENTS FOR 2004[1]

After the announced 20% cut in taxes and contributions and after consultations and negotiations with the IMF and the World Bank, the Government of Montenegro, in May of 2004, adopted the revenue decrease from income tax, contribution on pension and disability insurance and contribution for health insurance in the total amount of 10%. This is going to be implemented by a tax and contribution decrease of 5% during the period between July 1st 2004 and November 30th 2004 and an additional 5% tax and contribution decrease in December of 2004.

The tax and contribution decrease in 2004 will result in a decline of budget revenues, as well as Social Funds revenues. In order to balance these budgets, the Government of Montenegro proposed, and the Parliament adopted, the Law on Changes and Amendments to the Budget Law for 2004. Namely, the Government realized that the cut in the contribution rates will decrease revenues for the Fund PIO and Health Fund, in the amount of €3.38 million and €1.55million, respectively. Additionally, the first quarter of 2004 realized a total of €4.8 million less in revenue of the non-budget funds that are based on contributions for pension and disability insurance and for health insurance. Therefore, changes and amendments of the Budget Law ensure that insufficient resources for non-budget funds, totaling €9.73 million, are going to be provided through the Budget expenditure decrease and the increase of transfers to non-budget funds (€6.08 million for Fund PIO and €3.65 million to the Health Fund).

The Government Budget revenues, based on fiscal facilities application, were estimated at a lower level, €2.14 million. Together with the lower revenues in the first quarter, lower by €4 million, this decrease led to total revenues that were €6.14 million lower. The application of new legal arrangements (Law on Taxes on Motor Cars, Law on Taxes on Services of Insurance, increase of excise on cigarettes, etc.) is planned and should provide additional revenue in the amount of €4.5 million. With this in mind, the changes and amendments of the budget are estimated to provide an insufficient amount of €1.58 million through the budget decrease.

In order to decrease the budget by the afore-mentioned amount and recompose expenditure categories in order to make transfers to social funds, many expenditure categories are decreased, totaling €9.82 million in reductions. The greatest reduction is related to current expenditures (expenditures for material, official travels, telephone services, services from contracts, program activities of Radio Television, etc.) totaling €3.5 million, followed by capital expenditures (infrastructure construction on the republic level and residential structure - building of apartments), totaling €3.2 million, and then subsidies to agriculture, totaling €1.5 million.

[1]Changes and amendments of Budget for 2004 are presented on table 5.1

Table 5.1. Central Budget Revenues and Expenditures, 2001-2004 (in mil. €)

		2001 Jan-Dec Execution	2002 Jan-Dec Execution	2003 Jan-Dec Plan	2003 Cumul Jan-Dec Execution	Comp.	2004 plan	jan-mar 2004 plan	jan-mar 03	jan-04	feb-04	mar-04	jan-mar 04 Execution	Jan-mar 2004/2003
	Deposits from previous year			20.000	11.000									
A	**Total revenue and grants (1+2)**	**233.140**	**256.804**	**384.200**	**350.103**		**71.220**	**53.168**	**19.937**	**24.420**	**28.296**	**72.653**	**136.65%**	**71.220**
1	Total revenue (1.1+1.2)	221.220	229.847	361.000	**337.519**		**71.220**	**53.168**	**17.206**	**24.420**	**25.494**	**67.120**	**126.24%**	**71.220**
1.1	Current revenue (1.1.1+1.1.2)	221.220	229.847	361.000	**337.519**	**100.00%**	**71.220**	**53.168**	**17.206**	**24.420**	**25.494**	**67.120**	**126.24%**	**71.220**
1.1.1	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	331.365	**312.918**	**92.71%**	**61.460**	**48.731**	**16.182**	**22.823**	**22.281**	**61.286**	**125.76%**	**61.460**
1.1.1.1	Personal income	56.654	57.899	76.200	**63.961**	**18.95%**	**15.500**	**13.002**	**2.710**	**5.258**	**3.553**	**11.521**	**88.61%**	**15.500**
1.1.1.2	Turnover (retail sales) tax	58.488	56.528	98.300	**137.222**	**40.66%**	**21.350**	**8.975**	**6.879**	**10.296**	**10.571**	**27.746**	**309.16%**	**21.350**
1.1.1.3	Excises	35.664	50.786	86.300	**58.197**	**17.24%**	**13.270**	**11.294**	**3.736**	**4.142**	**3.837**	**11.715**	**103.73%**	**13.270**
1.1.1.4	Taxes on international trade and transactions	27.274	26.376	52.000	**36.845**	**10.92%**	**8.450**	**12.630**	**1.522**	**2.532**	**2.911**	**6.965**	**55.14%**	**8.450**
1.1.1.4.1	Custom tariffs	13.894	12.605	30.000	**35.078**	**10.39%**	**7.270**	**11.517**	**1.376**	**2.342**	**2.658**	**6.376**	**55.36%**	**7.270**
1.1.1.4.2	Custom transit fees	13.380	13.771	22.000	**1.766**	**0.52%**	**1.190**	**1.113**	**0.146**	**0.190**	**0.253**	**0.589**	**52.87%**	**1.190**
1.1.1.5	Other taxes	9.920	17.342	18.565	**16.694**	**4.95%**	**2.890**	**2.830**	**1.335**	**0.595**	**1.409**	**3.339**	**118.00%**	**2.890**
1.1.2	Nontax revenues	33.221	20.916	29.635	**24.601**	**7.29%**	**9.760**	**4.436**	**1.024**	**1.597**	**3.213**	**5.834**	**131.50%**	**9.760**
1.2	Capital revenue	0.000						**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**#DIV/0!**	
2	Grants	11.920	26.958	23.200	**12.584**		**0.000**	**0.000**	**2.731**	**0.000**	**2.802**	**5.533**	**#DIV/0!**	**0.000**
B	**Total expenditure and net lending (1+2)**	**259.309**	**266.771**	**451.152**	**381.090**		**112.290**	**61.671**	**20.098**	**22.837**	**29.490**	**72.425**	**117.44%**	**112.290**
1	Total expenditure (1.1+1.2)	252.585	247.517	431.178	**358.924**	**94.18%**	**110.165**	**58.066**	**18.275**	**22.466**	**28.090**	**68.831**	**118.54%**	**110.165**
1.1	Current expenditure (1.1.1+1.1.2)	233.287	236.697	407.983	**345.235**	**90.59%**	**104.626**	**56.745**	**18.039**	**21.764**	**27.438**	**67.241**	**118.50%**	**104.626**
1.1.1	Interest	0.622	12.880	25.500	**14.136**	**3.71%**	**4.375**	**3.424**	**5.016**	**0.346**	**2.821**	**8.182**	**238.95%**	**4.375**
1.1.2	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	382.483	**331.099**	**86.88%**	**100.251**	**53.321**	**13.023**	**21.419**	**24.617**	**59.059**	**110.76%**	**100.251**
1.1.2.1	wages and salaries	108.464	110.178	151.968	**134.262**	**35.23%**	**43.285**	**17.089**	**2.065**	**11.628**	**9.834**	**23.527**	**137.68%**	**43.285**
1.1.2.2	goods and services	55.351	41.817	44.461	**37.858**	**9.93%**	**15.214**	**6.254**	**1.717**	**2.509**	**3.573**	**7.798**	**124.69%**	**15.214**
1.1.2.3	Social Insurance and Social Security Transfers	45.327	35.825	155.681	**132.795**	**34.85%**	**33.242**	**23.483**	**8.464**	**6.207**	**9.881**	**24.552**	**104.55%**	**33.242**
1.1.2.4	Subsidies to enterprises	12.249	18.169	16.767	**14.631**	**3.84%**	**2.300**	**2.989**	**0.251**	**0.460**	**0.803**	**1.514**	**50.65%**	**2.300**
1.1.2.5	Reserve	6.461	14.819	9.794	**8.388**	**2.20%**	**3.371**	**2.884**	**0.390**	**0.517**	**0.408**	**1.315**	**45.59%**	**3.371**
1.1.2.6	Other non - interest expenditure	4.813	3.010	3.813	**3.165**	**0.83%**	**2.839**	**0.621**	**0.137**	**0.097**	**0.118**	**0.352**	**56.69%**	**2.839**
1.2	Capital expenditure	19.298	10.820	23.195	**13.688**	**3.59%**	**5.539**	**1.321**	**0.236**	**0.702**	**0.652**	**1.590**	**120.36%**	**5.539**
2	Net lending	6.723	19.254	19.974	**22.167**	**5.82%**	**2.125**	**3.605**	**1.823**	**0.371**	**1.400**	**3.594**	**99.70%**	**2.125**
	Lending	13.974	19.490	19.974	**22.590**	**5.93%**	**2.125**	**3.605**	**1.823**	**0.371**	**1.400**	**3.594**	**99.70%**	**2.125**
	Repayment	7.250	0.236	0.000	**0.423**	**0.11%**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**#DIV/0!**	**0.000**
	Overall budget balance excluding grants (cash) (A-B-2)	**-38.089**	**-25.179**	**-90.152**	**-43.572**				**-2.892**	**1.583**	**-3.996**	**-5.305**		
	Overall budget balance (cash) (A-B)	**-26.169**	**1.778**	**-66.952**	**-30.988**				**-0.161**	**1.583**	**-1.194**	**0.228**		
	Financing (1+2)	**26.129**	**38.254**	**46.952**	**18.394**				**3.001**	**-1.053**	**-1.290**	**0.658**		
1	Domestic and foreigh financing (net)	17.007	0.568	23.700	**6.233**				**3.001**	**-1.053**	**-2.484**	**-0.536**		
	Borrowing	76.436	40.445	24.000	**48.246**				**10.979**	**2.105**	**0.330**	**13.414**		
	Repayment	59.430	39.877	0.300	**42.012**				**7.978**	**3.158**	**2.814**	**13.950**		
2	Privatization receipts	9.122	37.686	23.252	**12.161**				**0.000**	**0.000**	**1.194**	**1.194**		

Source: Ministry of Finance of Montenegro, Central Bank of Montenegro, statements by Ministry of Finance Officials and ISSP calculations
Note: Category lending in 2002 and 2003 includes repayment of guarantees

5.2. BUDGET EXECUTION IN 2004

5.2.1. Budget revenues and grants in first quarter of 2004

As in previous years, budget revenues in the first quarter of 2004 experience seasonal fluctuations caused by the lower economic activity. Total revenues in January, February and March of 2004 amounted to €17.2 million, €24.4 million and €25.5 million respectively. Thus the average monthly revenues in the first quarter of 2004 were €22.3 million. Cumulative budget revenues for the first quarter amounted to €67.1 million or 94.24% of the plan. Cumulative budget revenues in this period are 26.24% higher than in the same period last year.

Executions of individual revenue categories

The most significant category in budget revenues was revenues from the *value added tax* (*VAT)*. This category amounted to €27.7 million in the first quarter of 2004, which represents 41.3% of total budget revenues. The amount of collected VAT is much above the planned level (130% of the plan). Compared to the execution of the same category in the first quarter of 2003, VAT revenues, increased threefold. This rise in the VAT collection signals an increasing trend in the legalization of economic activities in Montenegro. The amount of VAT revenue per month was €6.9 million in January, €10.3 million in February and €10.6 million in March.

Cumulated revenues from the *personal income tax* in the first three months of 2004 amounted to €11.5 million. This level represents 74.33% of the plan and 88.61% of the execution of this category in the first quarter of 2003. In specific months, execution of this category was as follows: January €2.7 million, February €5.2 million and March €3.5 million.

Excise revenues amounted to €3.7 million in January, €4.1 million in February and €3.8 million in March of 2004, or €11.7 million in the first quarter of 2004. Execution of this category represents 88.29% of the plan or 103.73% of the execution of this category in the same period last year.

Cumulatively in the period January - March 2004 revenues from *the tax on international trade and transactions* amounted to almost €7 million or 82.42% of the plan. The achieved level is roughly half of the execution of this category in the same period last year (55% of last year's execution).

Revenues from *custom tariffs* were also significantly lower than in the same period of 2003 (55.36% of last year's execution) and amounted to €6.4 million. Additionally, the executed level of this category is lower than planned (87.71% of the plan).

The category that was most significantly under-executed with respect to the plan is that of *custom transit fees* (49.47% of the plan). The cumulated amount of this category for the first three months of 2004 is €0.59 million. This represents 52.87% of the execution of the same category during the first quarter of 2003.

Other tax revenues cumulated for the first three months of 2004 amounted to €3.3 million or 115.5% of the plan and 118% of last year's first quarter execution. The amount of collected "other taxes" in January, February and March of 2004 were €1.3 million, €0.6 million and €1.4 million, respectively.

Non-tax revenues (fees, fines and other revenues) at the end of March 2004 reached the level of 5.83% or 59.77% of the plan.

Grants

Total foreign aid in the first quarter of 2004 amounted to €5.5 million. Grants were received in January and February in the amounts of €2.7 million and €2.8 million respectively. In March no grants were received.

5.2.2. Budget expenditures and net lending in first quarter of 2004

As concluded in one of the previous issues, expenditures in Montenegro are very much dependent on current revenues. According to the plan, which assumed a linear projection, average monthly expenditures and net lending in 2004 should be at a level of roughly €37.4 million. However, expenditures in January 2004 amounted to €20.1 million, and were much below the planned level, mainly because expenditures for the largest category, i.e. wages and salaries were negligible[1]. In February, expenditures reached approximately €23 million, and in March they reached an amount close to €30 million. Thus, total expenditures in 2004Q1 amounted to €72.4 million, which represents about 64% of the planned level, but this amount is 17% higher in comparison to the previous year.

Executions of expenditures category

As mentioned before, the largest expenditures category, *wages and salaries,* stood at a negligible level in January. In February and March wages and salaries were paid in the amount of €11.6 million and €9.8 million respectively. Cumulated over the first quarter, expenditures for wages and salaries at the end of March reached €23.5 million, and are 37% higher than in the same period of the previous year.

At the end of March, cumulated expenditures for *goods and services* amounted to €7.8 million, which represents about half of the planned amount. Expenditures in this category in 2004Q1 were 25% above those in 2003Q1.

Expenditures for *social insurance and social security transfer*s, at the end of March, represented 74% of the plan and amounted to €24.5 million. Executions of this figure in the first quarter of 2004 are at a similar level to the previous year (105%).

Subsidies to enterprises in 2004Q1 amounted to €1.5 million, which represents 66% of the planned level and half of the level from the previous year.

At the end of March, cumulative *capital expenditures* reached €1.6 million. While this is only 29% of the planned level, it is 20% higher than in the previous year.

Other *non–interest expenditures* (includes rent of government buildings and other related expenditures) cumulated for the period January-March 2004 reached €0.4 million.

[1] January's salary is usually paid in December of the previous year.

During the first three months of 2004, the Ministry of Finance paid €7.3 million of *interest on the old foreign debt* (debt accrued before 1990), and €0.9 million of *interest for domestic debt*. In total, interest expenditures in 2004Q1 reached a level of €8.2 million (almost double the planned level and more than double the level in the corresponding period of 2003).

At the end of March, *the reserves* reached €1.3 million, or 40% of the planned level

Net lending

In 2004, new credits are planned at the level of €8.5 million for the entire year, of which €3.6 million were given during the first quarter.

5.2.3. Budget balance and financing

Overall budget balance

In January and March, the overall cash budget balance was negative and amounted to -€2.9 million and -€4 million respectively. In February, the overall cash budget balance was positive and amounted to €1.6 million. However, cumulated over the first quarter of 2004, the overall budget balance on a cash basis was negative, amounting to -€5.3 million.

Financing

The negative cash budget balance (budget deficit) in the first three months of 2004 was totally financed through grants, which, as we already mentioned, amounted to €5.5 million. At the same time, the Government took new credits in the amount of about €13.4 million and repaid about €14 million, decreasing its net liabilities by €0.6 million.

5.1.4. Treasury bills[2]

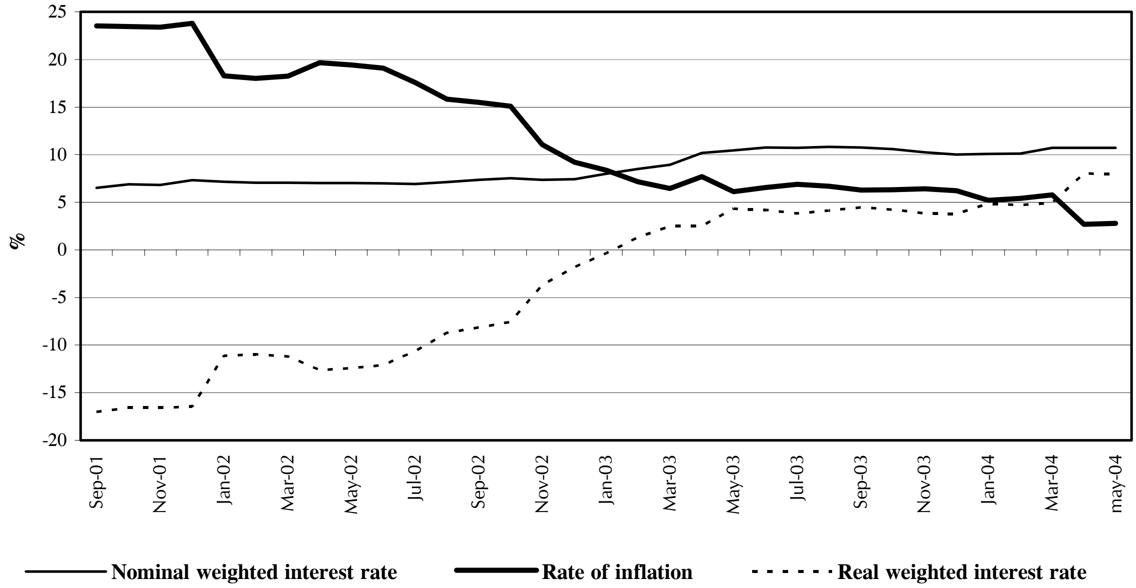
For all 26 Treasury bill auctions during 2003, the total offered value amounted to €157 million, of which, the total amount of sold T-bills was €143.22 million.

During the first half of 2004, five auctions of 28-day T-bills and seven auctions of 56-days T-bills were held. The total value of all offered 28-day T-bills amounted to €69.5 million while €25.5 million was offered through 56-days T-bills. The trend, which was present in 2003, of increasing the value of issued 28-day T-bills per auction has continued in 2004. The highest amount offered through 28-day T-bills in 2003 was €13 million (December 2003) while in 2004, the highest value of a 28-day T-bills auction was €17 million (April 2004). The auction value of 56-day T-bills in 2004 has been fluctuating between €3 million and €5.5 million, as in 2003. Since April 2003, the weighted interest rate was constantly over 10% for T-bills of both maturities.

It is very important to state once again that money used for the purchase of T-bills decreases the funds that can be used for investment. In addition, the interest rate on T-bills influences an increase of interest rates on commercial loans.

[2] Issue and repayment of T-bills is not evidenced in the budget. These are so called “flying positions” whose issue and repayment is done within the same fiscal year, so its recording through revenues and expenditures would blow-up aggregate budget positions. This is why the Ministry of Finance does not record issue of T-bills in the budget.

Graph 5.4: Annual weighted interest rate on 28-day T-bills and the rate of inflation



Graph 5.4 shows changes in the annual rate of inflation, nominal and real weighted interest rates on 28-days T-bills, in the period from their first issue until May 2004. The real interest rate shows an increasing trend due to the increasing trend of nominal interest rates and the falling rate of inflation, especially in April and May 2004.

Table 5.2. Overview of 28-day T-bill auctions, held in 2003

No.	Date of auction	Date of maturity	Amount of issue in mil. €	Total offered amount in mil. €	Amount of sold T-bills in mil. €	Interest rate		
						Lowest	Highest	Weighted average
1.	01/22//2003	02/20/2003	7.0	5.912	5.912	7.5	9.0	7.99
2.	02/19/2003	03/20/2003	6.5	5.762	5.762	7.5	9.0	8.49
3.	03/19/2003	04/17/2003	7.0	6.065	6.065	7.5	12.0	8.94
4.	04/16/2003	05/15/2003	7.5	7.028	7.028	8.0	12.5	10.17
5.	05/14/2003	06/12/2003	8.0	6.949	6.949	7.5	12.5	10.45
6.	06/11/2003	07/10/2003	7.5	6.674	6.674	7.5	12.5	10.75
7.	07/09/2003	08/07/2003	7.0	6.682	6.682	10.0	13.0	10.71
8.	08/06/2003	09/04/2003	7.0	8.285	7.000	10.0	11.99	10.83
9.	09/03/2003	10/02/2003	8.0	8.832	8.000	10.0	11.99	10.76
10.	10/01/2003	10/30/2003	8.5	8.847	8.500	10.0	11.5	10.57
11.	10/29/2003	11/27/2003	9.5	10.760	9.500	9.5	11.0	10.25
12.	11/26/2003	12/25/2003	12.0	10.629	10.629	6.0	10.98	10.01
13.	12/24/2003	01/22/2004	13.0	12.000	12.000	6.0	11.0	10.08
14.	01/21/2004	02/19/2004	12.0	12.162	12.000	6.0	11.0	10.10
15.	02/18/2004	03/18/2004	12.5	11.225	11.225	9.9	11.0	10.71
16.	03/17/2004	04/15/2004	12.0	11.647	11.647	10.0	11.0	10.72
17.	04/14/2004	05/13/2004	17.0	15.027	15.027	10.0	11.0	10.73
18.	05/12/2004	06/10/2004	16.0	15.840	15.840	10.0	10.8	10.49

Source: Central Bank of Montenegro
Note: Interest rates are expressed in annual terms.

Table 5.3. Overview of 56-day T-bill auctions, held in 2003

No.	Date of auction	Date of maturity	Amount of issue in mil. €	Total offered amount in mil. €	Amount of sold T-bills in mil. €	Interest rate		
						Lowest	Highest	Weighted average
1.	01/08/2003	03/06/2003	3.0	1.670	1.670	7.5	9.0	8.13
2.	02/05/2003	04/02/2003	3.0	2.250	2.250	8.0	9.5	8.38
3.	03/05/2003	04/30/2003	4.5	1.320	1.320	7.5	9.5	9.13
4.	04/02/2003	05/29/2003	4.0	2.866	2.866	8.0	12.5	10.05
5.	04/29/2003	06/26/2003	3.0	2.100	2.100	8.5	12.0	10.06
6.	05/28/2003	07/24/2003	3.0	2.876	2.876	9.0	12.5	10.76
7.	06/24/2003	08/21/2003	2.5	2.143	2.143	9.8	13.0	11.99
8.	07/23/2003	09/17/2003	4.5	3.826	3.826	9.5	13.0	11.24
9.	08/20/2003	10/16/2003	3.0	3.443	3.000	9.8	12.0	11.12
10.	09/17/2003	11/13/2003	4.5	5.340	4.500	9.5	11.5	10.63
11.	10/15/2003	12/11/2003	4.0	3.235	3.235	9.0	11.5	10.45
12.	11/12/2003	01/08/2004	5.5	4.982	4.982	9.5	10.9	10.03
13.	12/10/2003	02/05/2004	4.0	2.743	2.743	6.0	11.0	10.08
15.	01/12/2004	03/04/2004	5.5	3.788	3.788	9.75	11.0	10.22
16.	02/04/2004	04/01/2004	4.5	3.403	3.403	9.0	11.0	10.48
17.	03/03/2004	04/29/2004	4.5	2.568	2.568	10.5	11.0	10.8
18.	03/31/2004	05/27/2004	4.0	3.095	3.095	10.0	11.0	10.63
19.	04/28/2004	06/24/2004	3.0	2.873	2.873	10.48	11.0	10.82
20.	05/26/2004	07/22/2004	4.0	4.000	4.197	10.0	10.95	10.57

Source: Central Bank of Montenegro
Note: Interest rates are expressed in annual terms.

5.4. SOCIAL FUNDS

Table 5.5: Social funds revenues and expenditures (in mil €)

Social funds	Revenues in 2003	Revenues in first quarter of 2004	Expenditures in 2003	Expenditures in first quarter of 2004
Pension Fund	152.44	35.71	161.44	34.91
Health Fund	94.41	19.20	96.57	21.37
Employment Fund	15.04	2.47	14.61	2.23

Source: Ministry of Finance, Social Funds[3]

In the remainder of the chapter we will present a short analysis of revenue and expenditure executions in social funds (Pension, Health, and Employment) in 2003 as well as in the first three months of 2004.

[3] Data for the Pension Fund are preliminary data from the document of the Ministry of Finance, "Analysis of the execution of public spending in 2003".

5.4.1. Pension Fund

Executions in 2003

Total revenues of the Pension Fund in 2003 reached €152.44 million, while expenditures were at €161.44 million resulting in a deficit of €9 million, which was covered through privatization receipts and deposits.

In the structure of revenues, the largest portion was related to contributions, representing close to 70% of total revenues. Transfers from the budget represented 25% of total revenues, while revenues from other taxes represented 5% of total revenues.

Expenditures for pensions represented 81% of total expenditures. The second largest expenditure was related to contributions to the Health Fund for pensioners' health insurance, it reached €22.7 million or 14% of total expenditures.

Executions in first quarter of 2004

At the end of March total revenues of the Pension Fund were €35.7 million, of which, revenue from contributions represented 56% and transfers from budget 34%. In the same period, total expenditures were €34.9 million. Expenditures for pensions reached €26.7 million or 76%, while contributions to the Health Fund for pensioners' health insurance amounted to €5 million.

5.4.2. Health Fund

Executions in 2003

At the end of 2003, total expenditures of the Health Fund were at the same level as total revenues, amounting to about 94.41 million euro. Revenue from worker and employee contributions[4] reached €66 million and represented 69.9% of total revenues. Revenue from the Pension Fund (as we see in expenditures for the Pension Fund) amounted to about €29.9 million, which represented 31.7% of total revenues. Revenue from the budget for unemployed persons amounted to 2.8% of total revenues.

In the structure of expenditures, the highest share was had by expenditures for regular activities, which represented 93%. Expenditures related to payments to social insurance during sick leave reached €0.9 million and other costs during patients' sickness were at €3.1 million. Travel costs and per diems amounted to approximately €2 million, while material expenses amounted to €2.7 million.

Executions in first quarter of 2004

Total revenues of the Health Fund, at the end of March 2004, were €19.2 million, or €2 million less than total expenditures. Revenue from worker and employee contributions[5] reached about €14 million. In the structure of expenditures, the highest category was expenditures for regular activity[6], which amounted to approximately €20 million.

[4] Contributions from economic activity, non-economic activity, self employed workers, and agricultural workers.

[5] Contributions from economic activity, non-economic activity, self employed workers, and agricultural workers.

[6] Ambulance and dispensary services, medicines, treatments in stationary health care facilities, dentists' services and other forms of health care.

5.4.3. Employment Fund

Executions in 2003

Total revenues of the Employment Fund in 2003 reached €15.04 million. In the structure of revenue, worker and employee contributions (paid by employers as part of the tax on wages) represented 24.3%. The subsidy from the budget (for material support for unemployed and beginners) amounted to €2.3 million and represented close to 15.4%

Total expenditures of the Employment Fund in 2003 amounted to €14.6 million. Loans for self-employment reached €5.4 million and represented 37% of total expenditures. Wage expenditures amounted to €2.53 million while material expenditures reached €1.93 million. Expenditures related to the preparation of workers reached €2.6 million or 17.8% of total expenditures.

Executions in first quarter of 2004

Total revenues of the Employment Fund at the end of March 2004 reached €2.5 million, while expenditures amounted to €2.2 million. In the structure of revenues, worker and employee contributions (paid by employers as part of the tax on wages) represented 33%, while the subsidy from the budget (for material support for unemployed and beginners) amounted to €0.4 million or about 18% of total revenues. Repayment of loans given for self-employment represented 21% of total revenues. On the expenditure side, the Fund spent almost 27% on support for the unemployed and the employed, 12% for preferential credits for self-employment, and the rest on administrative, material costs, and credit repayment.

6. MONEY

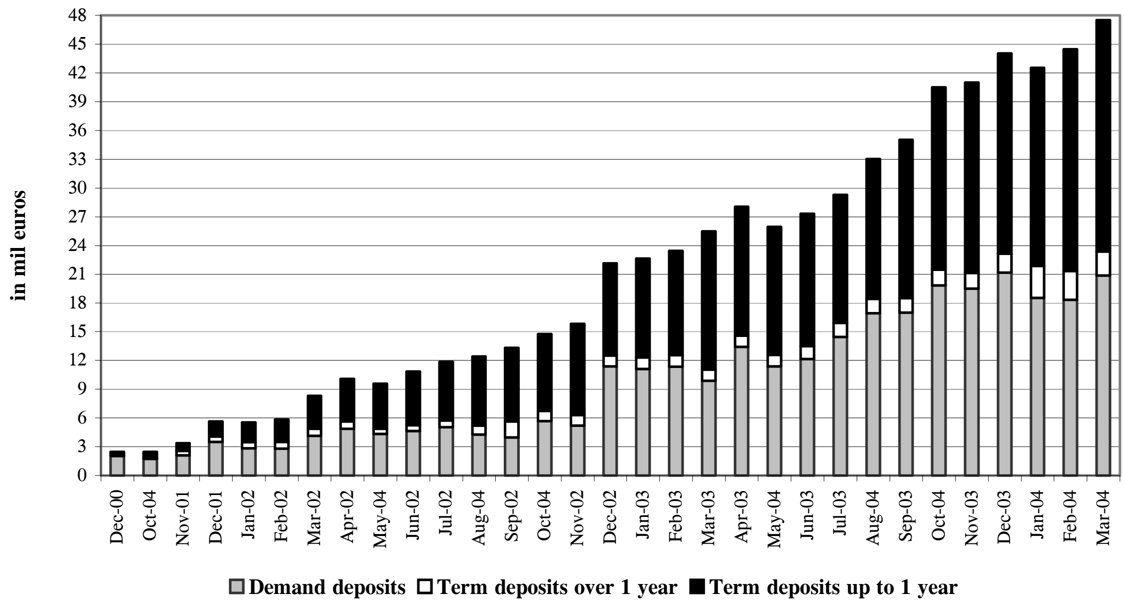
6.1. DEPOSITS OF HOUSEHOLDS

Table 6.1: Deposits of households (in million €)

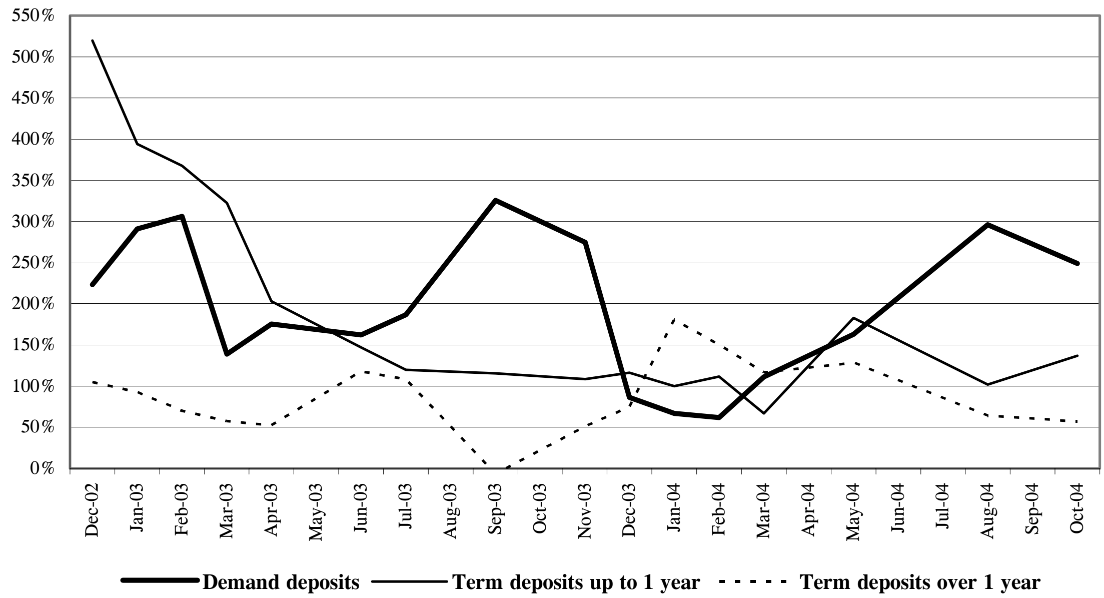
in mil €	**2. Demand deposits**			**2. Term deposits up to 1 year**			**3. Term deposits over 1 year**			**Total (1+2+3)**
	Total	€	Other currencies	Total	€	Other currencies	Total	€	Other currencies	
Dec-00	2.035	0.932	1.103	0.428	0.063	0.366	0.002	0.000	0.002	2.465
Oct-01	1.751	0.894	0.857	0.655	0.554	0.102	0.057	0.055	0.002	2.463
Nov-01	2.092	1.179	0.913	0.809	0.668	0.141	0.466	0.465	0.001	3.368
Dec-01	3.517	2.379	1.138	1.557	1.332	0.225	0.550	0.549	0.001	5.624
Jan-02	2.844	1.985	0.859	2.090	1.755	0.335	0.617	0.594	0.023	5.551
Feb-02	2.791	1.714	1.077	2.336	1.909	0.427	0.702	0.679	0.023	5.829
Mar-02	4.139	3.358	0.781	3.418	1.853	1.565	0.741	0.680	0.061	8.298
Apr-02	4.874	4.135	0.739	4.443	2.525	1.918	0.773	0.711	0.062	10.090
May-02	4.329	3.813	0.516	4.732	2.815	1.917	0.525	0.463	0.062	9.586
Jun-02	4.629	4.212	0.417	5.609	3.013	2.596	0.615	0.553	0.062	10.853
Jul-02	5.036	4.579	0.457	6.089	3.394	2.695	0.702	0.640	0.062	11.827
Aug-02	4.269	3.802	0.467	7.217	5.184	2.033	0.928	0.906	0.022	12.414
Sep-02	3.984	3.183	0.801	7.669	4.798	2.871	1.663	1.497	0.166	13.316
Oct-02	5.686	4.730	0.956	8.012	6.140	1.872	1.038	1.012	0.026	14.736
Nov-02	5.205	4.310	0.895	9.515	6.772	2.743	1.099	1.065	0.034	15.819
Dec-02	11.370	5.154	0.869	9.650	6.823	2.827	1.127	1.090	0.037	22.147
Jan-03	11.122	8.965	2.405	10.326	7.562	2.764	1.188	1.170	0.018	22.636
Feb-03	11.339	7.248	3.874	10.926	8.138	2.788	1.194	1.179	0.015	23.459
Mar-03	9.887	7.650	3.689	14.446	10.744	3.702	1.166	1.142	0.024	25.499
Apr-03	13.409	6.186	3.701	13.466	10.421	3.045	1.179	1.153	0.026	28.054
May-03	11.379	8.604	4.805	13.368	10.752	2.616	1.199	1.174	0.025	25.946
Jun-03	12.133	6.798	4.581	13.848	10.624	3.224	1.340	1.292	0.048	27.321
Jul-03	14.433	7.508	4.625	13.386	10.554	2.832	1.463	1.385	0.078	29.282
Aug-03	16.917	9.682	4.751	14.576	11.618	2.958	1.522	1.405	0.117	33.015
Sep-03	16.967	11.465	5.425	16.512	13.563	2.949	1.554	1.439	0.115	35.033
Oct-03	19.863	11.836	5.131	18.983	15.935	3.048	1.633	1.522	0.111	40.479
Nov-03	19.502	14.034	5.829	19.851	16.082	3.769	1.658	1.547	0.111	41.011
Dec-03	21.180	13.133	6.369	20.872	17.276	3.596	1.966	1.885	0.081	44.018
Jan-04	18.560	14.712	3.847	20.639	18.110	2.529	3.331	2.307	1.024	42.530
Feb-04	18.359	15.007	3.352	23.115	19.269	3.846	2.987	2.653	0.334	44.461
Mar-04	20.865	18.034	2.831	24.108	22.228	1.880	2.525	2.156	0.369	47.498

Source: Central Bank of Montenegro, reports of various banks

Graph 6.2. Deposits of households



Graph 6.2. Annual change of deposits

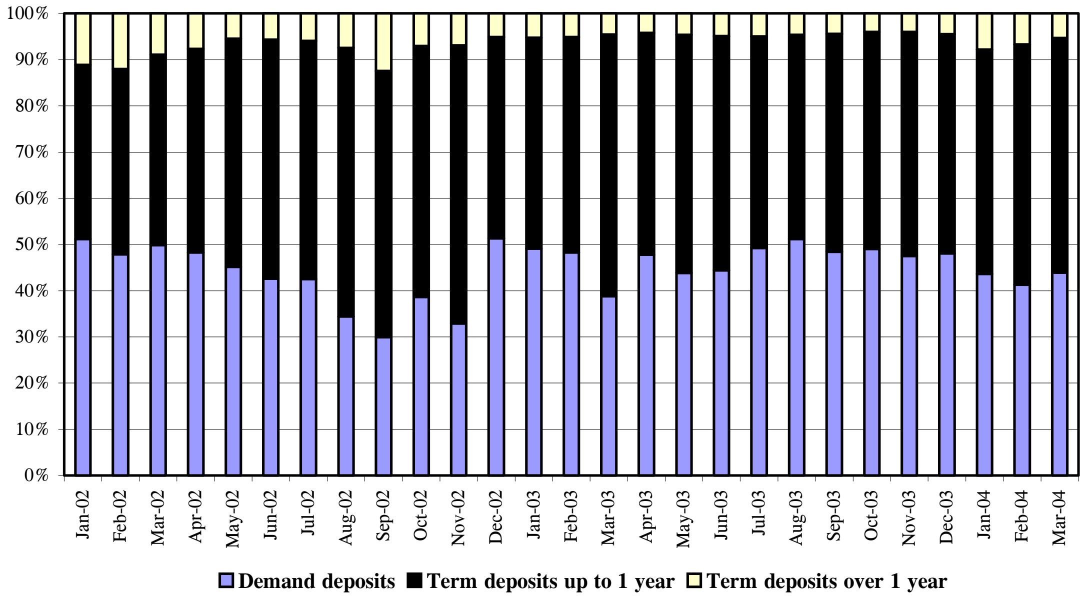


Source: Central Bank of Montenegro
Note: Since December 2002, transaction deposits are included in structure of demand deposits.

- *Total household deposits reached €47.7 million at the end of first quarter 2004*
- *Structure of household deposits shows an increasing share of term savings up to 1 year*
- *Total loans provided by Montenegrin banks reached €216million at the end of March 2004*
- *The highest share of loans was provided to private owned companies in amount of €121 million*

The increasing trend of total household deposits in 2003 was continued in the first quarter of 2004. At the end of March 2004, total deposits amounted to € 47.4 million. The annual growth rate of total deposits was 87.8%, 89% and 86.27% in January, February and March 2004, respectively. Of all deposit categories, term deposits over 1 year registered the highest growth rates during the first quarter of 2004. The highest growth rate of this category was recorded in January, when it grew by 180.39%. In February and March of 2004, this category registered an annual growth rate of 150.17% and 116.55%, respectively. Growth of these deposits is primarily a result of the increase of deposits in other currencies, which registered astounding growth rates of 5,588%, 2,126% and 1,437% in the first three months of 2004, respectively. Demand deposits and term deposits of up to 1 year both registered positive annual growth rates, but at lower levels than in previous months. Annual growth rates of demand deposits in the first three months of 2004 amounted to: 66.8%, 61.9% and 111%, respectively. In the same months of 2003 these rates amounted to: 291.1%, 306.2% and 138.8%, respectively.

Graph 6.3 Structure of households deposits



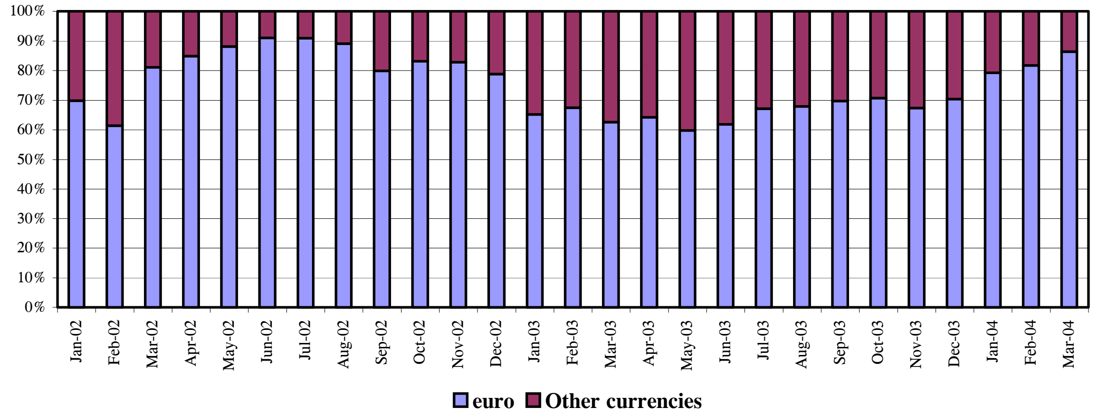
Source: Central Bank of Montenegro

Analysis of the structure of household deposits shows an increasing share of term savings of up to 1 year. On the other hand, demand savings show a decreasing share in total deposits. As a proportion of total deposits, the share of term deposits of up to 1 year represent 48.5%, 51.9% and 50.76% in January, February and March 2004, respectively, while the share of demand deposits amounted to 43.6%, 41.2% and 43.9% in these months, respectively. Term deposits over 1 year have the lowest share in total deposits of households in the first quarter of 2004, with 7.8%, 6.7% and 5.3%, respectively. However, compared to the same months in 2003, the share of term deposits over one year is higher in Q1 2004 than in Q1 2003.

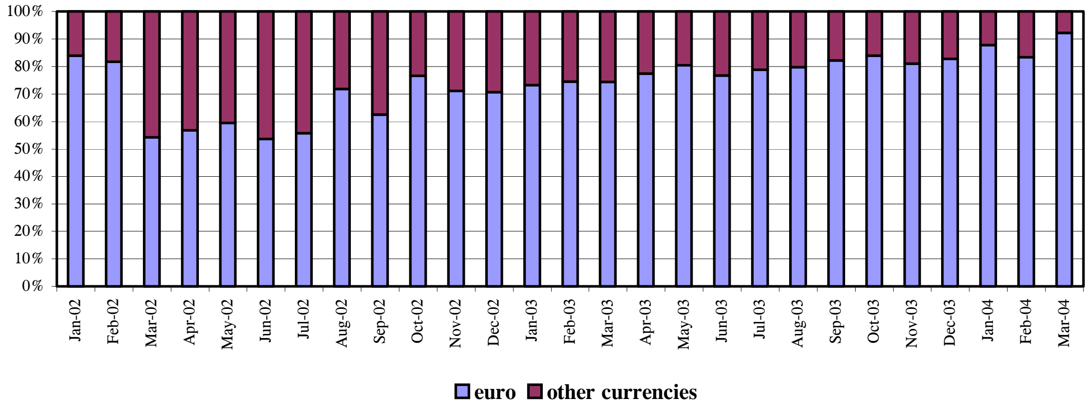
Graph 6.4 presents the currency structure of household deposits. As the graph indicates, the majority of deposits are denominated in euros. The currency structure of demand deposits is variable and changes periodically, as the following graph shows. In the currency structure of term deposits up to one year, the share of these deposits in other currencies continues to decrease during the entire analyzed period. Among all deposit categories, term deposits of over one year have the largest share of deposits in other currencies. Since March 2002 through the end of 2003, among all term deposits of over 1 year, the share that were in other currencies amounted to between 2% and 10%. In 2004, this share increases. The highest increase was registered in January and it amounted to 30%. In February and March of 2004, the share of term deposits over 1 year in other currency in total deposits over 1 year was 11% and 14%, respectively.

Graph 6.4 Currency structures of households deposits

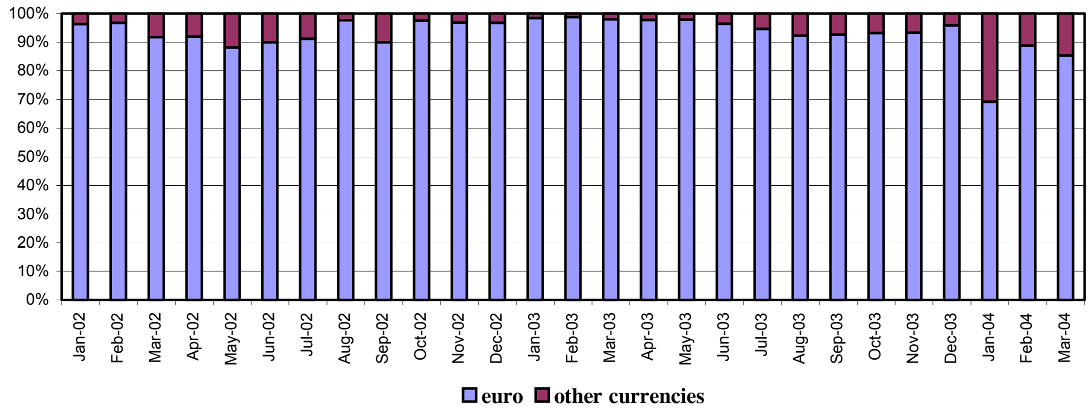
Demand deposits



Term deposits up to 1 year



Term deposits over 1 year



6.3. LOANS

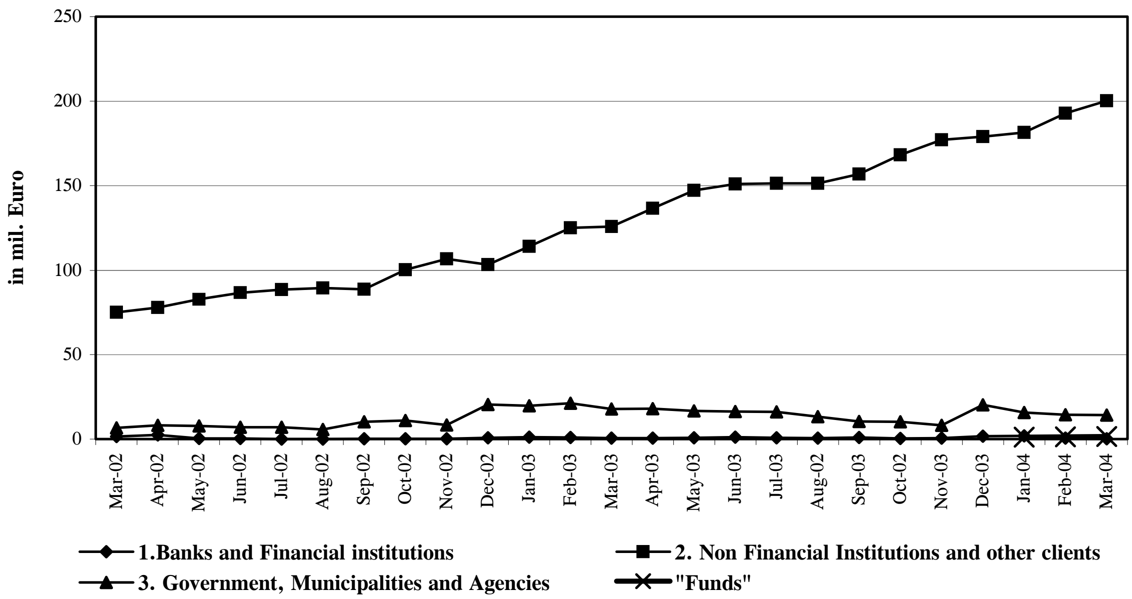
Table 6.2. Loans in 2002, 2003 and first quarter of 2004 (in million Euros)

	Loans	1.Banks and financial institutions	2. Non Financial Institutions and other clients.					3. Government, Municipalities and Agencies	4. Funds
			2.1 Privately owned local companies	2.2.Publicly owned organizations	2.3. Individuals	2.4. Other	Total		
Mar-02	**82.990**	1.533	59.855	8.607	3.027	3.371	74.86	6.597	
Jun-02	**94.078**	0.314	71.36	6.687	5.098	3.562	86.707	7.057	
Sep-02	**99.162**	0.128	67.498	5.639	11.99	3.63	88.757	10.277	
Dec-02	**124.663**	0.788	70.305	8.448	22.032	2.559	103.344	20.531	
Jan-03	**134.900**	1.098	78.323	10.027	23.171	2.676	114.197	19.605	
Feb-03	**147.152**	0.872	82.178	15.155	25.461	2.357	125.151	21.129	
Mar-03	**144.055**	0.535	84.018	13.683	25.895	2.167	125.763	17.757	
Apr-03	**155.119**	0.525	91.327	14.24	29.014	1.989	136.57	18.024	
May-03	**164.737**	0.771	96.381	18.342	30.352	2.177	147.252	16.714	
Jun-03	**168.48**	1.167	100.206	17.954	30.503	2.309	150.972	16.341	
Jul-03	**168.295**	0.832	103.911	13.761	31.358	2.385	151.415	16.048	
Aug-02	**165.245**	0.652	104.921	12.297	32.256	1.951	151.425	13.168	
Sep-03	**168.306**	0.93	103.699	14.353	36.362	2.494	156.908	10.468	
Oct-03	**178.909**	0.379	108.014	15.021	42.865	2.347	168.247	10.283	
Nov-03	**185.865**	0.577	114.677	13.328	46.778	2.29	177.073	8.215	
Dec-03	**200.898**	1.625	116.289	12.414	47.671	2.566	178.94	20.333	
Jan-04	**200.149**	1.850	110.638	15.401	48.088	7.327	181.454	15.621	1.224
Feb-04	**209.167**	525	120.020	14.963	50.770	7.073	192.826	14.402	1.414
Mar-04	**216.264**	279	121.168	13.945	57.231	7.936	200.280	14.112	1.593

Source: Central Bank of Montenegro

Data presented in table 6.2 shows that total loans provided by Montenegrin banks increased in the first quarter of 2004. However, loans to several categories of clients registered declines (loans to banks and financial organizations, privately owned local companies and to governments and municipalities). During the observed period, total loans registered positive annual growth rates. In the first three months of 2004, annual growth rates of total loans amounted to 48.3%, 42.1% and 50.1%, respectively.

Graph 6.5 Loans provided by Montenegrin banks



In the first quarter of 2004, different categories of loans exhibited different trends.

The largest share in total loans is had by loans to non-financial institutions (90.6%, 92% and 92.6% in January, February and March 2004, respectively). The annual dynamics of this category was growing in the first quarter of 2004, with annual rates of 58.8%, 54% and 59.2% in January, February and March 2004, respectively. The majority of these loans were approved to domestic private companies. The volume of credit in this category has grown continuously since March 2002, with the exception of January 2004, when it registered a negligible fall (approximately 5% compared to the previous month). At the end of March 2004, total sum of loans approved to private owned companies amounted to around € 121 million.

Loans to households have been on the rise since March 2002 as well. In the first three months of 2004, loans in this category amounted to €48.08 million, €50.7 million and €57.2 million, respectively.

Loans to government, municipalities and agencies, have been falling throughout the first quarter, since their peak in December 2003 (when they reached €20.3 million). At the end of the first quarter, this category reached €14.12 million.

The structure of loans in the first three months of 2004 has been relatively stable. In all three analyzed months, loans to privately owned companies had the largest share in total loans (55.2% in January, 57.3% in February and 56% in March 2004) and were followed by loans to households (24%, 24.2% and 26.4% in the analyzed months, respectively). The smallest share belonged to loans to banks and financial institutions (0.92% in January, 0.25% in February and 0.12% in March 2004).

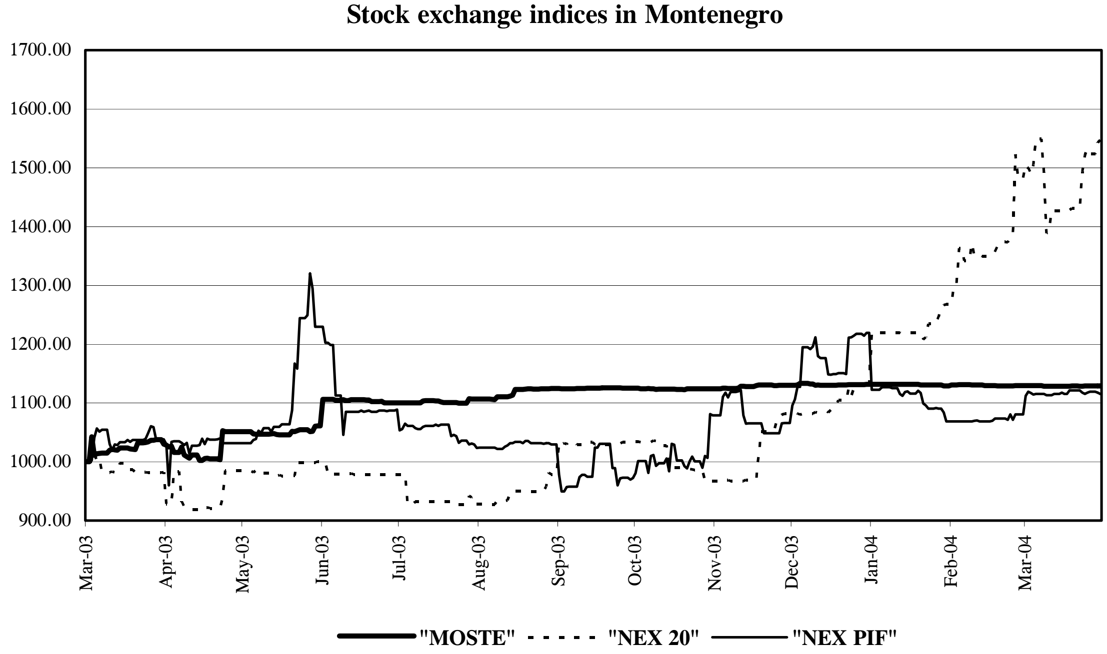
A new category of loans was introduced in 2004, specifically, loans to funds. This category is related to loans given to Government Funds that previously were included in the category, "loans to government, municipalities and agencies." From the beginning of 2004, this category is recorded in a separate account – loans to funds. This category made up a mere 0.65%, 0.67% and 0.73% of total loans in the first three months of 2004, respectively.

7. CAPITAL MARKET[1]

- *Total turnover on the Montenegrin capital market in the first quarter of 2004 negligible decreased, compared to the same period last year*
- *Total number of transactions in the first quarter of 2004 was significantly higher than the same period last year*
- *All stock exchange indices increased*

7.1. INDICES[2]

In the first quarter of 2004, the stock exchange indices showed different trends. Graph 7.1 presents the trends of all three indices during the first three months of 2004.



Source: NEX Montenegro and Montenegroberza

Montenegroberza's index – MOSTE, was stable during the first quarter of 2004. Its value varied insignificantly between 1128 and 1130 points. Compared to its initial value, at the end of March 2004 the index was approximately 12% higher.

The NEX 20 index increased significantly in the first three months of 2004. The value of this index fluctuated between 1219 points (at the beginning of January) and 1547 points (on March 30, 2004). Since the beginning of the year through the end of the first quarter 2004, the index increased consistently with a negligible fluctuation in the beginning of March. By the end of March 2004, the value of the index was about 27% higher than in the beginning of the year. Compared to its initial value, the index was about 50% higher at the end of March 2004. This increase resulted from the growing share prices of Jugopetrol and

[1] Two stock exchanges operate in Montenegro: Montenegroberza and NEX Montenegro.
[2] In Montenegro exist three stock exchange indices: MOSTE (Montenegroberza), NEX PIF and NEX 20 (NEX Montenegro)

Telekom (which have the highest weights in the index) as well as the prices increase of Trebjesa, Bjelasica Rada and Budvanska rivijera.

The NEX PIF index didn't exhibit significant fluctuations during the analyzed period, as shown in the graph above. The index registered its lowest value in the period between January 30th and February 16th, 2004 when it amounted to 1,068 points. The index registered its maximum between January 5th and 9th, 2004 when it amounted to 1,126 points. The stability of the index is an effect of the stable prices of the investment units for all PIFs in Montenegro during this period.

Table 7.1. Stock exchange trade in Montenegro

MONTH	MONTENEGROBERZA				NEX MONTENEGRO				TOTAL			
	TURNOVER (in €)			Number of transactions	TURNOVER (in €)			Number of transactions	TURNOVER (in€)			Number of transactions
	Primary	Secondary	Total		Primary	Secondary	Total		Primary	Secondary	Total	
Jan-03	130,123	73,770	203,893	105	0	588,673	588,673	374	130,123	662,443	792,566	479
Feb-03	1,459,751	511,390	1,971,141	351	0	175,566	175,566	782	1,459,751	686,956	2,146,707	1,133
Mar-03	2,170,818	174,930	2,345,748	414	0	298,291	298,291	1,167	2,170,818	473,221	2,644,039	1,581
Apr-03	0	496,648	496,648	236	0	603,269	603,269	1,268	0	1,099,917	1,099,917	1,504
May-03	0	204,256	204,257	283	989	740,889	741,878	1,955	989	945,146	946,135	2,238
Jun-03	723,937	951,350	1,675,288	685	723,938	922,216	1,646,154	1,393	1,447,876	1,873,567	3,321,442	2,078
Jul-03	0	11,244,223	11,244,223	478	0	1,568,723	1,568,723	1,298	0	12,812,946	12,812,946	1,776
Aug-03	0	259,073	259,074	301	0	841,434	841,434	1,258	0	1,100,508	1,100,508	1,559
Sep-03	246,895	959,449	1,206,345	364	0	3,863,012	3,863,012	1,672	246,896	4,822,462	5,069,357	2,036
Oct-03	270,983	149,686	420,670	303	0	1,449,375	1,449,375	1,610	270,984	1,599,061	1,870,045	1,913
Nov-03	300,000	1,719,989	2,019,989	774	0	2,405,935	2,405,935	1,044	300,000	4,125,924	4,425,924	1,818
Dec-03	3,497,227	892,159	4,389,386	1,699	1,265,954	1,669,419	2,935,373	1,510	4,763,181	2,561,578	7,324,759	3,209
Total 03	**8,799,736**	**17,636,926**	**26,436,662**	**5,993**	**1,990,881**	**15,126,802**	**17,117,683**	**15,331**	**10,790,617**	**32,763,728**	**43,554,345**	**21,324**
Jan-04	230,000	464,477	694,477	389	0	314,863	314,863	1,555	230,000	779,340	1,009,340	1,944
Feb-04	0	530,885	530,885	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
Total 04	**230,780**	**2,003,531**	**2,234,311**	**2,881**	**0**	**2,612,054**	**2,612,054**	**6,491**	**230,780**	**4,615,585**	**4,846,365**	**9,372**

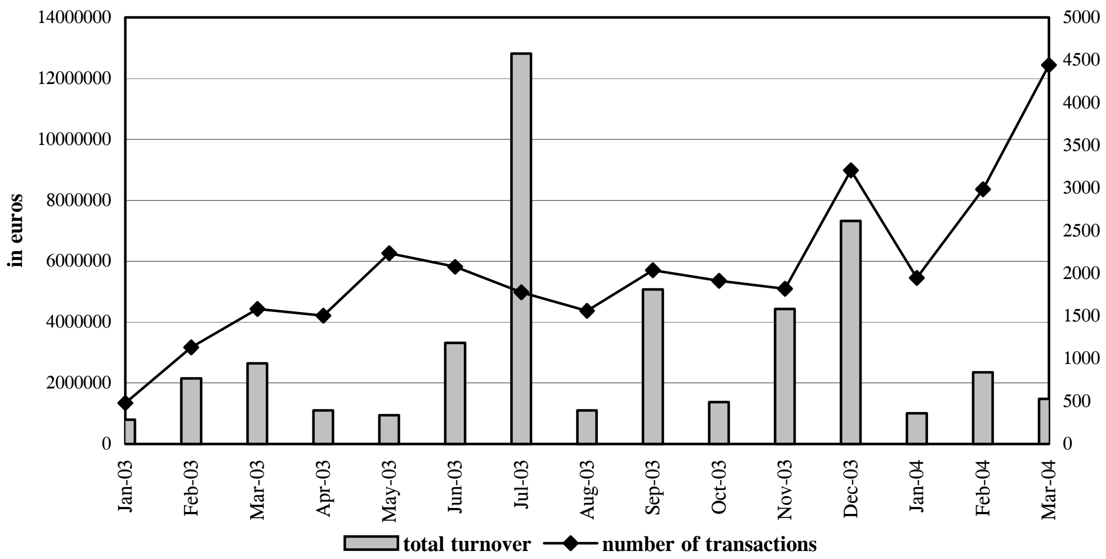
Source: Montenegroberza and NEX Montenegro

7.2 TURNOVER ON STOCK EXCHANGES

Total turnover on the Montenegrin Stock exchanges in the first quarter of 2004 amounted to € 4,846,365. A total of 9,372 transactions were realized during this period. Compared to the same period last year, total turnover decreased by about 15% while the total number of transactions nearly tripled.

Graph 7.2 shows total turnover and the number of transactions realized on Montenegrin stock exchanges during 2003 and the first three months of 2004.

Graph 7.2 Total turnover and number of transactions on Montenegrin stock exchanges



Source: Montenegroberza and NEX Montenegro

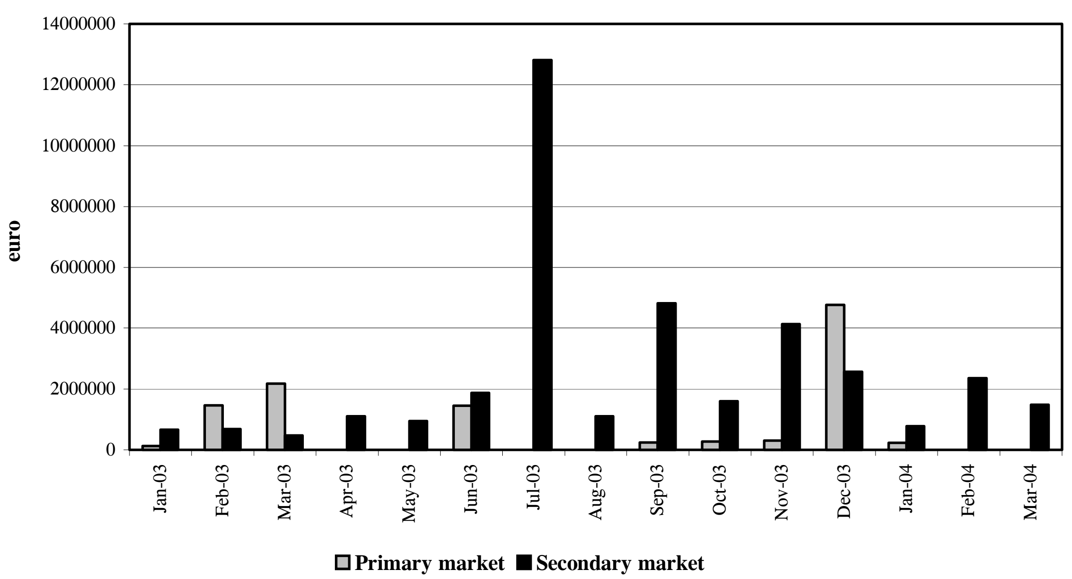
Total turnover varied from month to month during the first quarter of 2004. The highest turnover was realized in February (€ 2,353,736), and the lowest in January (€ 1,009,340). In March, turnover amounted to € 1,483,736. As the graph presents, the total number of transactions increased rapidly in the first three months of 2004 (going from 1,944 to 2,986 to 4,442), which is consistent with the increasing trend present throughout 2003.

The majority of turnover (95%) was realized in the secondary market, and the rest (5%) was realized on the primary market.

7.2.1. Trade on primary market

In the first quarter of 2004, the Montenegrin primary market registered turnover in the amount of € 230,780. Compared to the same period last year, total turnover in the primary market decreased 16 times.

Graph 7.3 Total turnover on primary and secondary market



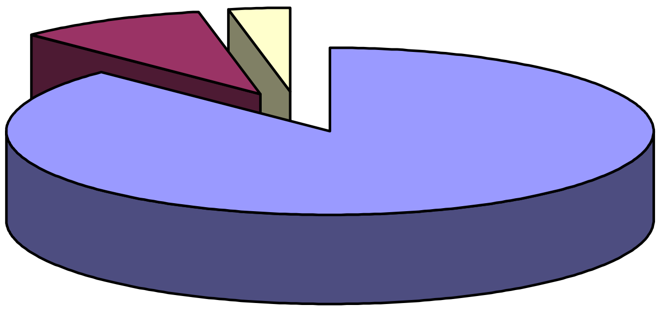
Source: Montenegroberza and NEX Montenegro

All turnover in the primary market was realized in Montenegroberza, where Magnat Insurance and Market Broker issued their shares (€ 230,000 and € 780 respectively).

7.2.2. Trade in the secondary market

In the secondary market, during the first three months of 2004, turnover of € 4,615,585 was registered, representing 95% of total turnover. The highest turnover was realized in February (€ 2,353,288), followed by March (€ 1,482,956), and January (€ 779,340).

Graph 7.4 Turnover structure on secondary market in first three months of 2004



Source: Montenegroberza and NEX Monetengro

Compared to the same period in 2003, total turnover in the secondary market, during the first quarter of 2004 increased by approximately 2.5 times. This growth is a result of trade with MVP company shares[3], which account for the majority of trade in the secondary market in Montenegro. In the first quarter of 2004 the majority of turnover in the secondary market was related to trade with shares (88%). Trade with investment units of PIFs amounted to € 425,560 giving it a 9% share of total turnover, while trade with old foreign exchange bonds amounted to € 145,303 and had a 3% share of total turnover. Compared to the same period of 2003, the share of trade with old foreign exchange bonds has decreased markedly. In March 2004 no trade with old foreign exchange bonds was registered. In November 2003, the Parliament adopted the Law on Settlement of Obligations and Claims related to Foreign Debt and Frozen Foreign Exchange Savings[4], which put out of power the Decree on the Purchase of Shares with Old Foreign Currency Savings[5]. As a consequence of these changes, new bonds will no longer be issued, therefore, since November 2003 only the old foreign exchange bonds that were issued before this Law was implemented can be traded.

[3] Companies on the list for Mass Voucher Privatization
[4] Official gazette of RM, No 55/03
[5] For details see MONET 14, chapter Capital market

Trade with shares

During the first quarter of 2004, the NEX Montenegro stock exchange traded shares of approximately 70 companies[6]. Of the total turnover that was realized with shares, one-third of it (34%) was related to shares of only six companies: Napredak, Telekom, Jugopetrol, Atlasmont bank, C Vračar i Lutrija Crne Gore. Table 7.2 shows the turnover and share prices realized by trade with shares of these companies.

Table 7.2. Most tradable shares on the NEX Montenegro

Company	2003			
	Max price	Min price	Turnover in €	Quantity
NAPREDAK A.D KOTOR	0.0189	0.0189	434,700	23,000,000
TELEKOM CRNE GORE A.D. PODGORICA	1.5005	0.7500	189,505	176,615
JUGOPETROL A.D. KOTOR	3.4999	2.7000	149,291	48,399
ATLASMONT BANKA A.D. PODGORICA	4000.0	4.915	50,106	4,150
C-VRAČAR A.D HERCEG NOVI	1.3500	1.3500	32,508	24,080
LUTRIJA CRNE GORE A.D PODGORICA	1.000	0.7205	27,205	27,906

Source: NEX Montenegro

Montenegroberza traded with shares of approximately 40 companies, however, 54% of total turnover on this exchange was related to shares of PKB Herceg Novi, Plantaže, Otrant komerc, Hipotekarna bank, Mješovito Herceg Novi i VUP Danilovgrad (table 7.3.).

Table 7.3. Most tradable shares on the Montenegroberza

Company	2003			
	Max price	Min price	Turnover in €	Quantity
PKB HERCEG NOVI A.D. ZELENIKA	2.3001	2.272	380,920	166,242
PLANTAŽE A.D PODGORICA	0.0527	0.0505	288,344	5,679,341
OTRANT KOMERC A.D. ULCINJ	1.91	1.91	173,810	91,000
HIPOTEKARNA BANKA A.D.	409.00	288.00	113,860	305
MJEŠOVITO A.D HERCEG NOVI	0.4000	0.4000	74,297	185,744
VUP A.D DANILOVGRAD	5.2100	3.0000	58,514	15,533

Source: Montenegroberza

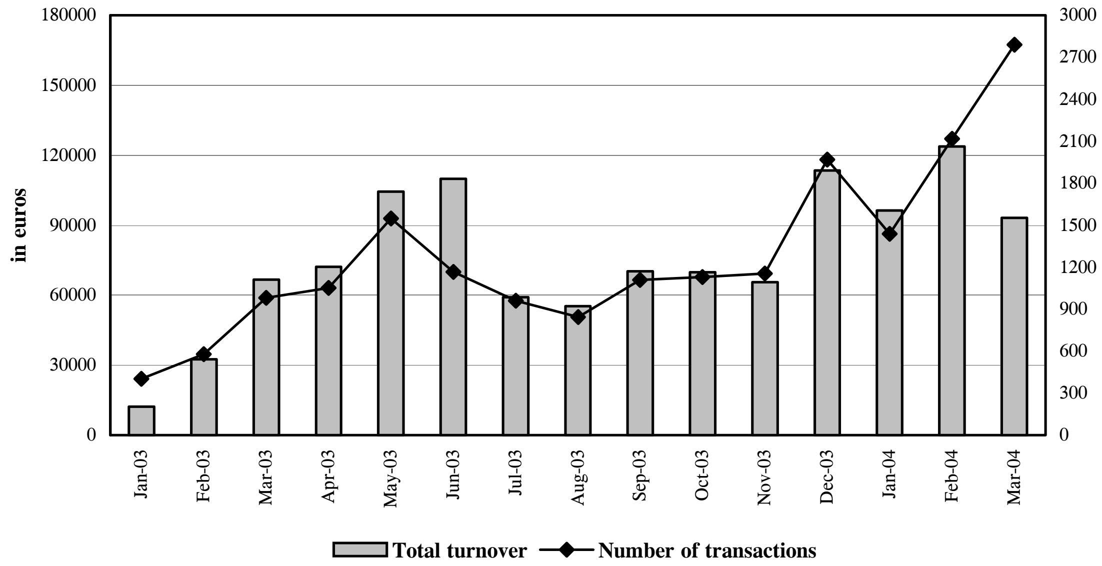
Trade with investment units of Privatization Investment Fund[7]

Investment units of all six Privatization Funds were traded in the first quarter of 2004 in both Montenegrin stock exchanges. During this period, 6,347 transactions were realized, of which 5,132 occurred in the *NEX Montenegro* stock exchange and 1,243 in *Montenegroberza*. It is important to note that the number of transactions realized with investment units of PIFs represents approximately 68% of the total transactions realized in both stock exchanges during the analyzed period. Total turnover amounted to €425,560 (€104,634 on *Montenegroberza* and €320,926 on *NEX Montenegro*).

[6] Excluding shares that offer the Development Fund, the Pension Fund and the Employment Office of Montenegro

[7] By transferring voucher points to privatization funds in the third phase of the MVP program, 237,316 citizens became fund shareholders (For more details see MONET 8, Comment 11).

Graph 7.4 Monthly turnover with PIF investment units in 2003 and first quarter 2004



Source: NEX Montenegro and Montenegroberza

The number of transactions with investment units of PIFs had an increasing trend in the first three months of 2004. Namely, the total number of transactions rose from 1,440 in January, to 2,119 in February, and up to 2,789 in March 2004. Total turnover realized with investment units of PIFs in those months amounted to: €96,139, €123,763 and €205,436, respectively.

Trade with shares of old foreign currency saving bonds

Turnover related to old foreign currency savings bonds in the first quarter of 2004 amounted to €145,303 (3% of total turnover). More than 99% of turnover took place in NEX Montenegro, and the rest in Montenegroberza. In March 2004, old foreign exchange bonds were not traded due to the aforementioned reasons.

In *Montenegroberza,* 1 euro of old foreign currency savings was worth, on average, 0.89 euro, while in the *NEX Montenegro* 1 euro of old foreign currency savings was sold for between 0.85 and 0.93 euro.

Table 8.1 Imports and Exports im 2002 and 2003 (euros 000)

	Sector	Exports				Imports			
		2002		2003		Jan-Feb 2003		Jan-Feb 2004	
		total in euros	as % of total	total in euros	as % of total	total in euros	as % of total	total in euros	as % of total
1	Meat and meat products	206,579	0.08	84,587	0.04	0	0.00	3807.38	0.01
2	Milk products and eggs	636,501	0.24	332,287	0.17	65556.00	0.16	0.00	0.00
3	Fish and fish products	5841	0.00	105,142	0.05	2650.00	0.01	1684.00	0.00
4	Cereals and cereal products	1,619,618	0.62	839,048.50	0.43	397789.00	0.97	72009.94	0.14
5	Vegetables and fruits	3,991,286	1.53	4,376,604.41	2.27	410902.00	1.00	212073.35	0.43
6	Sugar, sugar products and honey	561,577	0.21	190,650.80	0.10	120711.00	0.29	17679.02	0.04
7	Coffee, tea, cocoa and spices	794,144	0.30	377,759.71	0.20	208725.00	0.51	46260.81	0.09
8	Animal fodder (except cereals)	187,003	0.07	118,765.30	0.06	5049.00	0.01	42161.30	0.08
9	Various nutrition products	1,080,514	0.41	285,963.93	0.15	175040.00	0.43	3841.44	0.01
11	Beverages	3,736,361	1.43	4,139,066.78	2.14	274314.00	0.67	587574.27	1.18
12	Tobacco and tobacco products	18,698	0.01	7,260,924.49	3.76	21570.00	0.05	2764565.43	5.56
21	Raw leather and pelt	3,967,900	1.52	1,708,982.38	0.89	391146.00	0.95	427252.50	0.86
22	Oil grain	7,410	0.00	7,380,339	3.82	0.00	0.00	0.00	0.00
23	Natural rubber	0	0.00	0	0.00	0.00	0.00	0.00	0.00
24	Cork and wood	3,904,883	1.49	2,719,606.96	1.41	325209.00	0.79	271434.20	0.55
25	Cellulose and paper pulp	74,354	0.03	82,349.99	0.04	7502.00	0.02	7686.01	0.02
26	Textile fibers and textile byproducts	7,375	0.00	42,163.50	0.02	0.00	0.00	0.00	0.00
27	Compost and minerals	422,239	0.16	1,464,728.65	0.76	16524.00	0.04	473304.82	0.95
28	Metal ores (nickel, aluminum and copper)	5,407,188	2.07	3,211,901.84	1.66	388970.00	0.95	233439.78	0.47
29	Animal and plant products	164,323	0.06	189,385.83	0.10	76168.00	0.19	6400.00	0.01
32	Mineral coal, coke and briquettes	14,351	0.01	6,073.04	0.00	0.00	0.00	1057.30	0.00
33	Oil and oil derivates	41,435,667	15.84	12,932,695.92	6.70	4727532.00	11.53	203026.03	0.41
34	Natural and industrial gas	0	0.00	0	0.00	0.00	0.00	0.00	0.00
35	Electricity	0	0.00	0	0.00	0.00	0.00	0.00	0.00
41	Animal oil and fat	0	0.00	0	0.00	0.00	0.00	0.00	0.00
42	Solid animal oils and fats	290,526	0.11	17,902	0.01	17902.00	0.04	1195.80	0.00
43	Animal and vegetable fats and oils	353,317	0.14	85,400.38	0.04	29270.00	0.07	0.00	0.00
51	Organic chemical products	20,140	0.01	12,182.12	0.01	1352.00	0.00	1435.20	0.00
52	Inorganic chemical products	95,857	0.04	39,420.46	0.02	9187.00	0.02	9297.58	0.02
53	Products for painting	120,519	0.05	824,569.61	0.43	0.00	0.00	125001.54	0.25
54	Medical and pharmaceutical products	110,681	0.04	74,261.75	0.04	16555.00	0.04	25217.08	0.05
55	Ether oils, perfumes and other products	1,071,514	0.41	486,265.51	0.25	287495.00	0.70	26016.30	0.05
56	Fertilizers (except unprocessed)	51,620	0.02	0.00	0.00	0.00	0.00	0.00	0.00
57	Unprocessed plastics	10,731	0.00	20,928.07	0.00	0.00	0.00	2122.30	0.00
58	Molded plastics	188,988	0.07	21,887	0.01	156.00	0.00	0.00	0.00
59	Chemical substances and products	220,967	0.08	5,371.32	0.00	0.00	0.00	103655.00	0.21
61	Leather and leather products, pelts	434,303	0.17	0	0.00	0.00	0.00	0.00	0.00
62	Rubber products	275,460	0.11	261,631.96	0.14	29059.00	0.07	36040.04	0.07
63	Cork and wood products	241,385	0.09	175,240.44	0.09	28362.00	0.07	2705.00	0.01
64	Paper, cardboard and cellulose products	704,811	0.27	183,326.90	0.09	88879.00	0.22	8641.55	0.02
65	Yarn, tissue and textile products	109,336	0.04	32,320.10	0.02	2674.00	0.01	3549.65	0.01
66	Construction materials (cement, glass, sand etc.)	292,664	0.11	128,802.05	0.07	20853.00	0.05	7706.85	0.02
67	Iron and steel	1,408,589	0.54	5,762,324.48	2.99	953789.00	2.33	801796.33	1.61
68	Ferrous metals	165,435,964	63.24	107,863,371.98	55.88	25927179	63.26	35641980.73	71.63
69	Metal products	965,519	0.37	5,939,291.57	3.08	258243.00	0.63	889325.53	1.79
71	Industrial machines and devices	30,142	0.01	2,241,134.51	1.16	1165.00	0.00	101526.34	0.20
72	Special purpose machinery	79200	0.52	827,212.18	0.43	1141.00	0.00	208268.60	0.42
73	Machines for metal processing	1,278	0.00	12,159.19	0.01	0.00	0.00	180.00	0.00
74	Industrial machines for general use	1,365,048	0.52	762,559.01	0.40	15641.00	0.04	199300.11	0.40
75	Machines for offices and data processing	138,462	0.05	88,721.90	0.05	230.00	0.00	9376.71	0.02
76	Telecommunication equipment	27,325	0.01	150,386.20	0.08	0.00	0.00	25006.30	0.05
77	Electrical machines and equipment	372,761	0.14	536,489.13	0.28	115408.00	0.28	12145.70	0.02
78	Vehicles	201,908	0.08	1,130,473.03	0.59	29385.00	0.07	239198.26	0.48
79	Other transportation equipment	16,423,570	6.28	14,751,792.00	7.64	5204127.00	12.70	5389703.37	10.83
81	Prefabricated buildings	55,361	0.02	72,909.45	0.04	0.00	0.00	7765.04	0.02
82	Furniture and parts	366,863	0.14	449,362.23	0.23	19942.00	0.05	51645.46	0.10
83	Traveling equipment	2,695	0.00	3,186.10	0.00	515.80	0.00	0.00	0.00
84	Clothing	373,094	0.14	436,948.20	0.23	66300.00	0.16	43940.47	0.09
85	Footwear	745,339	0.28	815,824.47	0.42	116638.00	0.28	30521.76	0.06
87	Scientific instruments	32,720	0.01	504,865.82	0.26	0.00	0.00	491.40	0.00
88	Cameras and clocks	4,256	0.00	163,208.57	0.08	11910.00	0.03	25380.00	0.05
89	Other finished products	748,068	0.29	295,425.69	0.15	119138.00	0.29	338245.96	0.68
93	Special transactions	0	0.00	14,376.42	0.01	0.00	0.00	12600.00	0.03
TOTAL		261,614,792	100	193,041,759	100	40,987,853	100	49,756,240	100

Source: Central Bank of Montenegro.

8. EXTERNAL SECTOR

- *Oil and oil derivates was the most dominant imports in the first two months in 2004 (11%);*
- *Ferrous metals (aluminum) was key exports in the first two months in 2004;*
- *Considering imports according to the country of origin, the most dominant are Slovenia (13.9%) and Croatia (8.8%) during January- February 2004;*
- *Considering exports by countries of destination, the structure continues to be dominated by exports of aluminum to Switzerland (36.1%).*
- *Trade balance (goods plus services) in 2003 amounted US$ 285.6 million or around 19% of GDP and nominally decreased by 8.4% compared to 2002.*

8.1. FOREIGN TRADE

8.1.1 Foreign Trade Structure by Goods

The divisional structure of imports and exports by goods is given for 2003, as well as for the first two months in 2004 and correspondent periods in 2003 and 2004 (see table 8.1). Data was obtained from the Central Bank of Montenegro and covers foreign trade with all countries, excluding Serbia but including Kosovo.[1]

With respect to **imports** in 2003, oil and oil derivatives accounted for the highest share of total imports (10.9%), however, their share is less than in the same period of 2002 when they accounted for 17.9%. Vehicles in 2003 ranked second with a share of 9.14% in total imports, which is twice as much as compared to 2002 (4.6%).

Other key imports in 2003 were telecommunication equipment (5.6% of total imports compared to 2.4% in 2002), electrical machines and equipment (5% in 2003 and nearly the same in 2002), and non-metal material products (4.5% compared to 5% in 2002). In 2003, the category “other transportation equipment” increased its share to 3.7% of total imports compared to 0.2% in 2002. The category “Ether oil, perfumes and other products” had a share of 3.9% in 2003, up from 2.4% in 2002. Meat and meat products had a lower share in 2003 as compared to 2002 (3.9% and 4.5%, respectively). The share held by the vegetables and fruit category declined from 5.4% in 2002 to 3.5% in 2003. The share of electricity also declined, going from 12.9% in 2002 to 2.8% in 2003. Total imports within these sectors accounted for about 50% of all imports.

The divisional structure of imports in the first two months of 2004 is presented in table 8.1. Oil and oil derivatives accounted for 11% of total imports, compared to 25% in the same period of 2003; vehicles accounted for 9% of total imports, more than twice than in the same period of 2003 (3.9%). The share of telecommunication equipment declined to 4.8% of total imports, down from 7.3% in January-February 2003. Import of non-metal materials made up 5.1% of total imports, an increase of 2 percentage points compared to the first two months of 2003. Imports of ether oils, perfumes and other products during January-February 2004 accounted for 5.3% of total imports, compared to 3% in the same period of 2003. Electrical machines and equipment had a 4.6% share in total imports in the first two months of 2004, while its share in the first two months of 2003 was 4.3%. In 2004, the share of meat and meat products declined to 3.6% from 7.5% of total imports in the first

[1] Data on trade with Kosovo according to this classification are not available since April 2003.

two months of 2003. The share of the vegetables and fruits category declined to 3.9% during January-February 2004, from 7.3% of total imports in the same period of 2003.

With respect to **exports** by sectors, it can be concluded that the export structure has not changed much in 2003 compared to 2002. In 2003, the most dominant sector in total exports was "ferrous metals" (aluminum), whose share amounted to 55.9% compared to 63.2% in 2002. Other transportation equipment ranked second with a share of 7.6% in total exports, which was higher than its share in 2002 (6.3%). The third most dominant exports sector in 2003 was oil and oil derivatives with a share of 6.8% in total exports, falling from 15.8% in 2002. The fourth dominant exports sector in 2003 was vegetables and fruits whose share increased to 2.3% of total exports compared to 1.5% in 2002. Metal ores ranked fifth with a share of 1.7% in total exports in 2003, while its share in the same period of 2002 was a bit higher (2.1%). In total, exports from these sectors accounted for 74.3% of total exports in 2003.

The structure of **exports** in the first two months of 2004 continues to be dominated by the ferrous metals sector, accounting for 71.6% of total exports; its share is significantly higher than in the corresponding period of 2003 when it was 63.2%. The second dominant exports sector was "other transportation equipment" (10.8% of total exports) whose participation declined 2.1 percentage points compared to the same period in 2003. The third dominant exports sector in 2004 was "tobacco and tobacco products" with a 5.5% share of total exports, a significant increase from its 0.05% share in 2003. In addition, the share of "beverages" increased in the first two months of 2003, going from 0.7% in 2002 to 1.2% in 2003. In total, exports from these 4 sectors accounted for 89.1% of total Montenegrin exports in the first two months of 2004.

8.1.2 Foreign Trade Structure by Countries of Destination and Origin

Foreign trade structure by countries is presented in table 8.2 and graphs 8.1 and 8.2

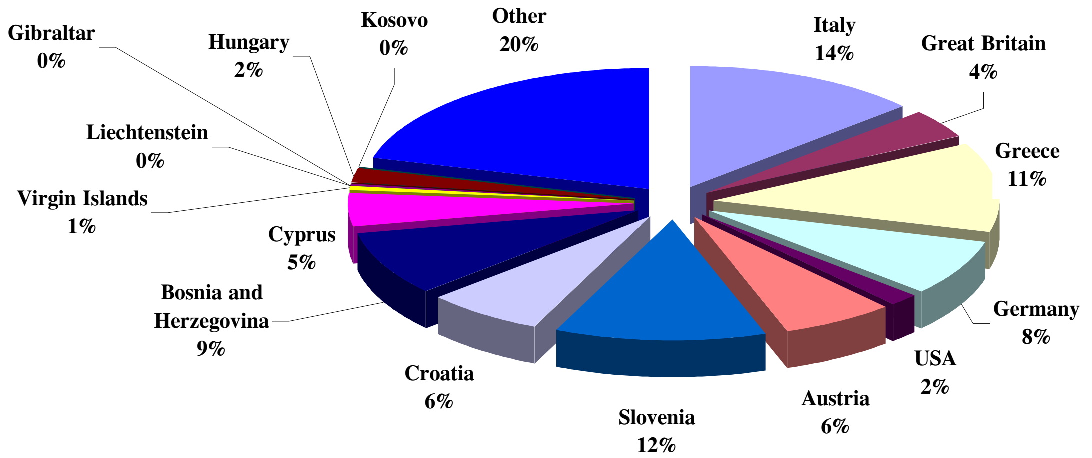
Table 8.2. Foreign trade structure by country

Country	Imports				Exports			
	2002	2003	Jan-Feb 2003	Jan-Feb 2004	2002	2003	Jan-Feb 2003	Jan-Feb 2004
	in % of total imports				in % of total exports			
Bosnia and Herzegovina	3.5	8.5	3.5	3.7	2.2	9.4	2.6	3.6
Croatia	9.5	6.6	9.8	8.8	0.7	1.8	0.4	2.20
Kosovo	0.3	0	0.2	0	20.5	0	16.4	0.00
Slovenia	9.6	12.1	9.6	13.9	0.4	1.2	0.4	0.9
Italy	11	13.4	10.3	15.4	5.6	11.3	6.8	31.80
Greece	7	11.9	23.6	5.4	0.3	3.10	0.90	1.70
Germany	5.9	7.6	7.1	7.4	0.3	0.6	0.6	0.70
Cyprus	4.4	4.5	4.7	2.8	2.3	3.4	1.9	0.40
Hungary	1.9	1.9	2.5	2.2	2	1.4	0	0.70
Virgin Islands	1.6	0.7	0.4	0.4	0.6	2.5	0	2.30
Albania	0.8	0.4			1	1.2	0.5	3.80
Austria	4.4	6.2	2.3	6.8	0	0	0.5	0.10
Gibraltar	0	0.1	2.6	0	0.2	0	0	0.00
Great Britain	8.1	3.9	0.7	1.9	0.1	0.1	0.2	0.10
Liechtenstein	0.9	0.2	0	0.1	0	0	0	0.40
Malta	0	0	0	0	1	0.8	0.6	0.00
Switzerland	2	2.9	1.6	4.7	59.3	57.3	66.8	36.10
USA	5.9	1.7	2.5	3.8	0.3	0.2	0.4	0.10
Other	23.2	17.4	18.6	2.9	0.1	5.70	1.00	15.10
Total	100	100	100	100	100.00	100.00	100.00	100.00

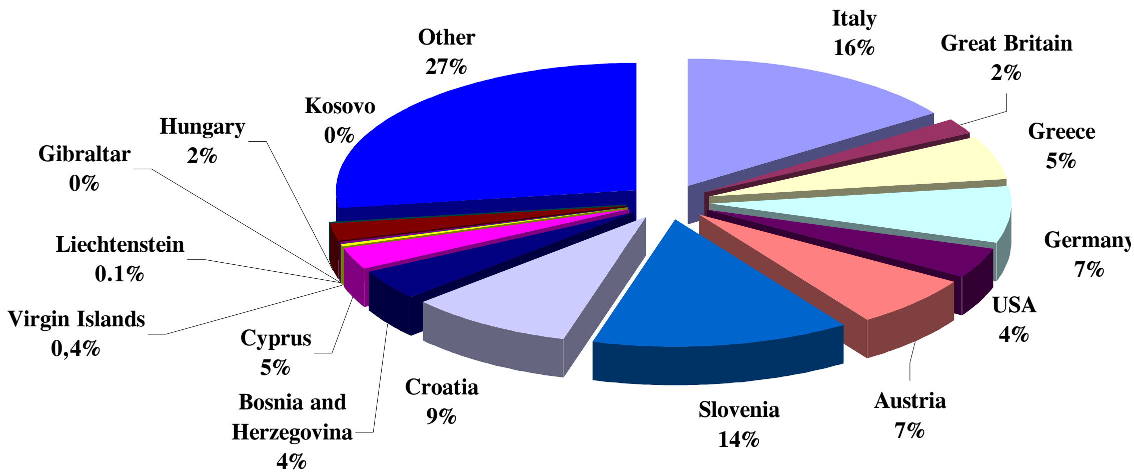
Source: Central Bank of Montenegro: Note: Due to the lack of data, Kosovo is not included in 2003 structure

Graph 8.1 Imports structure by countries of origin in 2003 and period January-February 2004

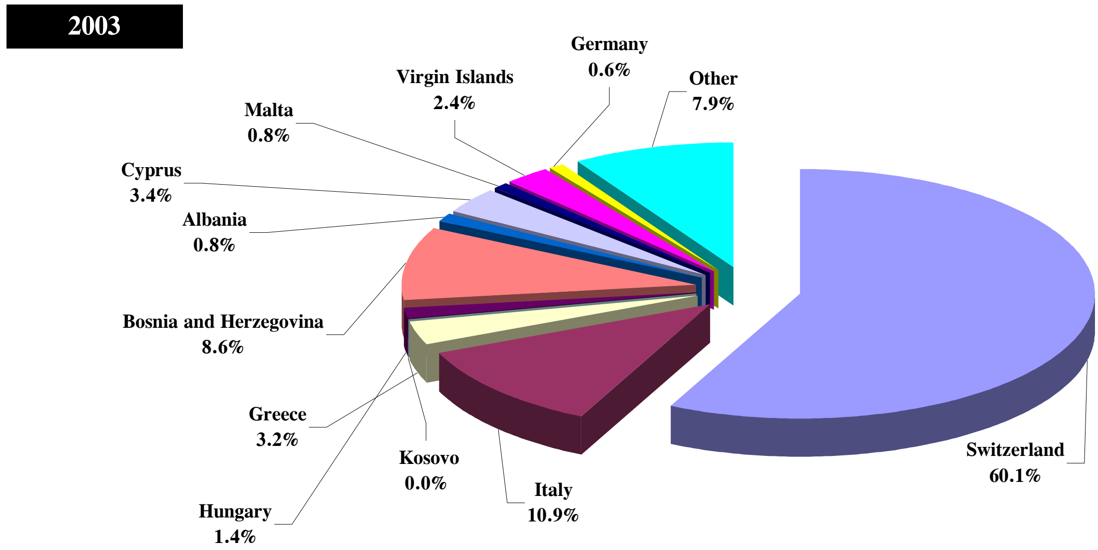
2003

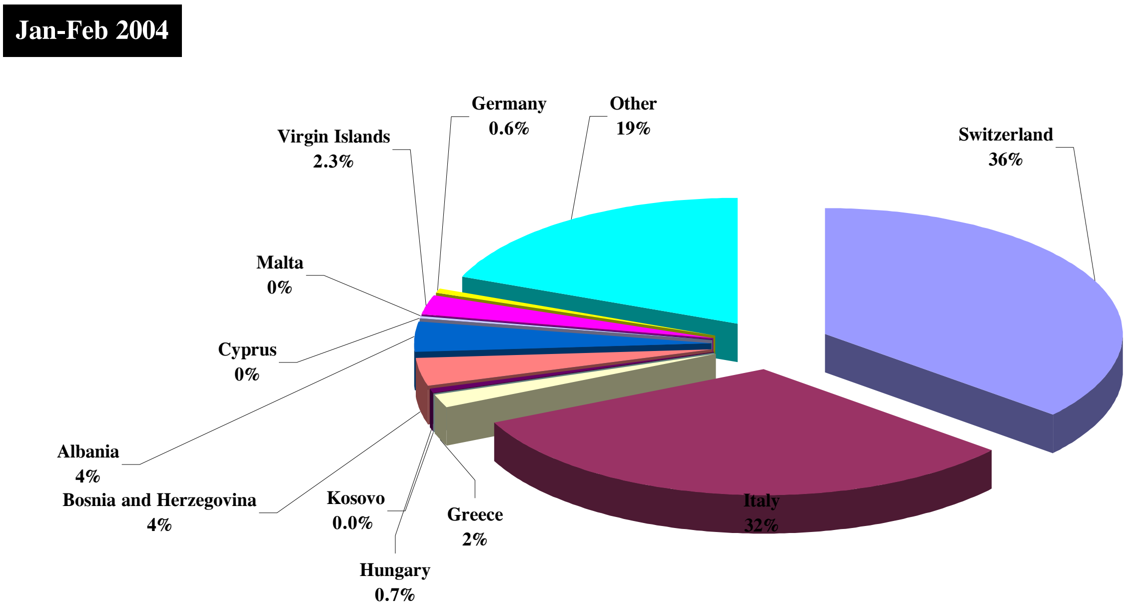


Jan-Feb 2004



Graph 8.2 Exports structure by countries of destination in 2003 and January-February 2004





Source: CBCG

The data on export and import of goods, according to their origin or assignment in 2002 and 2003, as well as in the first two months of 2003 and 2004, comes from the Balance of Payment statistics and do not include Serbia[2] (see table 8.2).

With respect to Montenegrin imports according to the country of origin, the former Yugoslav republics have had a significant share in total imports in 2003 and at the beginning of 2004. Particularly, the share of imports from Bosnia and Herzegovina in total imports rose to 8.5% in 2003, compared to 3.5% in 2002. Imports from this country accounted for 3.7% of total Montenegrin imports in the period January-February 2004, while it was 3.5% in the same period of 2003. The share of imports from Slovenia increased to 12.1% in 2003

[2] Data on imports and exports from/to Kosovo were not available since the second quarter of 2003, so import and export from/to Kosovo are not included in the total imports and exports.

from 9.6% in the preceding year. In the first two months of 2004, imports from Slovenia accounted for 13.9% of total imports compared to 9.6% in the same period of 2003. The share of imports from Croatia declined in 2003 to 6.6% from 9.5% in 2002. In the period January-February of 2004, imports from Croatia accounted for 8.8% of total imports, while in the same period of the preceding year it was 9.8%.

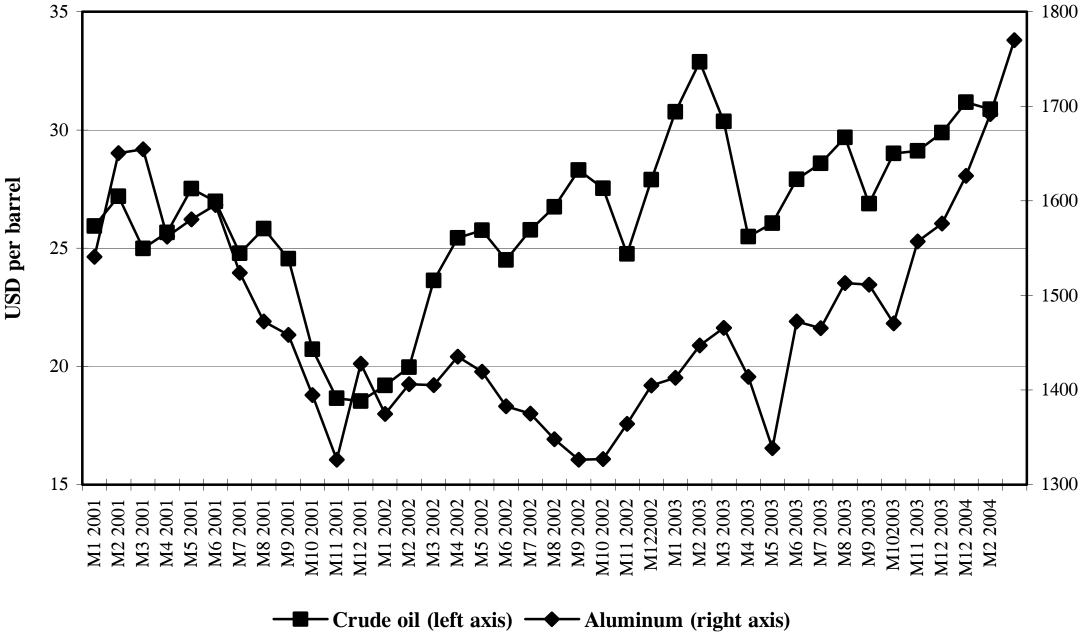
Considering that industrialized countries are dominant in total imports, several of them increased their share of total imports in 2003 and at the beginning of 2004. This is particularly the case of Greece whose participation in total imports increased from 7% in 2002 to 11.9% in 2003. However, in the period of January-February 2004, imports from Greece were just 5.4% of total imports compared to 23.6% in the same period of 2003. Italy's share of total imports increased from 11% in 2002 to 13.4% in 2003. Imports from Italy in the first two months of 2004 accounted for 15.4% of total imports, a 5.1 percentage point increase as compared to January-February 2003. In 2003, Germany's share of total imports increased from 5.9% in 2002 to 7.6%. Imports from Germany accounted for 7.4% of total imports in the period January-February 2004, nearly the same as in the first two months of 2003. Imports from Switzerland accounted for 2.9% in 2003 as compared to 2.0% in 2002, while imports from Austria were 6.2% in 2003 and 4.4% in 2002. In the period January-February 2004, the share of imports from Switzerland amounted to 4.7% of total imports compared to 1.6% in the same period of 2003. Imports from Austria accounted for 6.8% of total imports in the first two months of 2004, increasing from 2.3% in the first two months of 2003. On the other hand, the USA's share of imports declined in total Montenegrin imports from 5.9% in 2002 to 1.7% in 2003. The share of imports from Great Britain also declined from 8.1% in 2002 to 3.9% in 2003. However, in the first two months of 2004, imports from the USA were 3.8% of total imports, compared to 2.5% in the same period of 2003. Furthermore, imports from Great Britain increased their share in total imports as well, up to 1.9% in 2004 from 0.7% in the first two months of 2003.

Considering exports by countries of destination, the structure continues to be dominated by exports of aluminum to Switzerland. The share of this export in total Montenegrin exports in 2003 was 57.3%, while it was slightly higher in 2002 (59.3%). In the period January-February 2004, export to Switzerland presented 36.1%, which is much less than in the same period of 2003 when it was 66.8% of total exports. The share of export to Italy rose to 11.3% in 2003 compared to 5.6% in 2002, and in the first two months of 2004, exports to Italy rose significantly, making up 31.8% of total Montenegrin exports, while it was just 6.8% in the same period of 2003. Exports to Bosnia and Herzegovina (BiH) accounted for 9.4% of total exports in 2003, compared to 2.2% in the same period of 2002. In the first two months of 2004, the share of export to BiH in total exports amounted to 3.6%, which represents a 1-percentage-point increase compared to the same period of 2003. In total Montenegrin exports in 2003, the share exported to Greece rose to 3.1% from 0.3% in 2002. Exports to Greece, in the period January-February 2004 represented 1.7% of total exports, compared to 0.9% in the same period of the previous year. In 2003, Cyprus had a significant share of total exports (3.4%), followed by the Virgin Islands (2.5%) and Croatia (1.8%). In the first two months of 2004, these three countries accounted for 0.4% -Cyprus, 2.3% - Virgin Islands and 2.2% - Croatia share of total exports.

8.1.3 "TERMS OF TRADE"

Terms of trade are conventionally defined as a ratio of the price of exports to the price of imports, and it is a measure of the relative profitability of foreign trade. Since *Monstat* does not calculate the full official terms of trade, the ISSP made an estimation of terms of trade as a ratio of the price level of the most important export and the price level of the most important imports in Montenegro. The highest share of imports consistently belongs to oil and oil derivatives[3] (17.9% in 2002 and 10.9% in 2003), while on the exports side, aluminum accounts for the main share of all exports (63.2% in 2002 and 55.9% in 2003). Despite the fact that the ratio of prices of aluminum to prices of oil products does not precisely represent terms of trade, it is a good measure of profitability of Montenegro's foreign trade.

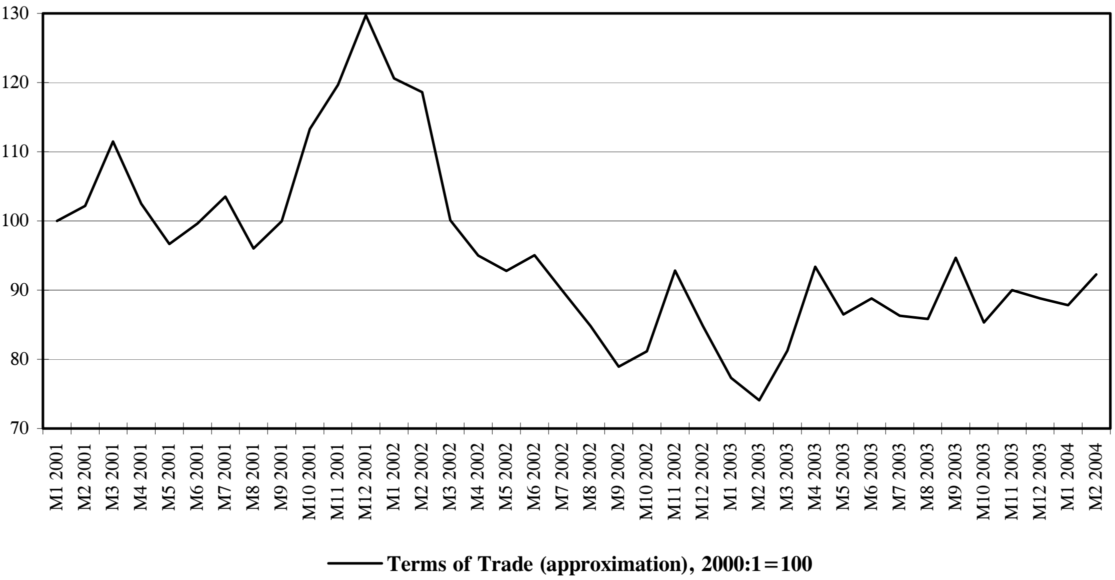
Graph 8.3. Price of crude oil and aluminum



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

Graph 8.3 presents the export prices of aluminum (in USD per ton), as provided by the Aluminum plant Podgorica (KAP), along with world prices of crude oil[4] (USD per barrel), which is listed in the IMF's International Financial Statistics.

Graph 8.4. Terms of Trade in Montenegro (Approximation)



Source: ISSP's calculation based on data from KAP and International Financial Statistics

[3] About 30.5% of oil and oil derivates in 2003 is later re-exported thus being reflected in the prices of exports. This lowers the net contribution of oil imports to actual terms of trade.
[4] The average crude price of SPOT oil.

Graph 8.4 presents an approximation of the Montenegrin terms of trade. The series has been set equal to 100 in 2001. The graph shows that Montenegrin terms of trade have improved in 2001, deteriorated in 2002, recovered somewhat in the first quarter of 2003 and have remained relatively stable since then. Recent months have seen stabilization at a level of about 90 points (compared to 100 in 2000:1).

8.2. BALANCE OF PAYMENTS

8.2.1 Current account

The current account balance consists of the following accounts: balance of goods (export and import of goods), balance of services, balance of income (compensation of employees and investment income) and balance of current transfers.

The current account deficit in Montenegro in 2003 amounted to US$ 114 million (around 8.0% of GDP) and nominally declined by 26.2% compared to 2002. Total revenues were equal to US$ 729.3 million and rose by 11.4% compared to 2002 when these revenues amounted to US$ 654.6 million. Total expenditures of the current account in 2003 amounted to US$ 843.3 million and nominally increased by 4.2% compared to 2002, when they amounted to US$ 809.2 million.

Goods trade

Total trade of goods (imports plus exports) was US$ 1.02 billion in 2003, at nearly the same level as in 2002. Exports decreased by 0.1% compared to the previous year, while imports increased by 1%. Overall, the ratio of exports to imports was 40%, nearly the same as in 2002. This deficit amounted to approximately 27% of GDP in 2003.

Exports and imports increased in 2003 primarily due to the increase of trade with Serbia and Kosovo, particularly in the case of imports. Namely, imports from Serbia in 2003 amounted to US$ 245.7 million and increased by 44.9% compared to 2002, while exports to Serbia and Kosovo amounted to US$ 105.4% million and increased by 9.4%. In addition, one reason for the increase of total imports in 2003 was the import of electricity, which increased by 14.6% compared to 2002.

Balance of services

The surplus on services amounted to US$ 126.6 million (or 8.3 of GDP) and nominally increased by 34.9% compared to 2002. A higher surplus on tourism services was primarily due to the increase of transportation revenues by 31.2% as well as increased revenues from tourism by 31.2%. The only deficit in the category of services was registered in the sector of financial services in 2003, but it did not have a significant impact on the total balance of services.

Income

The net balance of income was in surplus, amounting to 112.8% and nominally increased by 59% in 2003 compared to the previous year. This increase is mostly due to a 122.5% increase of total compensation for Montenegrin workers abroad.

Transfers

In 2003, the current transfer surplus amounted to US$ 55.1 million and decreased by 33% compared to 2002. This decrease of the surplus is primarly due to lower foreign assistance, which decreased by 30.5%, or from US$ 39.8 million in 2002 to US$ 27.7 million in 2003. Foreign assistance in 2003 was around 1.8% of the estimated GDP in 2003.

8.2.2 Capital and financial account

Capital account

Data on capital and financial transactions are, up to now, rather limited due to the ongoing process of the adoption of international standards to properly register these transactions. Consequently, capital account transactions have not been registered in Montenegro at all in 2001, 2002 and 2003.

Financial account

In the financial account of Montenegro, "*foreign direct investments*" still make up the most significant position, amounting to US$ 44.9 million (around 3.2% of GDP) in 2003, which represents a decline of 46.7% compared to 2002. One reason for the decline of foreign direct investments is the fact that the Government of Montenegro did not realize the Privatization Plan for 2003.

"*Other investments"* in 2003 amounted to US$ 41.3 million and they increased by US$ 151.6, mostly due to the increase of foreign loans.

Net portfolio investments were positive in 2003 and amounted to US$1.133 million, while they amounted to US$ 201,000 in 2002.

Additionally, the Central Bank of Montenegro includes in the financial account two items: "*change in net foreign asset of commercial banks"* and "*change in CBM foreign reserve asssets*." The position of "change in net foreign asset of commercial banks" was US$ 39.9 million in 2003, while it was US$ 22.8 million in 2003. The change in CBM foreign reserve assets remained negative (US$ -7.4 million) in 2003 but was smaller than in 2002 (US$- 9.8 million).

Net errors and omissions

The total balances of the current, as well as capital and financial accounts, was US$ 5.8 million in 2003. This represents a vast improvement over the same period last year when this balance amounted to US$ -86.6 million. 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.

Table19: BALANCE OF PAYMENTS IN MONTENEGRO 2001-2003 (in thousands USD)

	2001	2002	2003	Change in 2003 compared to 2002 in %
CURRENT ACCOUNT BALANCE	**-175,016**	**-154,515**	**-114,033**	**-26.2**
Total current account revenues	**565,685**	**654,635**	729,268	11.4
Total current account expenditures	**740,701**	**809,150**	843,301	4.2
GOODS AND SERVICES BALANCE	**-349,900**	**-307,775**	**-285,644**	**-8.4**
GOODS BALANCE	**-436,644**	**-401,590**	**-408,556**	**1.7**
Total export of goods	**210,800**	**305,065**	**304,884**	**-0.1**
Export of goods excl. trade with Serbia and Kosovo and aluminum	46,530	51,075	77,780	52.3
Export of aluminum	141,485	157,641	121,672	-22.8
Export to Serbia and Kosovo	22,785	96,349	105,432	9.4
Total import of goods	**647,444**	**706,655**	**713,440**	**1.0**
Import of goods excl. oil, electricity and trade with Serbia and Kosovo	358,815	390,600	358,097	-8.3
Import of electricity	33,327	46,159	52,920	14.6
Import of oil and oil derivatives	152,757	100,259	55,686	43.5
Import from Serbia and Kosovo	102,545	169,637	245,737	44.9
SERVICES BALANCE	**86,744**	**93,815**	**126,584**	**34.9**
Total revenues from services	**134,549**	**166,392**	217,137	**33.7**
Total expenditures for services	**47,805**	**71,057**	90,551	**32.1**
Total Transportation Revenues	25,422	30,297	39,753	31.2
Transport official data about revenues corrected by 12% (estimate)	23,648	27,501	39,753	22.2
Transport revenues from Serbia	1,774	2,796	33,610	119.7
Total Transportation Expenditures	17,965	20,830	**29,485**	**41.6**
Transport official data about expenditures corrected by 12% (estimate	16,705	16,822	17,154	33.8
Transport expenditures to Serbia	1,260	4,008	3,538	74.0
Balance of transportation services	7,457	9,467	10,061	6.3
Total Revenues from Tourism	94,910	117,474	**154,161**	**31.2**
Revenues from tourists abroad (estimate)	36,345	58,299	69,976	20.0
Revenues from tourists from Serbia	58,565	59,175	84,185	42.3
Total Expenditures to Tourism	4,496	7,573	**11,496**	51.8
Expenditures for tourism abroad	4,346	6,046	9,156	51.4
Expenditures for tourism in Serbia	150	1,527	2,340	53.2
Balance of tourism	90,414	109,901	146,665	29.8
Revenues from Financial Services	3,667	2,540	3,219	26.7
Commission fee	3,622	2,139	**1,770**	-17.3
Commission fee on Serbian import/export (estimate)	450	401	1,449	261.3
Expenditures to financial services	2,858	3,151	**7,623**	**141.9**
Commission fee	2,788	2,661	6,216	133.6
Commission fee on Serbian import/export (estimate)	700	490	1,407	187.1
Balance of financial services	809	-611	-4,404	720.8
Revenues from other Services	10,550	12,061	20,002	65.8
Expenditures for other services	22,486	37,003	41,947	13.4
Balance of other services	-11,936	-24,942	21,945	-12.0
INCOME BALANCE	**41,631**	**70,942**	**112,825**	**59.0**
Income revenues	77,720	95,225	**141,738**	**48.8**
Compensation of employees	36,578	43,820	97,479	122.5
Revenues from Serbia for physical persons	39,702	50,329	43,616	-13.3
Received dividends	152		4	
Interest revenues	1,288	149	639	328.9
Investments abroad		927		
Income Expenditures	36,089	24,283	**28,913**	**19.1**
Compensation of employees	30,043	2,983	3,815	27.9
Expenditures for physical persons in Serbia	103	296	1,210	908.8
Interest expenses	2,048	13,056	13,775	105.5
Paid dividends	3,895	7,948	10,113	27.2
CURRENT TRANFERS BALANCE	**133,253**	**82,318**	**55,114**	**33.0**
Current transfers to Montenegro	142,616	91,973	**65,511**	**-28.8**
Transfers to Montenegro from abroad	10,175	5,189	3,657	-29.5
Foreign assistance	62,262	39,784	27,663	-30.5
Foreign assistance financial and material (NGO, humanitarian	70,179	47,000	34,191	-27.3
Expenditures	9,363	9,655	**10,397**	**7.7**
Transfers from Montenegro abroad	9,363	9,655	10,397	7.7
CAPITAL AND FINANCIAL ACCOUNT BALANCE	**10,658**	**67,933**	**119,852**	**76.4**
CAPITAL ACCOUNT	0	0	0	0
FINANCIAL ACCOUNT	10,658	67,933	119,852	76.4
Direct investment	9,522	84,329	44,913	-46.7
Equity capital	4,218	73,861	44,913	-39.2
Reinvested earnings and undistributed branch profits	5,304	10,468		
Portfolio investment-net	-110	-201	1,133	
Other investments	-5,453	16,424	41,321	151.6
Loans	2,620	23,533	55,768	137
Repaid loans	8,073	7,109	14,447	103.2
Change in Net Foreign Assets	6,600	-22,830	39,480	
Change in CBM for. reserve assets (term deposits of CBM in for. banks)	0	-9,789	-7,405	
BALANCE OF CURRENT ACCOUNT AND CAPITAL AND FINANCIAL ACCOUNT	**-164,358**	**-86,582**	**5,819**	
NET ERRORS AND OMISSIONS	**-164,358**	**-86,582**	**5,819**	

Source: Central Bank of Montenegro. Note: Data for eleven months 2003 are preliminary

9. REGIONAL COMPARISON

- *The real GDP growth rate in South Eastern European countries was positive in 2003.*
- *CPI inflation in 2004 fell on an annual basis compared to the end of 2003 in all SEE countries.*
- *The highest unemployment rates were registered in Bosnia and Herzegovina, Macedonia, Serbia and Montenegro, while Romania and Bulgaria continue to be the countries with the lowest unemployment rates in the region.*

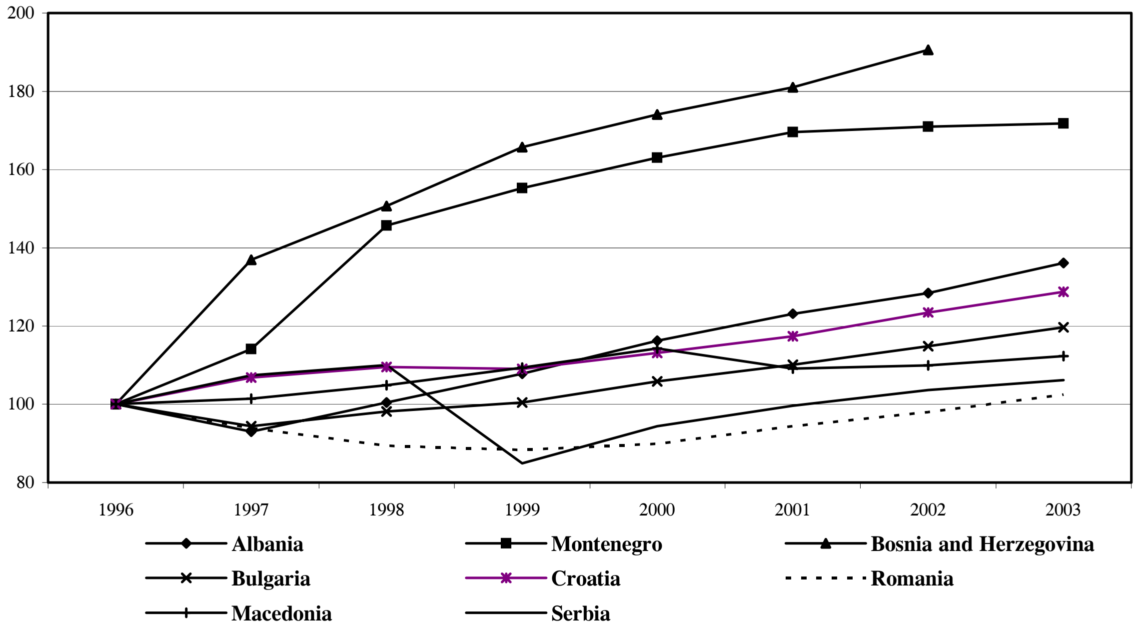
This chapter presents a brief outlook on the most recent macroeconomic developments of South Eastern Europe (SEE).

9.1 MACROECONOMIC INDICATORS

The real GDP growth rate in South Eastern European countries in 2003 was similar as in 2002. Real GDP growth rate in 2003 is estimated at 6% in Albania, 4.5% in Romania, 2.5% in Serbia and 0.5% in Montenegro. Official GDP growth rate in 2003 was 3.5% in Bosnia, 4.3% in Croatia, and 2.2% in Macedonia.

Graph 9.1 presents the cumulative real GDP index for most countries in the region starting in 1996:

Graph 9.1 Real GDP in SEE (1996=100)



Source: IMF, Vienna Institute, central banks web sites and ISSP

After reaching positive growth rates in almost all countries in 2003, industrial output has grown in 2004 as well. The average level of industrial production in the first quarter of 2004 increased in Serbia by 11.9%, while it declined in Montenegro by 1.7% compared to the same period of 2003. Annual growth rates in 2004 were positive in Serbia (17.7% in March), Romania (3.6% in February), Croatia (4.0% in February) and Bulgaria (1.4% in January), while they were negative in Montenegro (-1.1% in March) and Macedonia (-30.3% in February).

CPI inflation in 2004 fell on an annual basis compared to the end of 2003 in all SEE countries. The most pronounced decline took place in Romania (13.1% in March 2004 vs.

15.3 at year-end 2003), followed by Montenegro (5.8% in March 2004 vs. 6.1% at year-end 2003), Serbia (9.3% in February vs. 9.9% year-end 2003) and Croatia (1.4% in March vs. 1.8% at year-end 2003).

One reason for the lower inflation in several SEE countries whose currency is tied to the euro (Montenegro, Bosnia and Herzegovina, and Bulgaria) is the appreciation of the euro, as well as the increased overall macroeconomic stability.

Table 9.1: Macroeconomic indicators of SEE countries

		Albania	Bosnia and Herzegovina/ Republika Srpska	Bulgaria	Croatia	Macedonia	Montenegro	Serbia	Romania
Real annual GDP growth (change in %)	2001.	6.5	4.5	4.0	3.8	-4.5	4.0	5.5	5.0
	2002.	4.7	5.5	4.3	5.2	0.7	0.8	4.0	3.8
	2003,*	6.0	3.5	4.3***	4.3	2.2	0.5	2.5**	4.9***
Annual change of industrial production (in %)	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	-	2.0/-1.6 (Mar)	15.6	4.0	0.5 (Nov) 6.5 (Jan-Nov)	2.4	-3.1	3.2
	2004		-	1.4 (Jan-04)	4.0 (Feb-04); 2.4 (Jan-Feb-04)	-30.3 (Feb-04); -38.0 (Jan-Feb-04)	-1.1 (Mar-04) -1.7 (Jan-Mar 04)	17.7 (Mar-04); 11.9 (Jan-Mar 04)	9.4***(Mar-04)
Annual inflation rate (CPI, in %)	2001	3.5	3.2	4.8	2.6	1.2	24.0	38.7	34.5
	2002	2.1	0.3	3.8	2.3	2.2	9.2	1.8	22.5
	2003.	3.3	0.3	4.7	1.8	1.9 (Nov)	6.1 (Dec)	9.9	15.3
	2004.	-	0.1 (Jan-04)	6.1 (Jan-04)	1.4 (Mar-04))	1.4 (Feb-04)	5.8 (Mar)	9.3 (Feb-04)	13.1 (Mar)
National currency (per €)	Currency name	Lek	Convertible Mark; BAM	Leva	Kuna	Denar	Euro	Dinar	Lei
	2004. (u odnosu na €)	134.43 (Dec-03)	1.956 (May-03)	1.937 (Feb-04)	7.5 (Mar-04)	61.99 (Apr-04)	-	70.3 (Apr-04)	40,054 (Mar-04)
	Annual change in %	2.3	-	-	-0.02	1.3	-	9.9	11.8
Unemployment rate (in %)	2001	15.4	39.9/ 40.2	17.3	22.2	30.5	24.8	27.7	8.8
	2002	15.8	42.7/ 38.2	16.3	22.3	31.9	23.7	31.3	8.4
	2003	16.0	43.1/36.6 (Mar)	13.5	19.1 (Dec)	36.7 (Apr)	21.6 (Dec)	30.2 (Dec)	7.2
	2004	-		13.7 (Mar)	19.2 (Feb-04)	-	22.9 (Mar)	-	7.7 (Feb-04)
Trade balance (as % of GDP)	2001.	-22.6	-59.0	-11.6	-18.9	-15.3	-33,9	-26.1	-13.2
	2002.	-17.5	-59.2	-10.2	-23.5	-8.8	-29,6	-34.8	-8.6
	2003.	-	-55.7	-12.0	-23.9		-19	-32.3**	-8.9
Current account balance (as % of GDP)	2001.	-5.3	-24.3	-6.5	-3.7	-6.9	-17.1	-5.5	-5.9
	2002.	-9.5	-30.9	-4.5	-7.1	-14.2	-14.8	-8.2	-4.5
	2003.	-9.1	-29.6	-7.0	-7.1	-	-8.0	-12.9**	-4.6

Sources:

- *Data for Montenegro are from ISSP database ISSP-a*
- *Data for other countries are from their central banks*
- *Data for Bosnia and Herzegovina in 2003 are from IMF*
- ***www.dfat.gov.au;*
- ****www.insse.ro*

Unemployment rates in SEE countries were almost the same at the beginning of 2004 as at the end of 2003. The highest unemployment rates were registered in Bosnia and Herzegovina, Macedonia, Serbia and Montenegro. Romania (7.7% in Feb) and Bulgaria (13.7% in March) continue to be the countries with the lowest unemployment rates in the region.

In the majority of SEE countries, the current account deficit (as a percent of GDP) was nearly the same in 2003 as in the previous year. However, Bosnia and Herzegovina, Albania, Serbia and Montenegro continue to be the countries with the highest current account deficits, amounting to –29.6%, -9.1%, -12.9% and –8.0% of GDP respectively. On the other hand, Romania and Croatia continue to have the lowest current account deficits in 2003 (-4.6% of GDP and –7.1% of GDP respectively).

PART 2

COMMENT 1

BANK RESEARCH
Ana Bušković, Center for Aplied Research and Analisies

Bank research was conducted in November of 2003. Retrospective of the business environment and analysis of the barriers in the banking sector in Montenegro prompted this research. Commercial banks operate in an environment that is similar to all enterprises in Montenegro. The general movements of the economy have a great impact on their development and position. A team of experts from the Center for Application Analysis and Research (CARA) created a questionnaire consisting of 14 questions designed for all banks in the territory of Montenegro. Eight out of a total of ten commercial banks responded to the questionnaire. Mid- and high-level managers completed the questionnaire[1].

Research on the business environment and business barriers in Montenegro included commercial banks as external factors with the research being oriented towards enterprises and their perspective of banking. This type of research is different than others because it concerns banking and only the problems and barriers associated with banking.

The Central Bank of Montenegro was established more than three years ago. With its establishment came the enabling of monetary independence and the possibility of creating Montenegro's own monetary policy. Since then, many legal and sub legal acts were created with the main goal of strengthening competition in the banking sector and the liberalization of banking.

The main Legal Acts regarding the banking sector in Montenegro are: Law on Central Bank (Official Gazette Republic of Montenegro, No. 52/00 and 47/01), Law on banks (Official Gazette Republic of Montenegro, No. 52/00 and 53/00), Law on Bank Bankruptcy and Liquidation (Official Gazette Republic of Montenegro, No. 47/01), Deposit Protection Law (Official Gazette Republic of Montenegro, No. 40/03), Law of settlement of obligations and claims under foreign debt and frozen foreign exchange savings (Official Gazette Republic of Montenegro, No. 55/03) and Law on reform of Payment System. Thereby, many sub laws were provided, such as: Decision on the Uniform Manner of Calculation and Reporting of Effective Interest Rate on Loans and Deposits, Decision on Credit Unions, and Decision on Micro-Credit Financial Institutions.

EVALUATION OF THE ECONOMY IN MONTENEGRO AND BANKING PERSPECTIVES

The first question included an evaluation of: general perspectives of the economy of Montenegro, actual position of the bank, perspectives of bank, the business environment for the banking sector, and competition in the banking sector. Questions were rated on a scale of, "very bad," " bad," "good," and "very good".

[1] In each bank, each manager completed one questionnaire.

General review of the economy in Montenegro. When asked about a general review of the economy, three-quarters of managers (75%) consider the condition of the economy to be "bad," while 12.5% think it is "very bad". An additional 12.5% of managers consider this situation to be "good".

Perspectives of economy in Montenegro. When asked about the economic perspective of Montenegro, three-quarters of bank managers (75%) see the economy's perspective of Montenegro as "good," while 12.5% see it as "very good". An additional 12.5% view the perspective as "bad".

Actual position of bank. Half of managers (50%) view the actual position of their bank as "good," with an additional 37.5% considering it to be "very good". Just 12.5% of bank managers think that the actual position of their bank is "bad".

Perspective of bank. Three-quarters of bank managers view the perspective of the bank in which they work as "very good," and an additional one-quarter think that it is "good". When discussing expected changes to the current situation, 50% of bank managers expect improvement in the future, while the other half (50%) see their current and future position being similar. None see a future situation that is worse than today.

Business environment for banking. Five of eight managers (62.5%) think that the environment for banking is "bad," while 37.5% think it is "good". None believe the banking environment to be either "very bad" or "very good".

Competition in the banking sector. Five of eight bank managers (62.5%) think that competition is "good," and an additional 25% view competition as "very good". Just 12.5% consider competition to be "bad".

Evaluation indicators are conceived by assigning weight values to each question, with "very bad" having a weight of −2; "bad" −1; "good" 1 and "very good" 2. The indicators, defined in this way, could range from −100 to 100, with the higher indicator representing a better evaluation of the category.

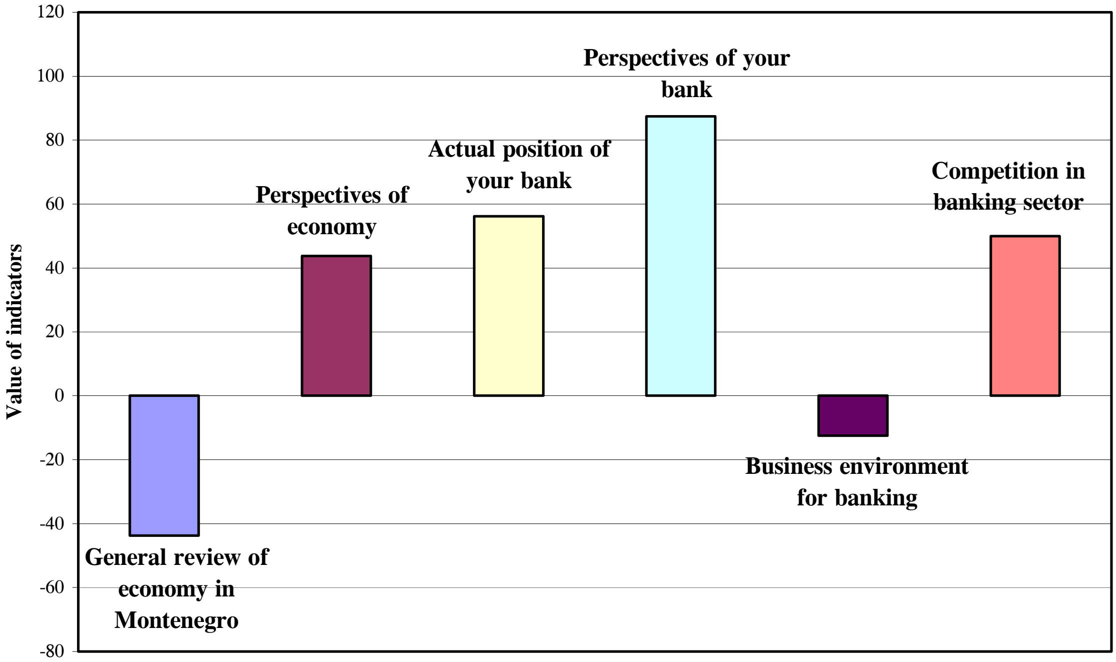
Indicators are shown in the next table.

Table1: Evaluation indicators of benchmarking banks

	Evaluation indicators of mentioned categories
General review of economy in Montenegro	-43.75
Perspectives of economy	43.75
Actual position of your bank	56.25
Perspectives of your bank	87.5
Business environment for banking	-12.5
Competition in banking sector	50

The same indicators are shown on the graph below.

Graph 1: Evaluation indicators of mentioned categories



The general review of the economy in Montenegro received the worst ratings (-43.75), while the most successful evaluation was given to the perspective of banks (indicator 87.5). After the general review of the economy, the business environment for banking received the worst evaluation (indicator –12.5).

EVALUATION OF INFLUENCE CURRENT BANKING REGULATIONS IN AREA OF BANKING

The second question centered on an evaluation of banking regulations in the banking sector in Montenegro. Answer list included the following choices: "very bad," "bad," "good," "very good," and "no influence".

Law on Central Bank. Three-quarters of surveyed managers think that the influence of the Law on Central Bank is "good," while an additional one-quarter think that it is "very good". Managers have the same opinion about the **Law on banks**.

Law on Bank Bankruptcy and Liquidation. Five of eight managers (62.5%) think that this Law is "good," while an additional 25% think that it is "very good". 12.5% of managers said that this law had "no influence". Managers have the same opinion about the **Deposit protection Law.**

Law of settlement of obligations and claims under foreign debt and frozen foreign exchange savings has a “very bad” influence on banks, according to 12.5% of managers. However, nearly two-fifths (37.5%) think this law is “good” and 25% think it is “very good”. 12.5% of managers report that this law has “no influence”.

Law on reform of Payment System has a “bad” influence on banks, according to 25% of managers. However, nearly two-fifths (37.5%) think that it has a “good” or “very good” influence.

Decision on Credit Unions. Decision on Credit Unions has a “good” on 50% of banks, and an additional 37.5% consider its influence to be “very good”. 12.5% of managers report that this law has “no influence”.

Decision on Micro-Credit Financial Institutions. According to 12.5% of bank managers, the Decision on Micro-Credit Financial Institutions has a “bad” influence on banks, while more than five of eight managers (62.5%) think that this decision has a “good” influence on their work. One of four managers (25%) thinks that this decision has “no influence” on the banking sector.

Decision on the Uniform Manner of Calculation and Reporting of Effective Interest Rates on Loans and Deposits has a “good” influence for 75% of banks and a “very good” influence for 25% of them, according to the bank managers surveyed.

Law on Accounting and Audit has a “good” influence on 62.5% of banks, and an additional 37.5% of managers think that this Law has a “very good” influence.

Tax Laws have a “good” influence on banks according to 75% of bank managers surveyed. On the other hand, 12.5% of bank managers report that tax laws have a “bad” influence and an additional 12.5% think that there is “no influence” on banks from tax laws.

Decree on tax release for new employees has a “good” influence for 75% of banks and is considered “very good” for 25%.

Labor Law has a “bad” influence on 25% of banks; “good” for 37.5%, “very good” for 12.5% and “no influence” for 25% of banks.

The collective agreement. One half of the surveyed bankers think that this agreement has a positive influence on banks, while 25% think it has either a “bad” influence or “no influence” at all on banks.

Again, by assigning weights for each of these questions with “no influence” having a weight of 0 (neutral answer), “very bad” –2, “bad” –1, good 1 and “very good” 2, we get evaluation indicators. Indicators are shown in the next table.

Table 2: Evaluation indicators of benchmarking banks

	Evaluation indicators of mentioned categories
Law on Central Bank	62.5
Law on banks	62.5
Law on Bank Bankruptcy and Liquidation	56.25
Deposit protection Law	56.25
Law of settlement of obligations and claims under foreign debt and frozen foreign exchange savings	25
Law on reform of Payment System	43.75
Decision on Credit Unions	62.5
Decision on Micro-Credit Financial Institutions.	25
Decision on the Uniform Manner of Calculation and Reporting of Effective Interest Rate on Loans and Deposits	62.5
Law on Accounting and Audit	68.75
Tax Laws	31.25
Decree on tax release for new employees	62.5
Labor Law	18.75
The collective agreement	12.5

Generally, none of the mentioned regulations have a negative influence on the operation of banks in Montenegro.

The most positive influence on bank operations, according to managers, is the Law on Accounting and Audit (indicator 68.75), while the least influential is the Law of settlement of obligations and claims under foreign debt and frozen foreign exchange savings and Decision on Micro-Credit Financial Institutions (indicators 25).

BANK EVALUATION ABOUT THE MOST IMPORTANT MEASUREMENTS INSTALLED BY CENTRAL BANK, SINCE ITS FOUNDATION

Managers were allowed to choose three measurements from those shown in Table 3 as being the most important. The table shows the percent of surveyed banks that view some measurements of Central Bank as important.

Table 3: The most important Central Bank measurements since its foundation

Central Bank Measurement	Percent[2]
Bank licensing	12.5
Reform on banking system and appliance IAS (International Accounting Standards)	25
Establishing of DEM	12.5
Establishing of Euro	37.5
Law on banks	25
Finishing law regulative	12.5
Payment system transition from ZOP to commercial banks	25
Regular control in bank operating	12.5
Required reserves rate depreciation	25
Law on Accounting and Audit	12.5
Deposit protection Law	12.5
Banking control	12.5
Strengthening of healthy banking system	12.5
Establishing effective interest rate	12.5
Establishing of financial discipline and bank obligations to consider measurements recommended by law	25.0
Law on reform of Payment System	12.5
Law on mortgage	12.5

As shown in the table, the most important measurement of the Central Bank is the establishment of the euro (3 of 8 banks think that this measure is one of the three most important). In second place is the Reform on the banking system and appliance of IAS (International Accounting Standards). Also considered as important measures are the Law on banks, required reserves rate depreciation and the establishment of financial discipline and bank obligations to consider measurements recommended by law.

All of these measurements are evaluated positively, with the exception of the Law on reform of Payment System, which received a negative measure by one bank manager.

EVALUATION INFLUENCE OF DEVELOPING PROCESSES IN MONTENEGRO ON DEVELOPMENT OF THE BANKING SECTOR

When questioned about the influence of developing processes on the banking sector in Montenegro, managers could respond with the following answers: “very bad,” “bad,” “good,” “very good,” and “no influence”.

Establishing the Euro is evaluated as a “very good” developing process among half of the surveyed banks, while an additional 37.5% consider it to be “good”. Just one bank (12.5%) considers the establishment of the Euro to be “bad”.

[2] Percent of total number of surveyed banks. Each manager could provide three answers.

Privatization is a "good" developing process for five of eight banks (62.5%), while 37.5% of bank managers evaluate it as a "very good" measurement.

Harmonization relations with Serbia is considered to be a "bad" developing process among one of four banks (25%), while five of eight (62.5%) think that it is "good" and an additional 12.5% view it as a "very good" process.

Agenda of economic reforms is a "bad" process for 12.5% of managers from the surveyed banks; 62.5% think that it is "good" and 25% of them think it is "very good".

Applying to EU standards is a "good" process in the opinion of one of four surveyed bank managers, and three of four consider it to be a "very good" process.

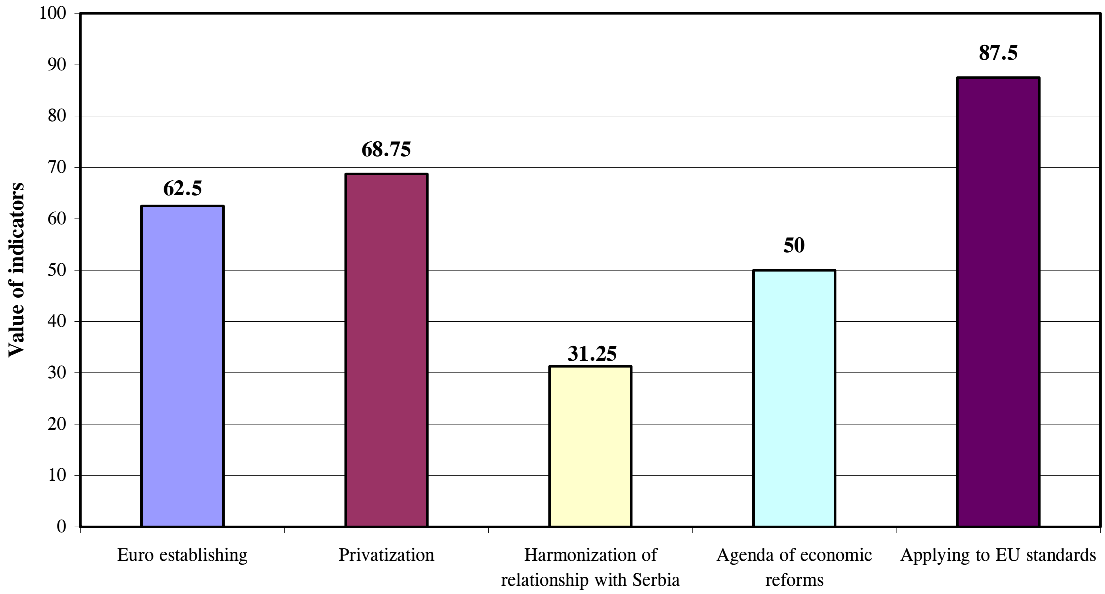
Using the same methodology as in the previous question, evaluating indicators of developing processes were determined.

Table 4: Evaluation indicators of benchmarking banks

	Evaluation indicators of mentioned categories
Establishing of Euro	62.5
Privatization	68.75
Harmonization relations with Serbia	31.25
Agenda of economic reforms	50
Applying to EU standards	87.5

The same indicators are shown on the next graph.

Graph 2: Evaluation indicators of developing processes



As shown in the table and graph 2, the most favorable evaluation was given to the application of EU standards (indicator 87.5), while the lowest evaluation was given to the Harmonization relations with Serbia (indicator 31.25).

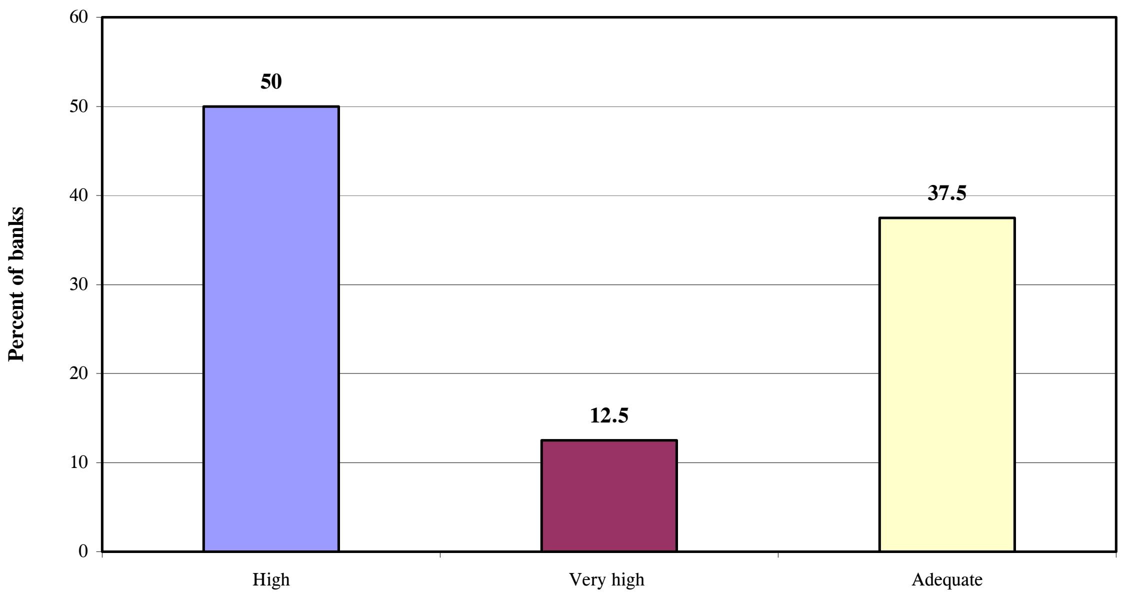
ACCOUNTING AND ANNOUNCING OF EFFECTIVE INTEREST RATES FROM BANKS IN MONTENEGRO

There was a question for bank managers about accounting and announcements of their effective interest rates. Just one bank refused to answer the question, while 87.5% responded and all of them report to account and announce effective interest rates.

EVALUATION OF REQUIRED RESERVES RATE

Bank managers were questioned about the level of required reserves rate. All of the surveyed banks responded to this question using an answer list of: “very low,” “low,” “high,” “very high,” and “conform”. Half of respondents think that the present required reserves rate is “high,” 12.5% (one bank) think it is “very high,” and 37.5% think that it “conforms”.

Graph 3: Banks’ responses about the level of required reserves rate



BANKING SECTOR IN MONTENEGRO DEVELOPMENT BARRIERS

With respect to the developmental barriers to the banking sector, bank managers were asked to rate particular barriers as: “causes serious problems,” “causes problems regularly,” “causes some problems,” “does not cause problems,” and “do not know”.

Legislative regulation as a barrier, according to Montenegrin banks, is valued as follows: for 50% of banks it does not cause problems at all, for 37.5% it causes some problems, and for 12.5%, legislative regulation causes problems regularly.

Frequent changes in administrative and law regulation cause serious problems for 37.5% of surveyed banks, cause problems regularly in 12.5% of banks, cause some problems in 37.5% and do not cause problems in 12.5% (in one bank).

Institutional framework causes serious problems for 25% of surveyed banks, causes some problems for half of the surveyed banks and does not cause problems for 25% of banks.

Strong competition is not a problem for 75% of surveyed banks, while it does cause some problems for 25% of banks.

Unfair competition causes serious problems for 37.5% of banks, causes some problems for 50%, and does not cause problems at all in one bank.

Lack of communication among environment does not cause problems at all for 37.5% of surveyed banks; however, 12.5% of banks report that it causes some problems, 25% say this causes problems regularly, and it is considered a serious problem for doing business in one commercial bank.

Lack of citizens' confidence in the banking sector causes serious problems for doing business among 37.5% of surveyed banks, causes problems regularly for 37.5% of banks, causes some problems for 12.5% of banks, and does not represent a problem at all in one bank (or 12.5%).

The level of economic activity of a country is a serious problem for doing business in 25% of banks, while this causes problems regularly for 62.5% of banks, and causes some problems in 12.5% of banks.

Lack of personnel does not cause problems for 37.5% of banks, while 25% of banks (two banks) report that this causes serious problems, 12.5% report problems regularly, and 25% of banks report that it causes some problems.

Level of employees training skills does not cause problems for 62.5% of banks, while it causes some problems for 25% of banks and causes problems regularly for 12.5% of banks.

Corruption does not cause problems for doing business among half of the surveyed banks, while it causes problems regularly for 12.5% of banks, and causes serious problems for 25% of banks. One bank did not evaluate this barrier.

Political situation does not cause problems for 37.5% of surveyed banks, while it causes problems regularly for 37.5% banks and causes serious problems in doing business for 25% of surveyed banks.

Claims payment problems cause serious consequences on business for 62.5% of surveyed banks, cause problems regularly for 12.5% of banks, and cause some problems for 25% of banks.

Inflation causes serious problems for 25% of surveyed banks, causes problems regularly for 37.5% of banks, causes some problems for 25% of banks, and does not cause problems at all in one of eight surveyed banks.

Lack of business information causes serious problems for doing business in one bank, causes problems regularly in three of eight surveyed banks, causes some problems in two banks and does not cause problems at all in one bank.

By weighting responses ("causes serious problems" -2, "causes problems regularly" -1, "causes some problems" 1, "does not cause problems" 2 and "do not know" 0), indicators are calculated and they show the evaluation of certain development barriers (table 5).

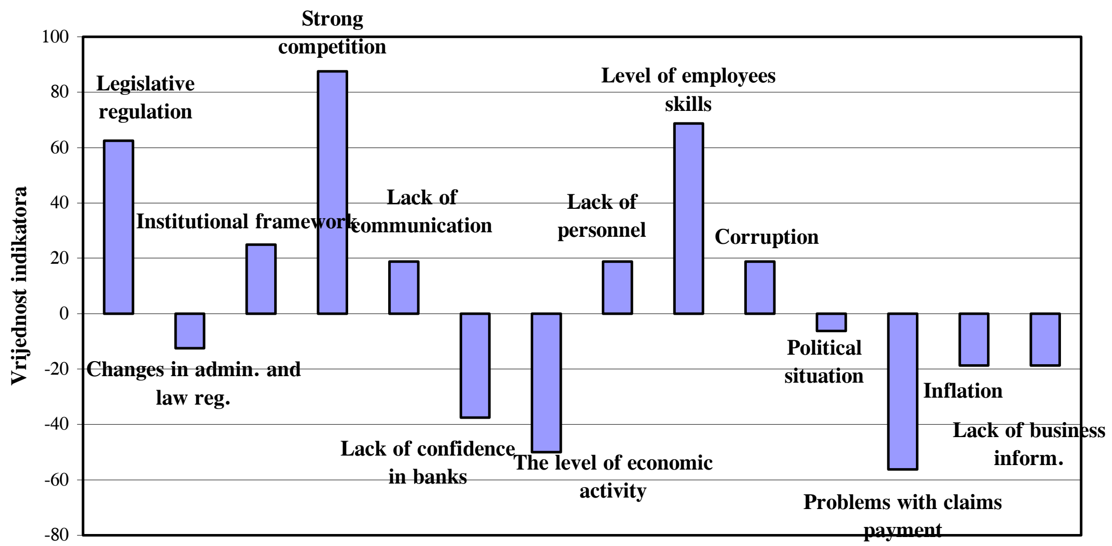
Table 5: Indicators of development barriers influence on doing business in surveyed commercial banks

	Indicators of development barriers influence
Legislative regulation	62.5
Frequent changes in administrative and law regulation	-12.5
Institutional framework	25
Strong competition	87.5
Unfair competition	0
Lack of communication among environment	18.75
Lack of citizens' confidence in banking sector	-37.5
The level of economic activity of a country	-50
Lack of personnel	18.75
Level of employees training skills	68.75
Corruption	18.75
Political situation	-6.25
Problems with claims payment	-56.25
Inflation	-18.75
Lack of business information	-18.75

As shown in the table and the graph below, half of the indicators have a negative value, meaning that, generally, they are perceived to have a bad influence or that they represent barriers for doing business in the banking sector in Montenegro.

The greatest barrier is a problem with claims payment (indicator –56.25), followed by the (low) level of economic activity in a country (indicator -50). The lowest barriers are strong competition (positive indicator 87.5) and the level of employees training skills (indicator 68.75).

Graph 4: Indicators of developmental barriers influence on doing business in surveyed commercial banks



Lack of citizens' confidence in the banking sector is also viewed as a very high barrier to doing business in the banking sector (indicator –37.5).

NUMBER OF CONTROLS THAT CENTRAL BANK HAD DURING 2002 AND 2003 IN COMMERCIAL BANKS

All banks responded to the question about the number of controls done by Central Bank of Montenegro in 2002 and 2003.

In 2002, five of eight banks (62.5%) had one control, 12.5% had two, while 25% banks had three controls from the Central Bank. In 2003, 37.5% of banks had one control, half had two, and 12.5% (or one bank) had four controls.

Summing both years gives 37.5% of surveyed banks having two controls, 25% of banks (or two banks) having three controls, while the remaining three banks had four, five or seven controls respectively.

EVALUATION OF COOPERATION WITH CENTRAL BANK

The question about cooperation between commercial banks and the Central Bank was designed to learn whether banks receive regular and up to date data and reports from the Central Bank.

Among the total number of surveyed banks, 37.5% evaluate cooperation with the Central Bank as "good," while the rest (62.5%) believe that cooperation is "very good". All three banks that had more than three controls in 2002 and 2003 evaluated cooperation as "very good".

REQUESTED CENTRAL BANK FOCUS OF ACTIVITIES IN FUTURE PERIOD

Bank mangers were asked what they felt was needed in the Central Bank's focus of activity; this was asked as an open-end question to gain managers' own recommendations. These suggestions are shown in table 6.

Table 6: Bank managers' opinion about Requested Central Bank focus of activities in future period

Focus of activity	Percent[3]
Further stabilization in the banking sector	12.5
Law regulation, implementation or more efficient regulation of certain areas	37.5
Coordination of activities in order to get more efficient system of claims payment from NBJ (Yugoslav National Bank)	12.5
Monetary policy	12.5
More practical perception of whole economy and more flexible classification of bank loans	12.5
Its own consolidation, informatics connection, improvement of report function (economy trends diagnostic and measurement)	12.5

[3] Every bank gave one suggestion for concrete measures

Evaluation of saving level in the banking sector and measures that would cause its increase (for citizens and enterprises) in banks

Managers in surveyed banks were asked an open-end question about their anticipation of saving levels in banks and the measures that could increase its low level. All surveyed banks consider the saving level in Montenegrin banks as low.

Measurements that were given by bank managers can be divided into two categories: those that are external, beyond their influence and come from the overall business environment in Montenegro and others that can be influenced by commercial banks.

In the first group, the opinion is that an increase of savings in banks will come over time, through the gradual increase of confidence and stability, by way of an increase in total economic output and living standards, with more stabile economic growth, total reform of the payment system, with regulation of old foreign currency savings and the abolishment of tax on citizens' capital revenues.

Measurements that can be influenced by the banks are simulative interest rates, favorable conditions for credits, and complete implementation of the deposit protection law.

EVALUATION OF INTEREST RATE FOR CREDITS IN MONTENEGRO BY COMMERCIAL BANKS

Among all surveyed banks, 37.5% consider the interest rate for credits (active interest rate) in Montenegro to be "high," while the rest (62.5%) think that they are "adequate". No bank considers them to be low.

Managers were asked an open-end question regarding the reasons behind the high interest rates in Montenegro. Table 7 shows managers' responses to this question.

Table 7: What, according to your opinion influences the interest rate level in Montenegro?

	Percent [4]
General instability	37.5
Supply and demand	25.0
Risk	75.5
Inflation	12.5
Lack of capital	12.5
Low level of deposits and loans protection	12.5
Problems in pay ups	37.5
Expensive assets, costs	25.0
Low level of credit portfolio per employee	12.5

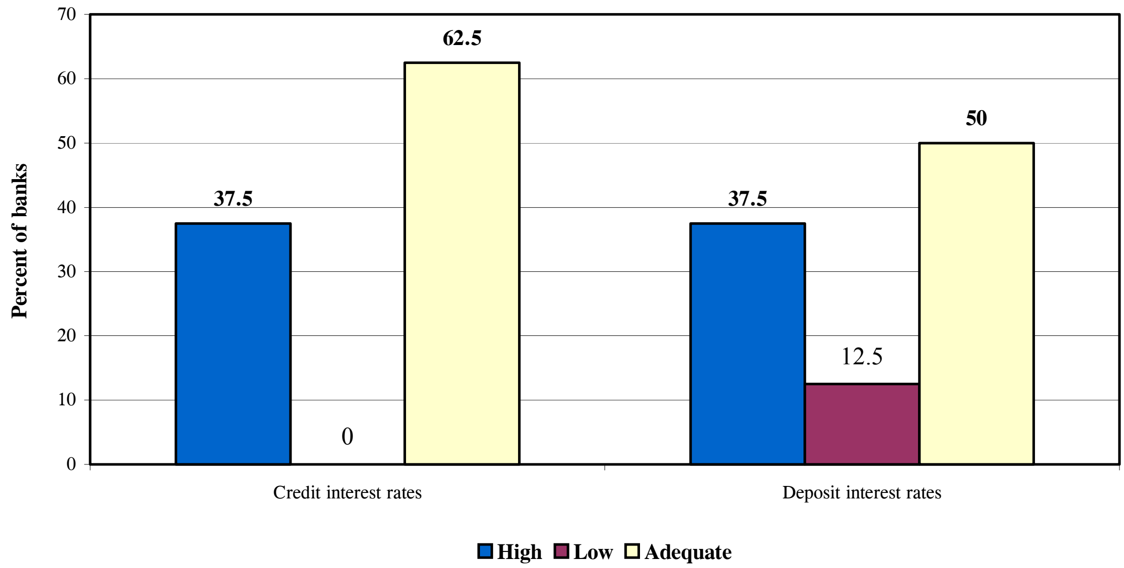
Six of eight surveyed banks (75.5%) consider risk to be the cause of the high interest rate level for credits in Montenegro (different kind of risk: country risk, loans risk).

[4] Percent from the total number of surveyed banks, where every manager could give three answers.

EVALUATION OF INTEREST RATE ON DEPOSITS IN MONTENEGRO BY COMMERCIAL BANKS

Among the total number of surveyed banks, 37.5% consider the interest rate on deposits (passive interest rate) to be “high,” 12.5% consider them to be “low,” while 50% consider them “adequate”.

Graph 5: Managers opinion about the level for credits and deposits



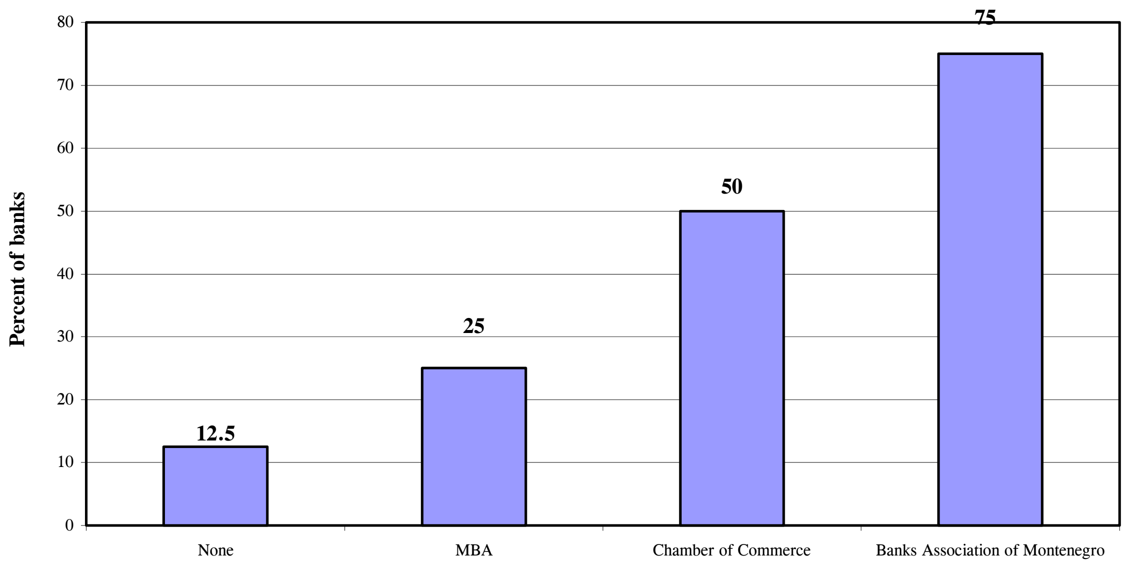
Half of surveyed banks consider the interest rate for credits and for deposits in Montenegro to be at an adequate level, while 37.5% consider them high in both cases.

MEMBERSHIP IN BUSINESS ASSOCIATIONS

Among the total number of surveyed banks, 87.5% are members of at least one business association, while one bank (12.5%) is not a member of any business association.

Among the total number of banks, 75% are members of the Bank Association of Montenegro, 50% are members of the Chamber of Commerce, while 25% are members of Montenegro Business Alliance. One bank can be a member of one or more association.

Graph 6: Membership in business associations



One of eight surveyed banks is a member of all three associations, three banks are members of both the Bank Association of Montenegro and the Chamber of Commerce, two banks are members of only the Bank Association of Montenegro and one bank is a member of only the Montenegro Business Alliance.

CONCLUSION

According to our survey, it can be concluded that a general review of the economy in Montenegro is one of the strongest reasons behind the current condition of the banking sector. This is mentioned by managers regarding possible measures for increasing bank savings.

Problems with claims payment are mentioned a few times, and they represent the highest barrier to doing business; also posing significant barriers are the lack of citizens' confidence in the banking sector and loans protection. Banks, generally, do not consider the level of employees' training skills as a barrier, nor do they view law regulation as a barrier to business development.

All banks view the level of savings in the banking sector as low, while the main measures for its improvement are perceived to be firstly in the environment. Half of surveyed banks consider the interest rate, both, for credits and deposits to be at an adequate level.

Bank managers perceive the most important measure taken by the Central Bank of Montenegro to be the establishment of the euro and the banking system reform. All banks report to have good cooperation with the Central Bank in terms of receiving up to date data and reports distribution

Besides the barriers in this sector, almost all managers perceive a positive perspective of their banks and their further development.

COMMENT 2

THE CHARACTERISTICS OF PRIVATE PENSION INSURANCE

Author: Tijana Stankovic, ISSP

Analyzing the development of the pension system over time, we have concluded that private pension insurance was estalished before state pension insurance. Saving for old age was a part of the occupational plan that companies provided for the loyalty of their workers. The workers found an interest in organized retirement programs, which they would not be able to create on their own. Even if they were to find a way to save for retirement, the transaction costs of contracted saving within the firm were much lower than they would be individually.

Such types of contracted savings exist today and represent a constitutional part of the company employment policy. State pension insurance of individual capitalized accounts or, popularly known as the second pillar, was based on the characteristics of pension occupational schemes. In this case, the initiator and creator of the saving contract is not a company, but the state. In both cases, the owners of saved contributions are the owners of pension resources accumulated on private accounts at the same time. It is the job of investment managers to invest pension resources in such a way as to get the highest investment turnover with the lowest risk.

The second and third pillars are based on the system of private pension insurance. The pension pillar represents an independent source of pension financing, one in which the individual or the state provides to contributors' income when they are not able to earn income from work.

In order to understand private pension insurance, this paper will analyze the components of such systems and explain their basic characteristics.

	Tip	Capitalization	Participation	Management
II pillar	Defined contributions	Fully or partially funded	Mandatory	Private
III pillar	Defined contributions	Fully funded	Voluntary	Private

1. PENSION SYSTEM OF DEFINED CONTRIBUTIONS

The generation solidarity system is based on a system of defined benefits. Contrary to that, the system of defined contributions specifies the contribution rate, not the pension. Defined contributions are amounts, based on the contribution rate, that are applied to a worker's gross wage. The contributions are invested unless he/she reaches the age of retirement. In that case, the worker's pension represents accumulated contributions and investment earnings. The lump sum is either paid out in full or converted to an annual pension.

The linking of contributions and benefits was a deterrent to the avoidance of contributions and an encouragement to formal labor participation. Workers are more willing to work in the formal sector when they know that the contributions they pay are not taxes, but are rather directly linked to their future pensions. The workers that avoid paying contributions by working in the informal sector or retiring earlier receive lower pensions in the system of linked contributions and benefits. If this connection did not exist, the government would transfer costs of the system to others.

The advantages of the defined-contribution system are:
- It is an easy concept for people to understand since it works in the same way as a bank account
- Workers can be assured that there will be money for them when they finally retire
- Pensions are closely linked to contributions
- Workers participate in the accumulation of their retirement account and no longer regard the benefits as a promise from government officials or politicans

The disadvantages of the defined-contribution system are:
- Redistribution of income is not automatic. Those who contribute more during their working periods receive higher pensions
- Workers' final pension depends heavily on the investment returns earned over his/her working period.

Pension systems – whether defined contributions or defined pensions – differ essentially with respect to the subject that bears the (investment) risk. In the system of defined pensions (capitalized or non-capitalized), the program creator is the primary risk bearer, while in the system of defined contributions, individuals are the risk bearers.

2. FUNDED PENSION SYSTEM

A fully capitalized pension system is an alternative to the generation solidarity system. Capitalized pension resources represent the accumulated sum of contributions and investment earnings. The workers, either by mandate or voluntarily, save money, which is then invested in capital markets and returned with earnings. Upon reaching conditions for retirement, they receive this sum as their pension.

The advantages of the funded pension system are:
- The system is actuarilly sound – expected payments from the system equal expected contributions into the system
- It provides better protection to future pensioners – from both demographic and economic shocks as money is set aside for them each year
- It encourages workers to have a stake in capital markets – nationally, regionally and internationally, thereby developing a greater self-interest in the global capital markets and leading them to support the inevitable shift to a shareholder society

A disadvantage of a fully funded system is the possibility that contributions could be invested, but not avaliable at retirement – due to poor investment policy, failure to permit diversification, failure to supervise the financial institutions, failure to properly license funds, etc.

By its nature, a system of individual accounts must be funded in a consistent manner each year. A defined contribution system is usually funded while defined pensions are often unfunded.

Besides having part of the system not funded while part is funded, the main advantages of a partly funded system are: reducing the amount of pension debt that must be financed in transition from PAYGO to funding, providing most of the benefits of a funded system and limiting some of the disadvantages of a system that is not funded, and allowing for risk diversification. However, its unfunded part is exposed to the problems of aging and future financing, which makes the functioning of the whole system more difficult.

Type of capitalization of the pension system is addressed in the form of mediation between the pension system and economic development, the legal framework and economic policy produce the quality of mediation. Since that quality is linked to the GDP level and the actual demographic picture, the traditional difference between a funded and unfunded system is unclear. Furthermore, a funded system of defined contributions that invest pension resources in government securities could just as easily be equal to an unfunded system that borrows pension resources from the government, giving rise to a deficit and explicit public debt. Ideally, the base for pension resource capitalization is private ownership and competition.

3. PARTICIPATION IN THE PENSION SYSTEM

This characteristic is the main difference between the second and third pillars.

The second pillar prescribes mandatory contributions for pension savings. Thus, according to the law, individuals save during their entire working life for the time when they will not be able to work. The main difference between the second and first pillar (generation solidarity system) is: the mandatory saving in the second pillar represents ownership of the individual who pays contributions and receives it later as a pension. The second pillar is mandatory because:

- Market failure is caused by adverse selection: people who prefer high risk pull out those who prefer low risk;
- A mandatory pension system is large and reduces total costs through economies of scale;
- Some people choose not to save during their lifetime and then expect the state social programs to take care of them;
- It acts paternally in helping those who are not capable to plan their own pension;
- It achieves redistribution between different social groups.

However, a mandatory pension system produces more negative consequences on the economy than it does positive because it affects the saving and labor decision of workers. Economists assume that spending and saving decisions are based on lifetime consideration. Workers save for a portion of their working life, and after retirement, they live from their savings and accumulated earnings until they die and bequeath what remains to heirs. The life cycle theory explains variations of income during the lifetime, while consumption is relatively smooth at a stable level.

Initially, when individuals first enter the workforce or are in school, their earnings are relatively low. At this stage, individuals consume at higher levels than their income allows, and thus are dis-savers. They do this by borrowing, or by using another agent's (i.e., their parents) resources. As individuals grow older and earn more income, they will consume less than they earn in order to set aside resources for their retirement. During this stage, individuals are savers. When individuals finally retire, their income drops dramatically, although their consumption remains at its relatively steady level. During retirement, individuals are no longer savers and are spending the resources that they had earlier set aside.

The main ways that a mandatory pension system may influence an individual's and a nation's pension savings are that:

- Workers may view their contributions towards government-provided retirement benefits as part of their own savings, and consequently, tend to save less on their own when the government taxes them for social insurance;
- Contributions represent a type of saving that increases the level of aggregated savings invested in capital.

Public pension programs may affect a country's macro economy by influencing workers' decisions in the labor market, especially those regarding early, partial, or full retirement. The tax treatment of retirement benefits also affects labor supply decisions, as do specific characteristics of the benefit formula and other parameters of the tax code.

Voluntary participation is usually restricted to additional, personal savings. People with disposable income will always find something to do with it, but in developing countries those things are typically related to disposal rather than saving, and hence contrary to government objectives. For example, in many developing countries people with disposable income send their savings abroad because investment opportunities within their own country are perceived to be high risk, to lack diversification as they are tied exclusively to the domestic economy, and to provide insufficient flexibility and liquidity.

A well-structured voluntary savings or pension program, which is designed to meet macroeconomic objectives, will benefit both workers and government by:

- International diversification should alleviate capital flight problems
- Providing incentive for people to save and provide for their own needs
- Providing incentive for savings and reinforcing confidence in the financial sector
- Protecting workers' savings by having clear definitions and regulations on what institutions or savings products can be used and the strength of the companies that provide such services, and by having strong oversight and supervision of the permitted voluntary pension programs.

Introducing such a savings or pension program may be a huge step for a developing country; however it can be done in stages:

- Initially, when there is little or no confidence in financial institutions, it may be better to set simple, easy to reach goals. This would include encouraging people to use the existing banking and capital market systems.
- As a next step, people should be encouraged to become educated about different programs available and to be better equipped to take care of themselves financially.
- Finally, the government could permit international investment (within limits if necessary) and introduce different types of certificates with tax benefits.

By following a step-by-step approach and allowing different products and tax incentives, the population is slowly exposed to tailor-made options designed for different target group needs.

4. MANAGING THE PENSION FUNDS

One of the main decisions in a pension program is pension resources investment. The choice of investment management places public management on one side and private management on the other. Different investment earning rates have been reached through the differing management in other countries (Table 1.)

Public management	Rate of investment earning	Private management	Rate of investment earning
Malaysia	-2.0%	Switzerland	4.0%
Singapore	-5.0%	Netherlands	3.5%
Sri Lanka	-4.0%	Great Britain	8.0%
Kenya	-4.5%	Australia	4.5%
India	-3.0%	Chile	7.0%

The source: IMF and OECD (Statistical data)

Table 1 shows that the rate of investment earning is higher in privately managed pension systems. A higher rate of investment earnings shows itself in higher pensions and efficient investments, which could lead to greater economic growth.

The privately managed pension system is more concentrated on maximizing investment turnover and minimizing risk for shareholders, owners of the pension fund. The publicly managed pension funds, especially in developing countries, are sensitive to political pressures to invest in state companies, which are, in most cases, without prospective or are unable to provide an available source of money for government projects. Secondly, a privately managed pension fund could initiate the development of financial markets through an increased demand for financial products and institutions. Both of these advantages are possible in a state pension fund, but, considering practice, the government has never shown itself as a better investor than the private sector.

Although the private sector in pension programs provides competitive business, public intervention should replace the faults of the market in this field, such as the public's education of the system or the socially inefficient burdens applied by employers.

No future income is free of risk, and this is true for pension resources as well. Pension fund management means managing the risk of investing pension resources. The main difference between public and private pension funds is the type of risk. The public pension fund faces the following risks:

- State as investor, which has not proven itself as a better investor than the private sector;
- Although pension systems are longer term than government mandates, the policy of public pension programs is under great influence of political preferences. This induces us to follow risk.
- Budget expenditures lead to the question: Are pension resources really going to be invested until workers' pensions are due in order to increase their value or will they be used to fill the "holes" in the state budget?

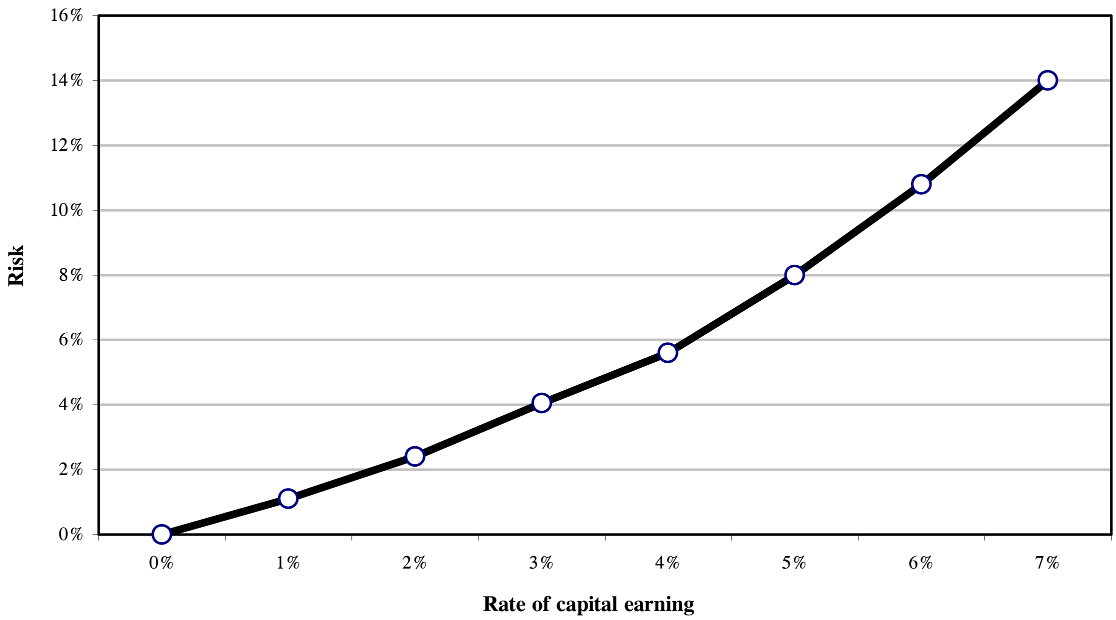
Pensioners represent a significant voting body, so politicians put their interests and income towards improving the economic environment, which should create resources for pensions. Political myopia favors the current generation of pensioners over future generations as younger persons sometimes do not vote. Thus, politicians have a strong motive to create a pension policy that is adequate for current pensioners, omitting the interests of young people. Creating and applying a pension policy with that approach does not provide long term stability of the pension system due to higher contribution rates and other taxes, does not increase the required age minimum for retirement, and does not provide adequate benefits for future generations of pensioners. As result, the current generation of workers receives lower net income and has less money to save. The whole economy suffers a lack of savings, therefore, fewer investments and an increase in the gray economy.

While the philosophies of the public and private sector management may be different, this does not mean that private pension funds invest in no-risk securities. The risks they face depend on: the professionalism and experience of the investment manager to invest pension resources with optimal capital earning, the dynamics of the average capital earning rate in the world and in the domestic market, business cycles, etc.

Whether public or private, the pension system is under constant demographic risk, based on the decreased birth rate and increased life expectancy. The result of such trends is an aging population. In the PAYGO system, an increasing number of pensioners could not be financed by the decreasing number of workers. In the private pension system, a smaller labor force could not produce enough to create an adequate increase in capital.

Some countries legally require that private pension funds reach a regulated capital earning rate every year. If the fund does not succeed, the firm has to pay penalties or transfer additional money to individual pension accounts. The reason for this is to lower the investment risk of pension resources; however, lowering risk goes hand in hand with lowering capital earning (Graph 1).

Graph 1.The capital earning rate as function of investment risk



The guaranteed earning rate could create high administrative provisions that funds have to pay, thus making the earning rate lower; or, in order to avoid risk, private pension funds might invest in a very conservative portfolio, such as investments in state bonds exclusively, thus, bringing a lower earning rate as well.

Securing pension resources should be addressed in the creation of investment rules that provide diversification of the pension fund portfolio and qualitative investing. For instance, let's say that a private pension fund cannot invest more than 5% of pension resources in one company, or a private pension fund cannot buy derivatives unless it appears to be the best solution for fund members.

CONCLUSION

In summary, private pension insurance represents a solution to the crisis that the generation solidarity system is facing, as well as answers the need of individuals to provide income in their old age. The way in which the market answers this need could be observed as the solution to the public pension system crisis. Thus, the government's role is to provide an optimal institutional framework for the functioning of private pension funds. Legislature should secure income from market insecurities but not shackle investments with regulations that could undermine the purpose of the private pension system – invested contributions capitalization.

Usually, individuals are not aware of the amount of resources they pay from their wages into the pension fund. The lack of knowledge is even more extreme in the system of defined benefits where there is no direct connection between contributions paid and pensions received. Private pension insurance provides access and awareness of contributions and investment earnings to individuals - as their ownership. In that system, individuals become more responsible for and interested in the money they save and invest for pension. In the system of generation solidarity, workers equalize contributions with other taxes, for which purpose they are used is not of interest to them. They only begin to think about the amount of pension they will receive when they reach the required age for retirement, and they rely on the government's promise made during their working period. However, there are too many factors that preclude accomplishment of that promise today. Additionally, the usual practice is that contributions current workers pay are twice as much as current pensioners paid when they were employed. In that way, the fair redistribution of resources is undermined as well.

Different from public, in the private system of pension insurance, the individual could be obligated by law to pay contributions, but they are conscious of the fact that saving is their ownership. Or, in the case of voluntary pension savings, individuals are free to choose in which fund and in which way they will save money and receive pensions. The state's responsibility is to create an environment where all participants will find long-term interests, not deterring interests of other social, current or future, groups. Additionally, private pension funds represent important liquid and long term resources, with which "healthy" investment could initiate many developmental processes in the economy.

COMMENT 3

FOREIGN TRADE LAW AND THE FREE TRADE ZONES LAW IN MONTENEGRO

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1. INTRODUCTION

In 2004, two Laws regarding foreign trade were adopted and one of them implemented. These laws are the Foreign Trade Law and the Free Trade Zones Law.

Both laws should provide the appropriate legal framework for further liberalization of the Montenegrin economy as well as improvement of its international competitive position. The aim of the new Foreign Trade Law is to enable free foreign trade while at the same time providing the degree of permitted protection of the interests of the Republic of Montenegro. Considering the Free Trade Zone Law, the main aim is to optimize the use of domestic resources and export-oriented production. This will provide the opportunity for increased employment and economic development, and will also attract foreign investments in Montenegro.

2. FOREIGN TRADE LAW

''Foreign trade” is every kind of trade, economic activity, contract, transaction and other activity that include the transport of goods, other material and nonmaterial things, and ownership rights, as well as services that are made between the territories of the Republic and other states, or territories outside the territory of Montenegro.

One of the aims of the Republic of Montenegro is full membership in the World Trade Organization. One of the fields, which should be fully harmonized with WTO standards, is foreign trade. The new Foreign Trade Law in Montenegro was implemented in the first half of 2004. The basic principles of this Law are made according to economic freedoms and free trade standards. This Law regulates foreign trade of goods and services.

According to the new Foreign Trade Law, foreign trade is free, and it can be limited only under the conditions proposed by this Law. Each legal person can operate within foreign trade according to the legal framework that prescribes these activities.

The articles of this law prescribe rules regarding the flow of goods. It addresses on one hand the open market economy, increasing the liberalization of goods and services turnover and equality of all participants in foreign trade turnover, while on the other hand, domestic production protection with its technical and technological progress is addressed.

The Law consists of five parts:

The first part consists of basic clauses.
The second part contains clauses on import and export of goods and has three chapters:
1. Import and export
2. Quantitative restrictions and licenses
3. Special conditions

The third part contains clauses on foreign trade of services.

The fourth part has clauses about protectionist measures- antidamping, compensatory and other measures.

The fifth part contains clauses for the Law on implementation control.

Despite the fact that the Law provides opportunities for free trade development, some sentences in the Law are formulated in such a way that can endanger basic principles of the Law, and free trade as well. This is concerning because it provides the possibility to introduce restrictions on foreign trade activities; firstly, quantitative restrictions are quotas and quotas are a precondition for state protectionism and market flow deterioration. This is particularly the case with *import quotas*. There are lower risks related to *export quotas* as well as import/export licenses, due to the nature of the problem they are related to.

The Government of Montenegro is the only one who can implement restrictive measures. Restrictive measures are an exception to the general rule of free trade, and if they are introduced, they must fulfill the conditions that are proposed by this law. Duration of these measures is limited by the duration of the circumstances that caused the restrictions to be put in place.

According to this Law, the Government of Montenegro can prescribe import and export licenses and transit licenses based on objective and rational criteria, conditions and proceedings.

The Law defines the necesity for certificates, veterinary, sanitary and phytosanitary conditions, as well as techical conditions.

With respect to services that are provided by foreigners, the principle of the most privileged nation is implemented. This is based on the international agreement that commits the Republic or the Government. The Law also prescribes that foreign persons in the Republic provide services in the same way and under the same conditions that are determined for domestic persons.

The Government can introduce protective measures on import or export of goods according to some articles of this Law and these measures are:
1) Antidamping customs,
2) Compensatory customs, and
3) Measures for protection of excessive imports .

Criteria for implementation of these measures are defined in the Law. The Government decides about the introduction of antidumping measures or the introduction of compensatory customs in the case of existing dumping or subsidies.

The Government can implement measures for protection of excessive imports or protectionism measures, in the case that it finds certain products are being imported in larger quantity as compared to domestic production, thus generating serious losses to domestic producers of the same or similar products. The protection measure is in force until the loss or damage is averted, up to a maximum of four years. However, the question is, what is going to happen if domestic producers are bad and inefficient? Should the Government still protect them in this way or should it provide them with the conditions that would enable them to be more competetive?

3. THE LAW ON FREE TRADE ZONES

Free zones and free storehouses are state territories that have customs exterritoriality. From the viewpoint of a custom regime, such zones are treated like foreign countries for the domestic market, but, in actuality, the territory belongs to the country.

Free trade zones and storehouses are very important for foreign trade and transit. Free trade zones provide the international trade participants with a more flexible, more efficient and more profitable work. Due to this fact, many free trade zones in the world have contributed to the development of industrial production, as well as activities of quasi goods processing.

The new Law on free trade zones was adopted in June of 2004 with the aim to develop the Montenegrin economy by creating favorable conditions to attract foreign investments, technology, knowledge, experience and managerial skills. This will increase the level of employment and the level of international exchange of goods, services, capital and knowledge. All of this is aimed to improve the international competitive position of Montenegro. In addition, the Law is important in overcoming all of the limits given in the current Federal Law on Free trade zones, such as the problem of competence.

Creation of the Law on free trade zones is a positive step. The advantage of this Law is the absence of excessive regulation in the creation of zones, the economic conditions set forth for their establishment, and appropriate deadlines being set for meeting the free trade zone establishment requirement. When it becomes economically or technically feasible, opening free trade zones within the whole territory of Montenegro, not only close to the ports and airports is possible. The Law prescribes the absence of all charges, such as customs and taxes, and this is very stimulating for entrepreneurs. The Law precisely defines relatively low taxes for wage contributions. In addition, there are no restrictions on payments, credit relations, relation between employees and employers, profit disposal, etc.

However, one of the disadvantages of the Law is stated in article 29, which says: “From the total number of employees that work in a company in the free trade zone, a maximum of 10% can be foreign citizens.” This article of the Law is a bit rigid if one of the goals of the Law is to facilitate the transfer of knowledge and technologies from abroad. This can be an obstacle for the companies that employ several people; for example, a company in the free trade zone that employs 6 persons, and one of them is a manager who is a foreign citizen, the percentage of foreign workers in the company is 16%, which is more than is permitted by the Law. The question is, what should be done in such cases? Should the company pay penalties or should it be shut down due to its disregard for the Law?

CONCLUSION

Generally, these two new laws are created in order to provide better conditions for Montenegrin economic development and international trade. They are drafted according to WTO and EU standards, which is a very important precondition in the process of international integration and economic development. However, the question exists, is there the possibility of obstacles in the implementation of these laws. If problems are absent in the implementation, these two laws will be an excellent framework for further economic liberalization, production and export growth, and they will provide overall improvement to the macroeconomic situation in Montenegro.

COMMENT 4

LAW ON INVESTMENT FUNDS
Jelena Musikic, Institute for Strategic Studies and Prognoses

Financial market reform and its development is one of the key elements of the total reform program in Montenegro. Implementation of the privatization process requires restitution and normal performing of a capital market with its full infrastructure. According to that, the general concept of a securities market is based on the dematerialization of securities, transparency and property rights protection.

Transformation and privatization of companies (especially the process of MVP) created a large number of owners. In order to provide ownership consolidation, it is necessary to build and develop adequate institutions and infrastructure of a capital market. A very important step in the process of financial market reform of Montenegro is resolving issues of Investment Funds operating.

PRIVATIZATION INVESTMENT FUNDS (PIF)

The privatization process in Montenegro created Privatization Funds, which became one of the most important participants on the secondary market with shares of privatized companies, and they are also significant owners in those companies. The behavior of the Privatization Funds has a key impact on capital market development after MVP. This is because the PIFs represent the greatest institutional investors on the market and, at the same time, the greatest issuer of shares for small investors. Data that approximately 240,000 citizens of Montenegro invested vouchers in PIFs speaks to the significance of Funds and the extent to which citizens trust Funds (150,000 of Montenegrin citizens invested voucher direct in company). PIF selected approximately 60% of the total number of vouchers.

PIFs in Montenegro, according to regulations, are organized as "closed" funds. The Management Company manages these funds according to a Contract and for its services the Fund pays an adequate ration. PIFs and management companies are regulated by the Decree on Privatization Funds and Specialized Management Companies[5]. They operate as a special form of investment funds named Privatization Investment Funds.

Privatization Funds are temporary institutions created for the support and enforcement of the privatization process. They should be transformed in standard institutions, which operate in developed markets, i.e. into Investment Funds. Additionally, adequate legislature should be coordinated with the operating standards of those institutions.

[5] Official Gazette, no 8/99, 18/00, 49/01 and 1/02

INVESTMENT FUNDS

Investment Funds are organizational forms (shareholder companies) that are established for the public collection of funds and investing collected funds in securities, money deposits and real estate, according to the Law.

When an investor creates his portfolio, it is necessary to diversify risk, and in doing so, decrease the possibility of loss. In other words, it is much better to invest in different types of shares, bonds and other securities rather than to invest in just one group. Also, for an individual investor to purchase securities with limited resources can be very expensive (considering the high broker provisions). While cost is a factor, the greater problem is in making the right decision at the right moment as to which security should be sold and which should be bought. If trying to invest individually, citizens would have many headaches as they attempt to be part of the game on financial markets; however, they could, with good strategy, realize significant gains on their resources.

The significance of Investment Funds lies in the fact that they decrease the risk of investment, because they invest in a great many companies. They also allow for simple turnover because small investors do not need to be registered in order to participate in a public share offer. The individual investor gains all these things from an investment fund. The work of Investment Funds is regulated by the Commission for Securities and experts manage Investment Funds, this fact should be noted.

An Investment Fund with its portfolio management continuously improves the dynamics and depth of trade as well as the efficiency of capital allocation in the economy, which is the basic and most significant mission of the financial market. Investment Funds provide to investors the potential for higher revenues with liquidity -- and this should be enough of a guarantee as to their advantage over banks.

Investments Funds are important because they increase the demand for a minor share in companies and in that way, they increase the price of those shares and they initiate inflow of capital in the country.

LAW ON INVESTMENT FUNDS

In order to complete the legislative framework for a normal functioning securities market, it is necessary to adopt the Law on Investment Funds. According to that, the Ministry of Finance of Montenegro created a working group whose participants were deputies of the Commission for Securities, the Central Bank of Montenegro, and Agency for Restructuring and Foreign Investments; Montenegrin Stock exchanges; Broker Houses, Association of PIFs; Fund for Development, and several experts from USAID/Barents, which provide expert help in document creation. The working group analyzed solutions defined with Directives of European Union about operating in Investment Funds area, regulative rules for most countries in the transition process, as well as conducted a comparative analysis of working efficiency in those Investment Funds. A public discussion was organized and text was proposed that regulates all questions about the operation of Investment Funds. The Government of Montenegro adopted a Law on Investment Funds Amendment, in May 2004. The Law on Investment Funds will become valid when The Parliament of Montenegro adopts it. The Law on Investment Funds includes the present privatization funds, as well as future funds.

The main principles of the suggested legal right solutions are:

Affirmation of the Investment Funds, as specific and sensitive mechanism for collection and concentration of resources is necessary to facilitate global economic and social growth;
Legality providing, which means to respect the rules (law, sub-law and autonomy) relevant for the operation of Investment Funds;
Investor's protection, which include investors who invest in Investment Fund's shares;
Speculative businesses discouragement, which are common in this kind of business.

LAW REGULATION

The Law on Investment Funds includes the establishment and management of organizations for Investment Funds operations. Those organizations are Corporations and Limited Liability Companies. They are established in order to manage the Investment Funds and no other type of activity is permissible for them. The Law on Investment Funds declares that those organizations can supervise one or more Investment Funds. By defining Corporations and Limited Liability Companies as organizations for the supervision of Investment Funds, we have produced legal security, which, until now, has been an unregulated area. Considering the fact that organizations for supervision enforce regulation about the legal position of Company and Company Insolvency Law, they are a base for the implementation of common legal principles, which already exist in Company Law.

Investment Funds in Montenegro are organized, according to the rules, like closed-end funds. Closed-end Funds operate like Corporations that have shares on the market. It results in competitiveness and transparency on the capital market.

The Depositary Bank operates with money transactions of Investment Funds. Particularly, an organization for supervision makes an agreement with a bank that has the permission of the Central Bank of Montenegro. With that contract the bank is responsible for money transactions of the Investment Fund. The Depositary Bank decree is in accordance with practice in EU and neighboring countries (Croatia, Bosnia and Herzegovina, and Macedonia). This solution provides a safety base for the Investment Fund's shareholders.

The regulation defines a minimum of 500,000 euros of equity capital, which provide "liveliness" and an active role for Investment Funds on a capital market. This is very important because Investment Fund activities weren't regulated until now. In this way, Investment Funds will have a significant role in citizen's saving allocation.

Law regulation prohibits one fund from investing in another fund, an organization for supervision, a depositary bank, an authorized broker on the stock exchange who participates and mediates in trade with the Investment fund's portfolio, and in legal entities that possess more than 10% of shares of an organization for supervision. This legal solution avoids the situation in which capital could be in danger if individuals' interaction could damage the interests of other shareholders in the fund.

Privatization Funds and Specialized Management Companies are obligated to coordinate their documents, organization and operations with the clauses of the Law on Investment Funds, until January 2005 when the Decree and regulations based on the Decree would be abolished.

Clauses of the Law allow existing funds with a majority of government capital and other legal entities in the Republic to be transformed into Investment Funds in a five-year period from the day of the law implementation.

We conclude that the solutions offered in the draft version of the Law on Investment Funds would allow:

- Further Capital market development in Montenegro,
- Ownership consolidation in privatized companies,
- Efficient capital allocation,
- Protection of minority shareholders,
- Inflow of capital in the country.

Therefore, quicker adoption and implementation of the Law is a very important precondition for further capital market development in Montenegro and for the total economy.