

## The current economic situation facing Montenegro in the time after the global financial crisis

### General concept

The recession in 2009 interrupted the extremely rapid economic growth of Montenegro which was achieved between 2005 and 2008, when average GDP growth amounted to around 8 %. The crisis and the difficulties have struck all branches of the Montenegrin economy and this has shown that small and highly open economies are very vulnerable.

The main characteristics of 2009 were the following: negative GDP growth rate; budgetary deficit; growth in the illiquidity of the economy alongside a record-breaking inflow of foreign direct investment; and the stabilisation of the banking sector. The positive consequences of the crisis were a decrease in the rate of inflation and in the current account deficit.

Economic policy in 2010 is facing a number of challenges. The prognoses for economic growth for our most significant partners in the EU (0.5 %) and economies in transition (1.8 %) point to extremely low growth which will have a negative impact on Montenegro. Besides this, there are also other risks, the most important of which are as follows:

1. lack of diversity of the Montenegrin economy, a high level of import dependency and a dependency on the metal industry and on tourism
2. low level of competitive ability of domestic producers
3. lack of diversity of exports and its domination by products with only a low processing level
4. decrease in the inflow of foreign direct investment and in export demand
5. high level of credit with late payments and inadequate assets
6. rising illiquidity of the economy and an increase of the number of enterprises with 'blocked' accounts
7. continuing high level of (private and public) expenditure.

Analysing the exchange of goods with foreign countries, the main board of the Chamber of Commerce of Montenegro evaluated that, since 2004, when Montenegro has been leading an independence policy in the area of foreign trade and customs, there has been an increase in the level of the exchange of goods alongside a deterioration in the negative trade balance and a decrease in import coverage by exports. A meeting of the Chamber concluded:

Because of the influence of the global economic financial crisis, the reduced economic activity and the decrease in trade turnover, there was a decrease in the total exchange of goods to an amount of 34.47 % in 2009 compared to last year. Total exports amounted to €287.9 million and was 41.5 % lower, whereas total imports amounted to €1.652.2 million and was 36.27 % lower. The deficit in goods amounted to €1.364.3 million, which represents 70.3 % of the total exchange of goods while the ratio of import coverage by exports was only 17.42 %.

In 2009, Montenegro exported to sixty countries while 89.13 % of exports were focused on ten countries, predominantly Serbia, Greece, Italy and Slovenia. At the same time, imports came from 95 countries, with 84.07 % of total Montenegrin imports being realised from ten countries (chiefly Serbia, Croatia, Bosnia and Herzegovina, Slovenia, Italy and Greece).

The results of the exchange of goods with foreign countries are a warning for Montenegro and they urge a more efficient support for enterprises – i.e. those producers and service providers who have an export orientation, as well as for those who are oriented towards the development of strategic areas: agriculture; tourism; and production based on natural resources.

Nevertheless, the Montenegrin legislation which regulates the volume of trade with foreign countries as well as the implementation of international contracts, SAA, CEF-TA, the free trade agreements with the Russian Federation and with Turkey – all of this makes a favourable framework within which to do business.

### *Foreign direct investment*

The largest capital inflow from abroad to Montenegro has been realised through privatisation investment.

There are three phases of foreign investment inflow in central Europe.

In phase one, investors are mostly interested in the privatisation of state property. The sale of state-owned enterprises provides a stimulus for a wave of greenfield investment which is oriented towards exports and which is specific for phase two of the inflow, and which is based on investors opening a new company or a new factory. This form of foreign direct investment leads to the creation of a large number of jobs and brings new products. Phase three is essential for sustainable economic growth and refers to the re-investment of profits. Central Europe has reached phase three but, in the conditions of the global economic crisis, there is a danger that the countries of central Europe will end up stuck between phases two and three.

Unlike the countries of central Europe, Montenegro (like other countries in the west Balkans) has been stagnating in phase one. Foreign direct investment is oriented towards exports and production is still very rare. Neither Montenegro nor other west Balkan countries think within long-term perspectives and they are not worried that investment through privatisation will not create jobs but rather, after the companies have been sold, there will be a so-called technological surplus of workers who will be given severance payments. However, in Montenegro (like in all other west European countries) the main question refers to how efficient FDI actually is and what is its contribution to the economic development of the country, not least since foreign investors, whose place of origin is often not known, have been eager to profit from the privatisation of former state-owned enterprises. For transition countries, it has been much more important, from a long-term perspective, to attract capital through greenfield investment because that is how the production of new products can be started, the quality of products and services raised and new people employed. That is the way to attract new technology and new brands which will then attract other investors to invest in transition countries.

*(In)Efficiency of FDI in Montenegro*

Foreign direct investment constitutes the placement of private capital abroad as a way of gaining ownership control over foreign enterprises. In other words, they include a long-term relationship between the direct investor and the foreign enterprise as well as a significant level of influence of the direct investor upon the management of the foreign enterprise.

According to the Central Bank of Montenegro, the inflow of direct foreign investment from 2002 until 2008 amounted cumulatively to €3.049.7m. In the structure of the inflow of direct foreign investments in this period, investment in land and property is dominant, while greenfield investments are insufficiently present. The economic branches that have attracted most direct foreign investment are the banking sector, tourism, industry and telecommunications.

However, it has been shown that, in practice, foreign direct investment has neither initiated production nor introduced new, internationally-competitive products. It has not stimulated Montenegrin exports but has mostly been used for personal expenditure. Foreign direct investment has been used for the purchase of attractive locations on the Montenegrin coast and other resources which are not geared directly towards creating GDP or the growth of efficiency of the local economy. One of the key problems of the Montenegrin economy is economic development being based only on foreign direct investment instead of on its own production, its own exports and the competitiveness of its products and services. Foreign direct investment has, without doubt, positive implications for the economy of a country, but it is necessary to look at it through the glass of the secondary and not the primary determinant of economic development.

Such a model of growth has turned out to be bad for Montenegro and, in future, it will be deteriorate further when the inflow of foreign direct investment starts to decrease as a result of the impact of the global economic crisis on the Montenegrin economy. Foreign direct investments are already seriously jeopardised on the world economic market. It is expected that the inflow of foreign direct investment will fall from \$1.7 trillion to below \$1.2 trillion in 2009, alongside a slow rate of recovery in 2010.<sup>1</sup> In the short-term period, with the global recession in 2009 and the slow growth projected for 2010, as well as with the drastic decrease in profits, FDI will most certainly be low.

The inflow of foreign direct investment in south-east Europe and the Commonwealth of Independent States (CIS) reached record high levels in 2008 in spite of the global financial and economic crisis and conflicts within and among countries in certain parts of the region. The growth of foreign direct investment started to slow down, however, in the second half of 2008, with signs of a serious decrease being shown in the first half of 2009. According to estimates, foreign direct investment in central and east Europe will, in 2010, have fallen to the level of 2001 and 2002. It is expected that this region will see a reduction of investment of an amount between 20 % and 80 % in the first quarter and, for south-east Europe, it is expected that there will be a decrease of more than one-fifth of the total amount.

1 *World Investment Report 2009*: p. 17.

Foreign direct investment does, in theory, bring capital, technology, know-how, maintenance and the development of international competitiveness. At this point, foreign direct investment constitutes the largest opportunity of development for Montenegro and the only form of the international movement of capital which can stimulate production, open doors to foreign countries, increase the employment rate and improve living standards.

## Analyses of the situation in the metal and textile industries<sup>2</sup>

### *Production of textile products*

The Montenegrin economy had huge problems with illiquidity even before the financial and economic crisis, which was made worse by stagnation, i.e. the decrease in the credit activities of banks at the end of 2009.

The worsened financial conditions led to an increase in the lack of financial discipline concerning the mutual fulfilment of obligations in the economy and the very significant problem of collecting outstanding bills.

In such conditions of doing business, the situation in the textiles, leather, rubber and chemical industries in Montenegro is extremely difficult. It is the most difficult compared to all other industrial sectors, because these are very intense sectors, highly import and export dependent with surplus employees and with the lowest wages of all industries. Many enterprises have gone under; a small number get by somehow, but with very poor results; and some of them seek privatisation. However, there is no progression at all.

There is almost no production in these sectors because there is no primary textile industry. The existing capacities are far beyond the needs of the Montenegrin market, especially if you bear in mind the uncontrolled import of articles of consumption, of questionable quality but at lower prices compared to those of domestic producers, which makes the sale of domestic products more difficult and which puts domestic producers in a poor position.

**Table 1 – Current production**

Name	Measurement unit	2006	2007	2008
Cotton yarn	T	0	0	0
Wool yarn	T	6	2	0
Raw cotton textile	Thousand m <sup>2</sup>	0	0	0
Wool fabric	Thousand m <sup>2</sup>	60	23	2

We can see that, based on the available information, the production of textile products is insignificant, i.e. almost non-existent.

2 Most of the information here refers to the period since 2006. Montenegro gained independence in this year, so most of the available information refers to this period of time.

**Table 2 – Value of industry**

	2006	2007	2008
Montenegrin imports from EU (kg)	356 502	722 484	1 303 508
Montenegrin imports from EU (€000)	6 325	14 545	25 209
Montenegrin imports from rest of world (kg)	293 969	1 560 856	2 298 935
Montenegrin imports from rest of world* (€000)	9 818	15 299	26 995
Montenegrin exports to EU (kg)	303 859	61 893	47 459
Montenegrin exports to rest of world (€000)	487	392	441
Montenegrin exports to EU (kg)	73 079	48 491	90 572
Montenegrin exports to rest of world** (€000)	280	236	466

\* China, Serbia, Turkey, Italy, Slovenia, Spain, France

\*\* Italy, Spain, Germany, Serbia, BH, Albania

*Production of basic metals*

**Table 3: Efficient and potential production of raw iron and steel (installed capacities and level of capacity use (%))**

	Installed capacity (t/year)	2006	2007	2008
Production of raw iron and steel	363 375	82.8	85.9	99.2

**Table 4 – Quantity and value of trade in raw iron, steel and ferrous alloys with EU and rest of the world**

	2006	2007	2008
Montenegrin imports from EU(kg)	13 527 582	13 178 872	16 983 864
Montenegrin imports from EU (€000)	9 015	9 013	9 013
Montenegrin imports from rest of world* (kg)	99 887 348	185 209 304	231 915 192
Montenegrin exports to EU (kg)	9 706 520	1 841 914	1 022 719
Montenegrin exports to EU (€000)	2 443	1 628	971
Montenegrin exports to rest of world (kg)	107 826 650	95 095 714	101 206 632
Montenegrin exports to rest of world** (€000)	44 250	40 026	52 951

\* Bosnia and Herzegovina, Serbia, Switzerland

\*\* Bosnia and Herzegovina, Serbia, Albania

The largest of the three enterprises in this area is *Željezara Nikšić*, which employs 1 600 workers. In the last three years (2006, 2007 and 2008), *Željezara Nikšić* (which is in private ownership) has produced 536 934 tonnes of raw iron. The company is the only producer of iron and steel (small quantities of special steel are, however, produced by the *Black Metallurgy Institute*) and in that it has a monopoly of production.

An investment programme is being realised during which the company's existing sixty-tonne electric furnace will be modernised, a dust extraction system installed (smoke treatment facility), current machines for continuous castings revitalised and a water treatment facility (WTP) built. The total resources envisaged for this investment amount to 30 359 000 of which 7 380 000 has already been spent. The investor is the Dutch company MNSS BV, which is the majority shareholder.

A restructuring plan is also being worked on which foresees a 20 % reduction in the number of *Željezara Nikšić* employees, which will reduce price and increase productivity. The realisation of planned investment in production equipment will improve quality and enable the presence of a larger proportion of special quality steels in the production structure.

The only company involved in aluminium production is the *Aluminium Factory Podgorica* (KAP), which thus holds a monopoly. It employs 2 100 workers. KAP, which has been privately-owned since December 2005, has produced 325 706 tonnes of cast aluminium in the last three years (2006, 2007 and 2008).

There are no large enterprises involved with the production of metal construction and metal products, although the number of companies is on the increase, standing at 138 in 2008 from 112 in 2006. Most of these are micro and small enterprises, although there are nine medium-sized ones. The growth area is metal construction, which has doubled its tonnage between 2006 and 2008 to 1 685 tonnes, to a value of €1 825 000 from €1 326 000. The total production of the industry stands now at 2 755 tonnes, with a value of €3 160 000.

Micro and small enterprises also dominate the production of machines and equipment, which has a value of €3 268 000, a small reduction on the 2006 value. Production has dropped, however, by just over 10 %.

Montenegro has no developed car industry. There is only one enterprise which deals with the production of car products, i.e. parts and components, and which employs 119 workers. This company is owned by a foreign owner, Daido Metal Japan Ltd, which has 98.85 % of the shares with the rest being owned by domestic shareholders.

The only enterprise engaged in shipbuilding and ship repair is Adriatic Shipyard Bijela (*Jadransko brodogradiliste a.d. Bijela*), a large enterprise with an expanding turnover of €25 511 000 in 2008, up from €17 503 000 in 2006.

A joint enterprise for yacht overhaul is envisaged for the oldest part of the shipyard by the owner of the marina in Tivat, the company *Porto Montenegro* and *Adriatic Shipyard a.d. Bijela*. *Porto Montenegro* would invest approximately €4m while *Adriatic Shipyard a.d. Bijela* would invest certain facilities and installations while also making a non-financial investment (via the renting of the whole space). The joint enterprise would rent that space at a market price for yacht and mega-yacht overhaul. An interested French company is planning to make an additional investment of €3m. The mentioned investments refer to the cultivation of the ground, the building of necessary

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objects and the purchase of the modern yacht overhaul equipment. *Adriatic Shipyard a.d. Bijela* is planning to use the proceeds to invest in the restructuring of the capacities of its main activity, i.e. ship overhaul.

### Current economic situation

Montenegro achieved a significant increase in GDP from 2000 until 2005, thanks to the dedicated political support of the government for the overall economic reforms, the presence of a favourable tax policy compared to other countries, a constant increase in foreign direct investment and free capital flow. The period from 2006 until 2008 also brought high rates of economic growth with per capita GDP reaching a level of €3 443 in 2008.

In spite of the continuing growth during the last couple of years, GDP per capita is still below the EU average, with rates similar to the minimum rates recorded in Bulgaria and Romania. In the area of real GDP growth, the 2006-2008 period saw very high rates compared to EU member and candidate countries, with GDP growth similar to those of Slovakia. This was the result of the constant increase in demand for foreign direct investment in tourism, building and the banking sector. Gross capital was even increased from 25 % in 2006 to 40 % in 2008. The significant dependency on imports and exports, as well as the exchange of services, saw Montenegro having to deal with the symptoms of the financial crisis at the end of 2008, when it saw a 4 % drop in real GDP during 2009, near the average for the EU-27.

The Montenegrin economy has a low level of diversification and still depends too much on aluminium and steel, on the domination of raw products in the export, as well as on construction and tourism.

**Table 5 – Macroeconomic indicators**

	2006	2007	2008	2009	I-III 2010	I-XII 2010
GDP market price (€m)	2 148.9	2 680.5	3 085.6	3 083.0*		3 201.0
Real GDP growth (%)	8.6	10.7	6.9	-5.3		0.5
GDP per capita (€)	3 443	4 282	4 908			
Population (000)	624.2	626.2	628.8			
Inflation	2.0	7.7	6.9	1.5	0.2	
Growth in industry production (%)	1.0	0.1	-2.0	-32.2	-14.5	
Unemployment rate (%)	14.6	11.9	10.7	11.4	12.5	
Foreign debt (€m)	504	462.1	481.7	699.9	727.6	
Foreign debt as % of GDP	23.4	17.2	15.6	22.7	23.3	
Current account balance (€m)	-531.2	-1 007.6	-975.7	-896.3	-241.9	

Budget surplus/ deficit (€m)	71.5	176.1	15.1	-69.1		
As % of GDP	3.7	6.3	1.3	2.2		
Exports (€m)	627.5	487.1	433.2	277.0	55.7	
Imports (€m)	1 482.7	2 072.5	2 527.2	1 654.0	310.3	
Goods deficit (€m)	-855.2	1 585.4	-2 094.0	-1 377.0	-254.6	
Services balance (€m)	197.1	440.1	399.4	384.5	-17.0	
Inflow of FDI in (€m)	644.3	1 007.7	832.1	1 068.4	148.8	

Inflation, measured according to the consumer prices index, amounted to 1.4 % in September 2009 compared to December of 2008. Sectors that saw the highest increases were from hotels and restaurants (15.9 %), transportation (10.9 %), alcoholic beverages and tobacco (7.6 %) and communications (5.2 %), whereas a decrease was recorded in household products and equipment (6.0 %), clothing and footwear (0.8 %) and culture and recreation (0.4 %). At the annual level, consumer prices were 1.7 % higher, while the average rate for the period between January and September 2009 amounted to 3.9 % compared to the same period one year before.

**Table 6 – Movement in the consumer prices index**

	Structure %	Sept. 2009 Dec. 2008	Sept. 2009 Sept. 2008	I-IX 2009 I-IX 2008
Consumer prices index	100.0	101.4	101.7	103.9
Food and non-alcohol beverage	42.5	100.1	101.6	104.2
Alcohol beverage and tobacco	4.8	107.6	107.8	107.1
Clothing and footwear	8.2	99.2	99.7	101.0
Residence	12.8	100.0	107.8	117.5
H/hold products and equipment	5.4	94.0	94.1	98.5
Health care	2.3	100.9	102.2	103.3
Transportation	10.0	110.9	96.0	92.8
Communication	6.6	105.2	105.1	103.2
Culture and recreation	2.9	99.6	99.1	100.9
Education	0.2	100.0	100.0	100.0
Restaurants and hotels	0.1	115.9	115.9	106.8
Other goods and services	4.3	101.1	101.2	101.3

Source: Monstat

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**Table 7 – GDP of the whole economy (€m)**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Agriculture, hunting, forestry, fishing	120.3	140.0	148.6	150.3	154.7	159.0	178.2	194.1	230.5
Ore mining and quarrying for stone	27.9	24.7	29.9	28.6	25.9	26.0	28.6	31.7	37.4
Processing industry	98.9	149.7	141.5	132.3	145.8	148.7	164.7	144.9	166.5
Electricity production	58.3	69.1	72.9	87.6	95.4	85.8	88.5	113.1	129.1
Construction indus.	41.4	45.5	49.5	43.5	49.8	52.2	76.0	155.1	190.7
W/sale and retail trade	136.1	146.8	160.1	165.2	170.2	190.1	237.9	357.2	382.4
Hotels and restaurants	26.6	28.6	31.9	35.4	49.4	53.8	64.1	117.6	132.7
Traffic	100.7	156.4	145.9	146.7	163.0	171.3	208.3	238.5	288.9
Financial operations	34.0	29.8	32.5	34.4	39.0	43.8	65.0	103.0	119.6
Real estate business, rent.	123.9	153.4	162.9	183.9	207.8	211.0	245.2	255.6	251.4
State admin, obligatory social insurance	86.7	91.3	102.8	116.7	130.9	166.4	174.3	195.3	269.1
Education	46.7	51.2	56.0	61.6	71.6	76.9	87.5	92.0	116.4
Health care and social issues	40.2	50.2	50.8	62.9	70.7	82.2	84.6	88.9	109.7
Other parts of society and other services	26.7	36.9	36.4	43.8	48.7	52.6	54.2	44.2	52.1
Services of financial mediation indirectly measured	-1.6	-1.9	-2.7	-2.1	-1.3	-1.8	-4.1	-	-
Total								2 131.3	2 476.6
Tax on production minus subsidies	98.7	123.3	141.5	220.0	248.3	295.0	396.2	549.2	609.0
GDP (current prices)	1 062.7	1 295.1	1 360.4	1 510.1	1 669.8	1 815.0	2 148.9	2 680.5	3 085.6

Source: Monstat, final data

### *Impact of transitional reforms*

The movement of Montenegro through the transition process has been distinctive. This distinctiveness was visible in an improved starting position of the market institutions compared to the average values for other observed groups of countries as well as by the inevitable stagnation in the years since 1998. The reasons for this lag refer to the conditions of a unique state with Serbia, which is the only one among Balkan and other economies in transition from the region which have registered a similar development. In the same period of time, countries in the region have achieved a level of development of the system and institutions of the market economy by a figure approximately three times higher, which is to their absolute advantage.

It has been obvious since 1999 that Montenegro is stronger and more determined to carry out market reforms. The comparison with other similar countries in the region points to a somewhat slower growth of reforms during the first years of the new beginning of the transition. However, if we bear in mind that Montenegro started on its transition path in 1998 almost from the very beginning, then the result of the achieved level of reforms can, in principle, be evaluated as successful. That evaluation is based on Montenegro surpassing in nine years the level of reforms which was, on average, achieved by all other transition countries observed together during a period of this same length and which had started out on a similar level of institutional establishment as did Montenegro at the end of the nineties.

However, we must not neglect that, for instance, countries in the region have achieved that level of reform in only three years on average (1990-1993). Also, the current level of the sum of EBRD evaluations (25 points) shows that Montenegro has, so far, achieved a progress of 16 points and that it is necessary to achieve another 14 in order to attain the system of a developed market economy, i.e. that it is a little over half way down the road in front of it.

### *Impact of the financial crisis*

The negative impact of the global financial and economic crisis on the Montenegrin economy from the end of last year continued in 2010 and is visible in the slowing down of all economic activities in the economic sector; a decrease in the liquidity of enterprises and banks; the high level of mutual debts and claims; the limited credit support for business; the slower recovery of debts and in the payment of own obligations; more difficult sales of finished products; etc.

A decrease in production has been registered in industrial production, in forestry and in construction and in a reduced amount of services in the areas of traffic and tourism. Nevertheless, the total economic growth of Montenegro in the period to come will depend on the impact of the global developments and measures taken in order to support entrepreneurship, new investment and development plans and projects in certain sectors.

The consequences of the global financial and economic crisis, which were felt in Montenegro in the last quarter of 2008 and which continued during 2009, have significantly worsened the public finances. It has also led to significant fall in the level of economic activity and imports, which have had a negative influence on the movement

of public income. In spite of the reduction of public expenditure, Montenegro has once again entered a budgetary deficit.

During 2009, the government decided to support a restrictive fiscal policy through the reduction of expenditures and implementing savings measures in the current budget. The government has also continued with tax reform through the reduction of income tax rates and contribution rates for obligatory social insurance, and has introduced subsidies for electric power bills for impoverished categories of the population as well as for small and medium enterprises.

In the second half of the year, after the further fall in original income was determined (above all in VAT and customs duties) compared to the plan, a budget rebalancing and additional savings measures were adopted. Capital expenditure was reduced only on items which would not significantly influence future economic growth. The growth problems in the economy demanded an increase in social protection transfers, above all in expenditure on severance payments for technologically surplus workers in privatised enterprises or in enterprises which are currently in the process of being privatised.

On the revenue side, excise dues for mineral fuels were raised, which was intended to contribute to the increase in budget income without over-burdening the living standards of the population. After the rebalancing, and in order to rationalise budget expenditures further, some additional saving measures have been introduced which refer to current expenditure: reduction in the wages and other incomes fund, through the rationalisation of public administration or the reduction of gross income in the public sector and the reduction of other expenditures on materials and services.

According to the IMF, the main risk lies in a high structural fiscal deficit, of 6 % of GDP in 2009. This is the result of a too-high growth in public expenditure and the reduction of taxation during the expansion. However, the Ministry of Finance considers this deficit to be significantly lower.

The total running public income in 2009, according to the Ministry of Finance, amounted to €1 366.5m, i.e. 45.5 % of estimated GDP for 2009. Compared to 2008, public income was 12 % lower and, compared to the plan after the rebalancing, it was 7.3 % lower. The reduction of running income is the result of the evident reduction in tax incomes which are participating in public income of 58.2 %.

Consolidated public expenditure in 2009 amounted to €1 472.9m, i.e. 49 % of estimated GDP. Compared to the previous year, public expenditure was realised at a level lower by 5.4 % while, compared to the plan after the rebalancing, it was 7.2 % lower. The reduction of expenditure on the previous year was influenced by reduced running and capital expenses, transfers to institutions, individuals, the non-governmental and public sector, reserves and approved loans and credits while, at the same time, transfers to social protection were increased.

Running public expenditure amounted to €1 200.1m, or 40.6 % of GDP, and this is 7 % lower compared to the planned one, i.e. 2 % lower compared to 2008.

In the structure of public expenditure, the highest participation is realised by transfers – 42 %; then running expenditures – 38.2 %; and capital expenditures – 17.2 %. All other expenditure has a participation of 2.8 %.

A lower level of public income than the realised consolidated public expenditure was realised in 2009, so that the public sector deficit amounted to €106.4m, or 3.5 % of estimated GDP.

The fiscal risks for the realisation of a stable financing of budgetary expenditure in 2010 are as follows:

- exposure to external shocks. Montenegro – a small, highly open economy whose official currency is the Euro – is highly subject to transferring shocks. A new negative external shock would slow down economic growth and thus jeopardise the realisation of planned public income
- tourist activity (seasonal character and external dependency). Processes in tourist activity are especially significant for the development of the Montenegrin economy. This risk is increased by visa liberalisation in the countries of the region, while tourist activity is mostly dependent on the economic situation in those countries from which most tourists are coming
- growth in the deficit and in external debt. The budgetary deficit is a consequence of the crisis and is leading to a growth of public debt and, in the current circumstances, the costs of financing are rising
- reduction in public expenditure. This will influence aggregate demand which can cause a slowdown in economic growth
- guarantees and the other implicit obligations of the state. The issued credit guarantees of the state for the economic (and banking) sector could be activated in the coming year under the influence of the further deterioration in the business activities of enterprises. This would raise the costs of paying off debt and reduce the already limited available resources for budgetary expenditure
- an increase in the unemployment rate and the reduction of wages. The increase in the unemployment rate and the reduction of wages (in the public sector and, probably, also in most of the others) can influence not only the raising of transfer expenditure but also have an additional negative influence on tax income
- the uncertainty of the timely realisation of envisaged privatisations. The suspension of the realisation of the planned privatisation of state-owned property in some companies would lead to a slowing down of the dynamics of planned inflows to the budget and would also slow down economic recovery
- high obligatory and non-obligatory transfers. High and growing transfers have a negative influence on the fiscal position of the country. Apart from that, the suspension of the reform of the retirement system has an additional negative influence on the financial position of the budget in the long-run
- the renewal of the heavy industry sector. The lack, or postponement, of the restructuring of companies in heavy industry and the lack of agreements with strategic partners when it comes to the development of these companies would reduce the growth potential of the Montenegrin economy, as well as tax incomes to the budget
- the economy and the population are over-indebted. The economy and population have too many debts, which narrows the possibility to use new sources of credit for development projects in order to stimulate growth, and it also has a negative influence on aggregate demand as its main stimulus

- the banking sector in consolidation. Trust in the banking system has been restored, but certain problems with delayed credit, with high credit risks and the insufficient capitalisation of the banks are still present. This makes more difficult the renewal of the economy and, indirectly, its fiscal position.

### The metal industry in Montenegro

After more than twenty years of transition, the economic situation in Montenegro is particularly alarming. The real growth of the Montenegrin economy amounted to -4 % in 2009. The drop in industrial production is being continued, while imports have also significantly dropped (a decline of 40 % in trade exchange with foreign countries is a major indicator of the fall in economic activity). The processing industry has already experienced a significant drop. There is no renewal of the economy expected in 2010 because there is no economic basis for a swift, sustainable growth of the economy and of budgetary income.

The illiquidity in the Montenegrin economy is growing every month so that, at the end of April 2010, 12 995 enterprises had blocked accounts. The total debts of those enterprises amounted to as much as €204.5m.<sup>3</sup> Industrial production is among the Montenegrin sectors which have been hit the hardest by the crisis so far, with a fall in activities amounting to 30 %.

### Sector structure

In 2000, industrial production contributed 19.1 % of GDP and, during the years to come, that participation was reduced, to 12 % in 2007. This fall was caused by significantly lower growth rates of industrial production than the growth rate in GDP, which were higher during the previous years.

**Table 8 – Participation of industrial production in GDP**

Year	2000	2001	2002	2003	2004	2005	2006	2007
Industrial production (€m)	204	244	245	248	269	260	282	284
Industrial production (% of GDP)	19.1	18.9	18.0	16.4	16.1	14.3	13.1	12.0
Index of industrial production	100	99	100	102	116	114	101	101

If we take 2000 as the base, we can conclude that industrial production varied throughout subsequent years. Industrial production in 2001 was 1 % lower than in 2000, whereas in 2002 and in 2003 there was an insignificant rise with industrial production being approximately at the same level. During 2004, industrial production rose significantly (16 %) primarily because of the increase of energy production which amounted

3 Central Bank of Montenegro, 2010.

to 26 % at this time. A similar trend took place in the three-year period from 2006 until 2008.

The structure of the sector in the total industry in 2008 was as contained in Table 9:

**Table 9 – Industrial production in 2008**

	2007 share (%)	Dec. 2008 Dec. 2007	I-XII 2008 I-XII 2007
Industry – total	100.0	79.7	98.0
Ore mining and quarrying for stone	6.3	85.3	117.7
Processing industry	76.4	69.4	88.7
Energy, gas, water production	17.3	106.8	131.9

In the processing industry – which provides, by the way, 76.4 % of total industrial production – there was a fall of 11.3 % compared to the same period one year before. Only three sub-sectors showed a growth in production (food; beverages and tobacco; and the production of leather and leather items) while ten saw a drop. It is most concerning that there was an 11.3 % fall of production in the production of base metals because of its share of total industrial production (45.7 %). The fall in this area is connected with the insufficient and unprofitable production of the aluminium factory throughout the year for several reasons (the drop of aluminium prices on the world market, the too-high price of electricity, surplus employees, strikes).

#### *Employment structure*

36 690 persons worked in the industrial production sector in 2001 and, during 2002 and 2003, that number was reduced. In 2004, there was an increase almost back to the 2000 level before a series largely of falls over the next few years.

**Table 10 – Employees in the processing industry**

	2001	2002	2003	2004	2005	2006	2007	2008
Ore mining and stone quarrying	4 132	4 346	4 278	4 579	4 079	4 159	3 753	3 721
Processing industry	26 786	25 645	24 241	26 277	25 971	26 065	25 697	24 335
Energy, gas, water prod. and supply	5 772	5 838	5 535	5 492	5 496	5 627	5 594	6 042
Industry – total	36 690	35 829	34 054	36 348	35 546	35 851	35 044	34 098
As % of total employment	26.00	25.45	23.86	25.33	24.62	23.77	22.40	20.51

Industrial production employees make up over 20 % of the total number of registered employees in Montenegro. If we look at employment in the sectors of industrial production, the highest number of employees can be found in the processing industry which employs more than 70 % of the total number of employees in industrial production.

### *Processing industry*

Production in the processing industry in the period from January to September 2009 was 30.9 % lower than in the same period of 2008. In this period, production was greater in three areas constituting 6.0 % of total industrial production (8.7 % of processing industry), while it was lower in thirteen areas making up 63.1 % of total industrial production (91.2 % of the processing industry).

Owing to the poor structure of the industry, in which the production of base metals (such as KAP and the ironworks) is dominant, production in the processing industry fell heavily under the influence of the global and economic crisis. The production of basic metals, which made up 41.3 % of total industrial production and 59.7 % of the processing industry in 2008, was 50 % lower in the observed period because of the difficulties in business activities caused by the reduction of demand and a fall in the sale prices of aluminium and steel below the level of production costs. Had the production of base metals been at the level of production in the comparative period, total industrial production would be 10 % lower in the observed period while production in the processing industry would be 6.5 % lower.

It is obvious that KAP, as the largest industrial producer, is significantly influencing and, most often, totally directing the character of the index of realised production. The structure of both total industrial production and of the processing industry was significantly less favourable in the period January to September 2009 compared to 2008. In order to create the conditions for short-term stability and long-term sustainability of the aluminium factory and ironworks, the government decided to undertake a number of activities. For KAP, a programme of consolidation measures was created which led to a so-called Settlement Contract being adopted on 19 October 2009 by the government. Under this, the government agreed to the obligation to issue a guarantee for the debt of KAP to an amount of €135m: €25m of that will be used for the social programme; €22m will be used as working capital; €3m will be used to pay back debt to Montenegrin banks; €63m will be used for obligations towards the banking consortium; and €21m for CKB. The contract foresees that the government should become the owner of 50 % of the shares held by CEAC in KAP, and that it should provide an energy subsidy in terms of the difference between the price on the market and the price determined by the energy regulatory agency which is now, at an annual level, an amount of around €15m. With the signing of this contract, the privatisation contract from 2005 will cease to be valid. If the credit for which the government has issued a guarantee is not paid back in time, it is foreseen that the state will take over the rest of the shares in KAP.

One of the key measures is also the optimisation of the number of employees (i.e. the reduction) through a social programme for voluntary redundancy under certain

conditions, with severance payments and the possibility of taking favourable self-employment credits.

A similar programme should also be realised in the *Željezari Nikšić* ironworks. Based on a Refinancing Protocol, signed by the majority owner MNSS BV and the government, the ironworks is obliged to create a restructuring programme under which the government would issue a credit guarantee which will facilitate the company's restructuring in accordance with the Law on state help and support.

In other companies in this sector, production is also very low and it is not expected that they will be able to realise their annual business plans. Daido Metal Kotor, the producer of bearings for the car industry, has reduced production for a few months already in 2009 and, in this period, production was 11 % lower. The complete production run is used for the car industry, which is facing many negative consequences of the economic crisis, so the registered drop is not too large. The electrodes factory Piva has also realised a level of production which was around 50 % lower compared to the previous period. The main reason was reduced sales as well as surplus stock.

### *Current situation*

The metal industry in Montenegro has been having problems with its business activities over a long period of time. The problems inherited from the past have not been appropriately and completely solved by privatisation. A large number of employees, obsolete technology, large debts and insufficient investment maintenance have significantly burdened the price and the quality of these products, while competition in this sector has made progress and conquered the market. Alongside these current problems, the global economic crisis has made the situation worse by lowering price and demand, thus questioning the very existence of the metal industry of Montenegro.

### *Main risks*

- a fall in the prices of the products of the metal industry
- a rise in energy prices
- surplus working power
- insufficiently expert management
- unsatisfied, demotivated and unproductive workers in this branch of the industry
- the level of expertise of those who are staying, as well as their motivation
- the increased credit risk in the banking sector – the lack of possibilities to pay back current obligations and debts at the level of the enterprise and at the level of employees
- risks in the fiscal sphere: the decrease of employment in this area leads to a significant reduction of finances for the retirement fund, via smaller contributions, which indirectly causes an increase in budgetary expenditure
- the worsening of the fiscal position also because of an increase in the costs of the government when solving the problems of the metal industry sector (subsidies, social programmes, bank guarantees, etc.)
- a lack of respect for environmental standards for doing business
- a worsening in the balance of payments, i.e. a significant reduction in the amount of exports of the main product within the export structure.

*Strategic directions for development*

- modernisation of the metal industry so as to respect all high environmental standards, adjusted to the needs of domestic demand and exports and with the use of energy efficient forms of production
- solving the present illiquidity and lack of cash assets in the long-run in order to secure the continuity of production
- solving the problems facing employees in this branch, both in terms of the technological surplus and the motivation and productivity of current workers.

*Operative measures*

Modernising production equipment and technology should be a priority in order to be able to establish an efficient product which satisfies standards and which would have a competitive price on the international market. Next to the acquisition of new equipment, current machinery needs to be overhauled in order also to satisfy safety standards for work within such plants but also environmental standards.

It is necessary to solve the problems facing employees in this industry in order to reduce conflict and increase the motivation and work productivity. Due contributions and taxes must be paid on behalf of employees, the technological surplus must be resolved and a social dialogue established in order to set down adequate solutions and to satisfy the priority interests of all three sides in the negotiations – employees; employers; and the government.

It is also necessary to put in place expert management which would efficiently resolve the problems of management and which would restructure enterprises on the foundations of good practice and the experience of successful, privatised enterprises in this sector with a positive development vision.

In all metal industry plants, stabilisers must be built as regards the energy supply as a way of cutting costs, while the level of competency of other factories in the region must be increased in order to have a competitive offer on the market when it comes to price and the level of achieved standards.

**Policy responses**

*Infrastructure*

Like in many similar countries in the region, the traffic sector is faced with significant difficulties which limit accessibility and mobility at the national level and towards neighbouring countries. Montenegro has, in addition, topographic limitations which have a direct influence on the growth in the costs of investment and maintenance in the railway and road traffic sectors. An under-developed network of roads and highways; problems within the railway infrastructure and vehicles; the insufficiently organised air traffic; the lack of experienced and highly qualified staff; and necessary improvements in the area of security and service quality – all of these are a part of the identified problems within this sector.

During the past years, efforts have been directed towards the improvement of the legal framework and the commencement of structural reforms in order to separate in-

infrastructure from the operative segment next to the solution of the most urgent problems (mostly road and, recently, railway infrastructure). Nevertheless, the needs are enormous and the financial resources necessary to resolve all the problems and overcome all the infrastructural difficulties are much larger than Montenegro's own, limited means. In that sense, Montenegro has already started promoting public-private partnerships, concession agreements, bank financing and contributions of international donors in order to be able to satisfy all investment needs.

In spite of it being neglected, since none of the defined corridors passes through its territory, Montenegro has the possibility to promote the Bar-Belgrade connection as a combined sea-railroad traffic corridor in order to open up access towards the back of the Balkans and south-east Europe and in order to gain comparative advantage in relation to the already-established alternative corridors through Croatia (Corridor Vb), Bosnia (Corridor Vc) or Albania (Corridor VIII).

#### *Investment promotion: subsidies, tax relief, public investment*

##### Investment

The main avenues of encouragement are also the competitive advantages of Montenegro, such as: political and microeconomic stability; an efficient and transparent tax system; a good legal basis for foreign investors; a liberalised foreign-trade system; an educated and skilled workforce; attractive space and a preserved environment; and a large number of projects which have been prepared for realisation. In the previous period, the foundations of the market economy have been successfully put in place and democratic institutions have been strengthened with the step-by-step development of capacities in public administration which are continuously dealing with the political and economic transformation. The government of Montenegro has the goal to keep working intensively on the reform of the legislation which is affecting the attractiveness of the investment environment.

One of the most significant stimulations for investment is a favourable tax system. The Montenegrin legislation envisages a system of tax reliefs both for corporate tax and income tax payers. The Law on corporate income tax foresees the possibility of using several tax reliefs (for conducting business in a municipality which is insufficiently developed economically; for the employment of new workers; for the programme activities of non-government organisations; for investments in continuing basic resources (which are being used for the production of energy from renewable sources, energy efficiency); etc).

Customs reliefs are defined in the Customs law.<sup>4</sup> Article 119 enables the use of procedures in the processing trade in order to work on goods within the customs area in one or more processes of final finishing: for foreign goods imported as raw goods, no customs dues are paid and there are also no other trade measures if it is intended to be exported again as a final product (delay system); and, for foreign goods which are being put into free trade after custom dues have been paid, it is possible to have a refund or to have the custom dues written off completely if the goods are exported as final products from the customs area (refund system).

4 *Official Gazette* of RCG, 07/2002.

Articles 184 and 188 of the Customs law are defined in the regulation on the procedure for the liberation of customs payments.<sup>5</sup> The customs exemption for goods which are being imported as the collateral of the foreign investor is defined in Article 43 of this regulation. The Law on customs dues (Article 1) prescribes that payment of customs dues is obligatory, but only when goods are being imported to the customs area of Montenegro, while export customs dues are not foreseen.

### *Exports*

In 2005, the government of Montenegro adopted its *Strategy for the stimulation of exports*. The Ministry of the Economy is responsible for co-ordinating the realisation of measures for the stimulation of exports, while the Directorate for the Development of Small- and Medium-Sized Enterprises is the main carrier for the implementation of the measures defined in the Strategy. Other relevant ministries in the government of Montenegro, as well as economic associations, are actively involved in the implementation of the export stimulation measures.

### *Miscellaneous*

The investment activity of the Development Fund started in 1995 and is aimed at two directions:

1. investment in small- and medium-sized enterprises – operational since 1996, when the first credit for the realisation of investment projects was approved, and since 2002 when the activity was directed exclusively towards small- and medium-sized enterprises, which are being stimulated through and with the guarantees of commercial banks. The primary goal of these activities is the securing of favourable financial means for the realisation of investment projects in small- and medium-sized enterprises under better conditions than could be found on the market. The goal is accelerated development, balanced regional development and the creation of new jobs. Credit support has been directed to enterprises in the following areas: tourism; food production; production activities; education; service activities; health care; information technologies; and energy. Projects of small- and medium-sized enterprises have priority if they have an innovative idea, a large number of newly-employed persons, better business indicators, a large level of product finalisation, significant use of domestic resources and a better project evaluation
2. investment activity which has the goal of resolving infrastructural and environmental projects of local governments and public and private enterprises; since 2006, it has proven to be a good and efficient instrument for solving the strategically important infrastructural and environmental projects of local administrations. Credits are used only through and with the guarantees of commercial banks.

With the goal of creating a more favourable business environment for the development of small- and medium-sized enterprises, and therefore to accelerate economic development, new employment and better living standards, the programme of the Directorate for the Development of Small- and Medium-Sized Enterprises entitled *State*

5 *Official Gazette* of RCG, 22/02.

*support and help for small and medium enterprises in 2009* has been adopted. According to the Report on the realisation of this programme, a credit line has been opened – *Encouragement of entrepreneurship* – as well as a programme called *Grant schemes for the refund of costs*, which provide financial support for small- and medium-sized enterprises when they are at fairs, improving information systems, creating promotional material and carrying out market research.

Within the programme, seventy projects with a value of €6.7m have been approved up to 25 February 2009. 21 of these are projects for the stimulation of business start-up projects, 39 are projects for the stimulation of entrepreneurship, 10 are for energy efficiency and renewable energy and there are also 37 projects for cost refunds in export marketing. There are also certain encouragements possible for investors within particular types of activities which are being determined by local self-governments.

The characteristics are the limited participation of foreign investors, especially when it comes to financial participation; and rules on tax reliefs on profit repatriation. Foreign investors have otherwise the same treatment as domestic investors – so-called ‘national treatment’. According to the Law on foreign investment,<sup>6</sup> there is no discrimination between foreign and domestic investors, with the sole exception of the weapons and military equipment industry, defined in Article 7 of the Law on foreign investment. According to that Article, foreign investors can invest in a domestic enterprise, which means that they can, together with a domestic legal entity or natural person, found an enterprise in Montenegro for the production and sale of weapons and military equipment. According to Paragraph 1 of this Article, however, the foreign investor cannot have more than 49 % of the share capital or ownership rights, i.e. of the voting rights, of such a company.

The Law on corporate income tax<sup>7</sup> sets down no prescribed limitations for foreign investment and no tax reliefs when it comes to the repatriation of the profit of legal entities. Profits that resident taxpayers achieve abroad, i.e. outside of Montenegro, have the same tax treatment as profits which resident taxpayers achieve in Montenegro. The profits of resident taxpayers earned both inside and outside Montenegro is subject to taxation in accordance with the regulations of the Law on the corporate income tax of legal entities, except where international, bilateral and multilateral contracts determine otherwise.

In order to avoid double taxation when it comes to profits achieved abroad, a method of tax credit is applied. A resident taxpayer earning profits outside Montenegro and who is paying corporate income tax in another country receives a tax credit to the amount of the tax paid in that country. The tax credit cannot be larger than the amount which would be calculated if the tax rate from the Law would be applied to the profit earned in another state.<sup>8</sup>

6 *Official Gazette* of RCG, 52/00 and 36/07.

7 *Official Gazette* of RCG, 65/01 and 80/04; and *Official Gazette* of RCG 40/08.

8 Article 33 of the Law.

### *Small and medium enterprises – reliefs*

Electricity prices have been reduced for small- and medium-sized enterprises. The government of Montenegro made a decision in December 2008 to reduce the price by 10 %, costing around €8m per year.

Special tax procedures are also foreseen for small entrepreneurs, agricultural workers, travel agencies and mediators in the sale of used products, art products, collections and antiques.

Small entrepreneurs whose taxed turnover in the last twelve months was lower than €18 000 are, according to the VAT Law, not obliged to register for the payment of VAT. Agricultural workers (who are not VAT payers) have the right to a lump sum settlement in the amount of 5 % of the sale price of their products (the taxpayer who has purchased agricultural products can have a tax credit approved for this amount).

Additionally, in the first three years following the commencement of business activity, a newly-founded legal entity or business unit is free from the obligation to pay corporate income tax in insufficiently developed municipalities if it is engaged in production.

### *Reliefs based on the employment of new workers*

The taxpayer who employs new workers for an indefinite period of time, as well as for a period of at least two years, can have his tax base in one business year reduced to an amount of the gross salary of those workers plus the employer's obligatory social insurance contributions. This relief is applied in the first year of the employment of the new worker.

There are also tax reliefs based on the employment of certain categories of people, such as: those with disabilities; people at least fifty years of age; people who have been unemployed for longer than five years; those engaged in public works; people in privatised companies who are technologically or economically surplus; and unemployed people engaged on seasonal jobs.

### *Cluster policies*

There is no strategic document in Montenegro which deals with industrial policies or competency policies.

In the national programme for the integration of Montenegro in the EU from 2008-2012, a *Development strategy for Montenegro* is planned within the country's medium-term priorities. This determines the basic elements and the long-term development orientation of Montenegro in the area of overall economic policy, as well as outlining a competency policy with a definition of the goals, directions, development dynamics and measures necessary for its realisation.

There is currently in Montenegro no form of cluster association. Consequently, the experiences of other countries in the region are particularly valuable in order to identify the best model of clustering. Connection and co-operation with similar clusters from the region is also very significant in order to be able to follow trends, be better represented on foreign markets, use the experiences of others, etc.

In certain economic sectors (such as the wood industry, the meat industry and the dairy and wine industry), there is great potential in terms of outlets joining together in clusters. The *Strategy for the Development of Small and Medium Enterprises from 2007-2010* foresees the foundation of clusters as an instrument of support for small- and medium-sized enterprises in the areas of dairy production and the meat industry, as well as in their connection with tourism. The Directorate for the Development of Small- and Medium-Sized Enterprises has, together with the support of GTY, initiated activities to form clusters in the sector of meat processing. Within the realisation of projects of support for the Association of Producers of Njegus Specialities, which was conducted by the Directorate for the Development of Small- and Medium-Sized Enterprises in co-operation with GTZ through the credit line *Competency Encouragement*, eight producers of this product have been supported. The enterprise holding the presidency of this cluster is DOO *Niksentrade Cavor* from Kotor.

The *Strategy for the Development of Tourism in Montenegro up to 2020* foresees the creation of tourism clusters which would be divided as follows: three on the coast-line; three in the continental part of Montenegro; and two connecting the coast with the mountains via Nikšić and Podgorica. The borders of the clusters are open to neighbours in order to create better opportunities for networking and co-operation which will enrich the offer, create a better price for the destination and improve the relationship between costs and benefits.

A large number of workshops and seminars have been organised in the last couple of years on the topic of clusters to explain the notion to enterprises as well as the advantages and benefits of joining one.

### Innovation policies

When it comes to research policies, the government of Montenegro adopted in 2008 its *Strategy for scientific and research activity from 2008-2016* which was processed by the Ministry of Education and Science and proposed by the Council for Scientific and Research Activities. The Strategy includes an overall plan for achieving its priorities. Supervision over the implementation of the Strategy is being carried out by the Council for Scientific and Research Activities, which is reporting to the Government on the results achieved annually. The development of the Strategy consisted of the expert work of the members of a nine-strong Commission, all professors at the University of Montenegro. The process of creation included numerous consultations with employees of the relevant Ministry, the use of data from the Ministry and from Monstat, and current national, regional and international studies, analyses and development documents. In the final phase of development, an online public discussion and two public sessions, at the University of Montenegro and at the Montenegrin Academy of Sciences and Arts, were held with comments included in the final version of the proposal. The activities foreseen in the Strategy are part of the jurisdiction of several ministries, national agencies and institutions.

The priority goals are the following:

- reform of the institutional framework for dealing with scientific and research activities
- encouragement of innovation and technological development in which the Ministry of the Economy and the Directorate for the Development of Small- and Medium-Sized Enterprises have a role through the introduction of measures encouraging investment in research and innovations in the economy and for the financing of scientific and research activity. An additional role is envisaged for the Ministry of Education and Science in providing marketing support and a consulting service for all factors in the area of innovation
- encouragement of international co-operation, in which the Directorate for the Development of Small- and Medium-Sized Enterprises has a role via involvement in the EUREKA programme
- realisation of the functional priorities of scientific and research activity, in which the Ministry of the Economy has a role in the introduction of financial instruments and regulations for the co-financing of projects for technological development
- increase of investment in scientific and research activities.

Within the area of policies on innovation, the University of Montenegro is currently working on several documents concerning strategic planning in research and innovation, technology transfer and the establishment of a centre for the support of technology transfer and research innovation. These initiatives are being carried out through a number of projects financed by the EC under programmes FP7 and TEMPUS.

### Innovation and support for small- and medium-sized enterprises

There are a couple of programmes in Montenegro which have the goal of promoting the spread of technology in small- and medium-sized enterprises. Through a 2009 programme for state support and help for small- and medium-sized enterprises and, within it, through the credit line of the Directorate for the Development of Small- and Medium-Sized Enterprises on *Entrepreneurship Encouragement*, support for the application of production technologies is foreseen. This has the goal of strengthening the capacities for innovation among small- and medium-sized enterprises as well as their contribution to the development of products based on technological progress.

The newly-formed *European Centre for Information and Innovation Montenegro* is a full member of the network for the support of entrepreneurship and innovation and offers a set of services for the development of small- and medium-sized enterprises, among which there are also services which refer to the transfer of innovation, technologies and know-how. The EIICM informs Montenegrin small- and medium-sized enterprises of the framework programmes of the EU for research and technological development, and research results which refer to innovation, while it also offers mediation services in the transfer of technology and know-how and encourages small- and medium-sized enterprises to engage in innovation. In addition, within the seventh framework programme for research and technological development, FP7, it is foreseen to strengthen the capacities of small- and medium-sized enterprises by creating new values which are based on market research and the transfer of developed technologies,

as well as to improve co-operation between universities and small- and medium-sized enterprises.

These are programmes which have only just started to be active, so we cannot yet speak of their results. Enterprises have been informed through newsletters, as have the media, and workshops have been organised on the promotion of the development of technological capacities, as well as of the possibilities of inclusion in the projects, but thus far there is only a low level of interest among enterprises for inclusion in the projects.

The participation of Montenegro in international research projects is not satisfactory. It is necessary to continue with intensive activities in the distribution of information on international research programmes and on the possibilities which these (in the technical sense) offer to participating companies.

### Influence of international support

#### *IPA (instrument for pre-accession assistance) and the European Bank for Reconstruction and Development*

Up to the end of 2007, Montenegro received help from the European Union through the CARDS programme, after which time Montenegro has been using the new Instrument for Pre-accession Assistance (IPA). The main IPA goal for Montenegro is to help the country confront the challenges of European integration, to conduct the reforms which are necessary in order to fulfil the requirements of the EU and to make progress in the process of stabilisation and association. Besides that, IPA is expected to offer support in the building of institutional capacities and to prepare these for the management of future structural funds after membership of the EU.

It is a potential candidate country, so Montenegro has access to the first two IPA components – IPA-I: support for the transition and strengthening of institutions; and IPA-II: border crossing co-operation. Achievement of candidate status and DIS accreditation will open the possibility to use two new components – IPA-III: regional development; and IPA-IV: development of human resources. Not only do these components include the main sectors like traffic, environment, employment and education, but they also prepare Montenegro for EU support within the cohesion policy and, in particular, for the European regional development fund (ERDF), for component III; and the European social fund (ESF), for component IV. The strategic framework of adjustment (SCF) is the reference document referring to EU financial support on the way to accession during the programme period of 2001-2013.

The results of the project for IPA 2010 are the following:

1. action plan for the adaptation of Eurocodes
2. action plan for the implementation of Eurocodes
3. preparation of national annexes for Eurocode 8 part 1.

There are currently activities in progress seeking to create a business incubator in Berane (northern Montenegro) in co-operation with the municipality of Berane, the organisation Caritas-Luxemburg and the Directorate for Small and Medium Enterprises. A business plan has been made and an outline of the construction works for the new facility where the incubator would be placed has been drawn up. This project initially

had the support of IPA 2008 – Improving the Business Environment for Small and Rural Enterprises.

The Ministry for Spatial Arrangement and Environmental Protection has, through the construction sector, applied for IPA 2010 funds for its project *Achieving the highest security and technical quality of Montenegrin building*. This project includes the creation of a programme for adopting Eurocodes and, as a pilot-project, Eurocode 8 – the creation of a national annex.

The reasons for accepting and adopting Eurocodes in Montenegro are political, economic and technical. They are political because this is one of the conditions for EU membership and will create the conditions for a free market for products, services and capital. They are economic because they will secure the profits of the creators of the project. The technical reasons come out of the need for innovation in the field of obsolete technical regulations, which is especially important in this period of intensive construction when many significant buildings are being erected with the investment of many foreign investors.

### Central European Free Trade Agreement (CEFTA 2006)

Throughout calendar year 2009, Montenegro held the CEFTA presidency. The CEFTA presidency represented a huge challenge for Montenegro. It was, first of all, a chance and also a possibility for Montenegro to show its capacities in the context of such a large project. It also provided an opportunity to contribute with an active approach so that the CEFTA signatories, as well as the EU, realise that Montenegro has the potential and possibility to perform all the tasks put in front of it. In order to have the best possible presidency, the government of Montenegro formed a working group for the presidency.

The level of liberalisation which Montenegro embodies is very high (full liberalisation of trade with Bosnia and Herzegovina, Macedonia, Serbia and Kosovo) although, in trade with Albania, Croatia and Moldavia, there are still either quota systems present in the area of agriculture for certain products or otherwise a level of customs rates.