

Macroeconomic aspects of privatisation in Montenegro

Abstract

The main issue treated in this article is whether the privatisation process, as a result of a number of listed economic and social limitations, was able to contribute to the economic development of the country, the change and modernisation of the Montenegrin economic structure, employment growth and a better definition of its basic development profile and development priorities. It also seeks to look at to what extent privatisation was followed by overall transition and reform processes aiming at the creation of a modern market and an economy open towards the world. Answers to these questions are given in chronological order given the key period where, together with changes in privatisation methods, specific macroeconomic changes appeared concerning the functioning of the overall economic system. The subject is related to three basic periods (a) the period of self-governing socialism (1951-1989); (b) the beginning of privatisation and its macroeconomic effects within the period of sanctions and isolation (1990-2000); and (c) the macroeconomic effects related to the privatisation process within the period of substantial independence of Montenegro (2001-2007), to which is dedicated the largest part of this article.

Keywords: *privatisation, transition economics, economic development, liberalisation, trade balance, capital market, mass voucher privatisation, tourism, stock market, poverty alleviation*

Introduction

The privatisation process in Montenegro was conducted under rather specific economic and social conditions and with numerous limitations. With the first twelve years of that process (1989-2001) in mind, the conclusion could be drawn that it was a case of a 'step-by-step' approach, under-rating the specificities of certain economic activities, the absence of a global strategy and privatisation plans, insufficient regard towards demands that were concerned with fair treatment and the social aspects of privatisation, etc. Arguments for such an attitude are not to be found in different models, i.e. laws regulating the privatisation process in the past period, but in:

- the legacy of social self-government and the specific role of social property
- the creation of an unfavourable economic and social structure as a product of the former system
- the economic, social and political circumstances in which the overall transition of the Montenegrin economy has taken place in the past twenty years (from the So-

cialist Republic within SFRJ, the Republic within SRJ and member of the State Union SCG, to the independent and sovereign state of Montenegro)

- the insufficient linkage of the privatisation process with other transition and reform processes, such as: macroeconomic stabilisation; internal and external economic liberalisation; the establishment and efficient functioning of market institutions; and, above all, property and contract protection.

These all form reasons why the economic and social conditions were not particularly favourable, while they often prevented the process of privatisation giving full effect to the macroeconomic and microeconomic spheres. Such a position was relevant up to 2001, when began the period of the substantial independence of Montenegro, as confirmed by the referendum in 2006, and its pro-European path.

Macroeconomic changes in Montenegro in the period of socialism from 1951 to 1989

The Montenegrin economy in 1989 was characterised by a very dynamic economic development and significant structural changes. The development of the Montenegrin economy up to this point was, of course, within the SFRJ and based on the development principles of socialist self-governance, founded within the concept of social property. During the multi-decade period of the socialist self-government system, some elements of a market economy were developed. Competitiveness on the commodities and services market was restrained due to the restrictedness of the domestic economy towards the world market and to the republic-regional autocracies. The labour market was not publicly acknowledged for ideological reasons. The financial market was reduced to a banking system under state control and political factors which decided the allocation of capital on a voluntary basis instead of on the basis of market criteria. Socio-property relations were economically and legally vague. Companies were allowed to survive despite losses and mismanagement; in return, this ensured artificial employment and the settlement of social problems within the company. Finally, the political system was under the control of a single political party, which led to its full domination concerning economic policy-making and to a statist tutelage of overall economic life. This system was a key factor in the creation of an out-dated and inflexible material structure of the economy whose main characteristics were ineffective economic activities and extensive development needs.

The main characteristics of economic development in Montenegro in the period from 1951 to 1989 were the following:

1. the growth of domestic product (DP). Domestic product was increased in the 1951-1989 period by 6.5 times, from \$218m to \$1 400m, while gross domestic product (GDP) per capita was increased 4.5 times, from \$518 to \$2 380.
2. investment growth. The consequence of using a socialist model of accelerated industrialisation in the first thirty years was the drastic changes which took place within the structure of the population. The main reason for such development may be found in the rather wide scope of investments, which extended to 54 % of realised GDP in the same period; while, in the second period (1981-1989), it amounted to just 5.4 %. Compared to the Yugoslav average, Montenegro achieved 19 % greater investment per capita between 1981 and 1989 but, for the reason of the 37 % lower

efficiency of that investment, registered a lagging behind in the level of development.¹ In 1952, Montenegro achieved 82.7 % of GDP per capita with respect to the Yugoslav average, but in 1989 just 75.1 %.²

3. structural changes in the population, as well as in employment and unemployment. The intensive process of industrialisation on the one side and the even faster process of the reduction of agriculture on the other caused dramatic changes within the socio-economic structure of the population. Above all, this is related to the dramatic fall in the share of the agricultural population in the total population, from 71.2 % in 1952 to 13.5 % in 1981 and only 7.5 % in 1991. Such an intense devastation process and the desertion of villages (the 'rural exodus') indicates not only the renunciation of the economic valorisation of important agricultural resources (in particular in the northern region) but also deep socio-economic disturbances. The sudden flow of the population into towns and the urban environment, and its pressure on employment in the secondary and tertiary sectors, principally in industry, caused high levels of over-employment and then redundancy, with the latter especially manifest in the '90s when the process of the transition into the market economy started. This intensive process of development and structural changes was followed by a very rapid growth in the number of employees within the public sector, namely from 30 000 in 1952 to some 163 000 in 1989 (an increase of 5.4). However, it is somewhat paradoxical that, in the period from 1981-1989, when GDP recorded growth of 0.5 %, the number of employed workers increased by 28 000. This reduced labour productivity by 15 %. The paradox is even greater considering that, in the same period, the number of unemployed people doubled (from 24 000 in 1981 to 48 100 in 1989).
 4. structural changes in the economy. The very dynamic economic development of Montenegro in the period from 1952 to 1989 caused major structural changes in relation to agriculture and industry. Within the realised GDP of the Republic, industry has enormously increased its participation, from just 7.4 % in 1952 to 37.9 % in 1989, while agriculture has recorded the reverse trend, with its level of participation reduced from 38.8 % to 12.6 %. In the period from 1961-1989 alone, industrial production increased 6.4 times and agricultural production just 1.5 times. In addition, other economic activities than transport, which increased its participation from 4.5 % to 18.8 %, recorded a dramatic drop in realised GDP. Alongside the highly-accelerated process of industrialisation, a rapid process of the development of the tertiary sector took place, which increased its participation in the structure of GDP in the period under consideration from 26.3 % to 40.1 %. Due to the applied model of socialist industrialisation and the intensive development of the
- 1 Such a low level of investment in Montenegro was mainly the result of the so-called 'heavy investments' intended for a few large infrastructural objects (the Beograd-Bar railway; the Adriatic Highway; the Port of Bar and the energy-metallurgy complex; the hydro-power plants at Perućica and Piva; the thermal power plant at Pljevlja; the Nikšić ironworks; KAP – Podgorica; and the coal mines in Pljevlja and Berane) that absorbed almost 80 % of total investment in Montenegro.
 - 2 Source: Dr. Risto Vukčević *Transformation and Modernisation of Material and Intellectual Production in Montenegro*, mimeo, Podgorica, pp. 15-25.

- energy-metallurgy complex, which was more in the function of the development of wider Yugoslav industry and less in the function of the development of the Republic and the valorisation of its resources, the energy-metallurgy complex took up 45 % of industry GDP although the participation of final production was just 15.8 %.
5. a high level of import dependency. The structure of the Montenegrin economy at the beginning of the nineties was highly unadjusted to internal and external levels of market demand, which was reflected in consequences for the foreign exchange position. Besides this, Montenegro was highly dependent on the national market; therefore, it placed 48.5 % of its goods on the markets of the other Republics and exported only 9.1 %. Moreover, the inherited import dependency in the area of raw materials and production materials, which was difficult to substitute with national production, as well as the reduced assortment of export offers concerning 90 % of industrial products, led to a significant deterioration in the external economic component and in GDP during the nineties.

Macroeconomic aspects and privatisation in Montenegro from 1990 to 1997

Taking into account the necessity of transforming the socio-economic system and developing a market economy at the end of the eighties and the beginning of nineties, Montenegro, together with other members of the former SFRY, started the process of transition. However, this process was halted at the beginning of the '90s by series of objective and subjective circumstances. The secession of former Yugoslav republics took place (Slovenia, Croatia and Macedonia) and then the war in Croatia and Bosnia and Herzegovina started. In 1992, Montenegro, together with Serbia, formed SRY. During the same period, economic sanctions and the blockade of SRY were introduced, first by the EU in 1991 and, later on, by the UN in 1992. In the Constitution of the newly-established SRY (1992) and in the republican constitutions of its members, Serbia and Montenegro, more or less all the elements for the development of a market economy had been put in place. However, the operationalisation of the new system was blocked by the new situation stemming from the introduction of international sanctions. The period of 'survival' then began, without the realistic possibilities of actual change in the economic system and leaving behind the former economic structure. This is the period when Montenegro, together with Serbia, experienced the most difficult economic and social crisis, falling into a real 'development hole'. Under those conditions, privatisation as a solitary element of transition could not deliver the results expected of it.

The major elements of this period are reflected in the following:

1. the dramatic drop in GDP and in all the relevant economic parameters during 1990-1996 was caused by a series of limitations of a mainly non-economic character

Table 1 – GDP and population trends in the 1990-1997 period

Indicators	1990	1991	1992	1993	1994	1995	1996	1997
GDP (in \$m)	1 259	1 126	822	524	549	561	752	763
GDP index (previous year =100)	-10.5	-10.6	-27.0	-36.2	4.8	2.2	34.0	1.5
Number of citizens (000)	612.7	616.6	624.0	631.9	635.3	638.6	642.8	646.7
GDP per capita (in \$)	2 055	1 826	1 317	830	864	879	1 169	1 178
GDP/pc index	-10.7	-11.2	-27.9	-37.0	4.0	2.2	33.9	1.08

Source: Republican Secretariat for Development, 2002; according to G. Đurović, P. Bošković and J. Stanković (2002) *Alternative Development Concepts of the Montenegrin Economy* Economic Faculty in Podgorica, pp. 9-43.

The data in Table 1 point to the very drastic fall in gross domestic product up to 1994, as a direct consequence of a major economic crisis and the war developments, which additionally weakened the overall economic potential of the Republic. In that period, industry, maritime transport and tourism suffered the greatest damages. Industry suffered not only due to the drop of its share in gross domestic product to 25.3 % but also since this share was largely only maintained as a result of the energy-metallurgy complex, which somehow survived, while the degree of the capacity usage of other industrial branches was decreased to less than 25 % with some of them being practically wiped out

2. an increase in unemployment and a decrease in employment which followed the decline in the size and scale of economic activity. The number of employed people in the reference period decreased by 38 000, while the wage was barely 20 % of the wage in 1989
3. a drastic fall in foreign trade, which also recorded negative trends in this period. Exports were halved, while the structure also lost the level of its acquired diversification
4. lagging behind in scientific-technological development
5. a flourishing of the grey economy. The period of economic sanctions was characterised by the development of the grey economy, whose share in GDP, according to estimates made at the time, was around 40 %. In the conditions of overall recession conditioned by the above-mentioned factors, this phenomenon was considered as a certain social bumper
6. hyperinflation culminated in improbable proportions in 1993-94. In the first three weeks of 1994 alone, right before the introduction of the stabilisation programme, inflation amounted to 313 million per cent.

The overall effects of the transitional recession show that, in the nineties, Montenegro fell into a major economic crisis, the consequences of which could not be removed in the short-run. Thus, they were also visible in the period after 2002. The effects of the recession on the development of Montenegro, beside these factors referred to above, are directly related to the fall in living standards caused by the decrease in real wages, pensions, social transfers and other incomes of the population. At the same time, the decrease in real wages had difficult consequences for social standards, primarily in health, education, housing and culture, as much as in the quality and structure of personal consumption.

Macroeconomic aspects of privatisation in Montenegro between 1998 and 2000

Bearing in mind the great number of limitations coinciding with the start of the process of transition of Montenegro, it can be said that the first phase of true transition and the first generation of reforms actually started in this period. Emphasis here may be put on: the introduction of the Deutschmark and the beginning of macroeconomic stabilisation; price liberalisation in the internal market; and foreign trade liberalisation. All of these must be considered together within the complex of transition activities. Thus, during this period, the first and most significant elements of progress were made with respect to the macroeconomic indicators. However, it should be stressed that, due to the short period of time which had elapsed, these could still not be seen as a consequence of the privatisation process alone, but more as reflecting overall efforts to change the circumstances for making projections in which the positive effects of privatisation could be noticed.

Speaking impartially, Montenegro had still not completed the market economy system, primarily due to some non-economic reasons; thus, the process of structural adjustment developed slowly. In the conditions of an emphasised and excessive state administration and para-state institutions, which was the legacy of the previous system, even economic organisations do not function in accordance with the laws of the market and, therefore, meeting considerable resistance, the privatisation, liberalisation and restructuring processes were rather slow. In that period, the social and state sector remained predominant, with a high degree of price control and non-customs economic protection. Consequently, the non-economic risk was also obvious when it came to securing foreign capital investments for financing current production and local investment.

Hence, in this phase both the economic and proprietary transformation of companies in Montenegro was under the permanent influence of strong foreign economic restrictions. With no foreign capital inflow and a lack of domestic capital, the additional capitalisation of companies was made impossible; only the nomination of the amount of social capital was developed and finalised. During this period, the necessary legal

and institutional infrastructure for the implementation of the privatisation³ process was built up and completed, but the outcome was that the overall results of privatisation by the end of 2000 were still rather modest. Logically, the economic policy of the government of Montenegro up to the end of 2000, generally speaking, put an emphasis primarily on the creation of the necessary pre-requisites for privatisation, which happened in the following period in the form of mass voucher privatisation. At the same time, during 2000, various individual models of privatisation were applied, such as the sale of shares, voucherisation, the sale of business assets of companies, additional capitalisation, joint investments or a combination of other different models.⁴

Already in 2000, Montenegrin economic relations with foreign countries were being developed in rather complex conditions for economic activities. Problems in the functioning of the single Yugoslav market had reached a point of culmination in March 2000 when the turnover in goods between Montenegro and Serbia was completely cut off, which conditioned a redirection of the import-export activities of Montenegro to new markets.

Due to the extremely negative measures taken at the federal level within the foreign trade and customs systems, which presented one of the key limitations to the recovery and overall economic development of Montenegro, independent solutions aiming at the liberalisation of imports and exports and the reduction of customs burdens to stimulate trade were passed at the level of the Republic of Montenegro in mid-2000. Foreign trade and customs operations were defined in decrees as temporary solutions until the Law on Foreign Trade Operations and the Customs Law, with accompanying regulations, could be enacted at the republic level. This established the normative pre-requisites within the area of economic relations of Montenegro with foreign countries, in order to protect the economic interests of the Republic and to develop legislation as a sound basis for the regulation of the status of Montenegro with the relevant international institutions.

With respect to economic activity, following two relatively successful years (1997 and 1998) economic policy was realised during 1999 in very unfavourable conditions resulting from the sanctions of the international community and the NATO bombing of Yugoslavia. A drop in industrial production of 7.6 %, together with a distinct lack of turnover resources, both in dinars and in foreign currencies, the low capacity usage and the outstanding insolvency of economic organisations, all contributed considerably to a decrease in the remaining economic activities. During 1999, the problem of the deteriorating unity of the Yugoslav economic system was additionally sharpened. Montenegro had, since July 1998, officially ceased to pay revenues from duties and a

3 The Law on Amendments and Changes to the Law on the Privatisation of the Economy was passed in Montenegro in March 1999 as were, later, the accompanying regulations: on privatisation vouchers, the de-materialisation of securities and privatisation vouchers; on the sale of shares via public tender; on privatisation funds and specialised private management companies; on the sale of shares and property of companies through public auction; on the purchase of shares by old foreign currency savings; and on the way that employees exercise their right to free shares. In addition, the Decree on the Central Register was also developed and, therefore, a great part of the legislative framework related to the implementation of the privatisation was completed.

4 *Yugoslav Review* 1, 2001: p. 101.

portion of turnover taxes and excises into the federal budget. In August, it took over the customs service on its own territory – an activity which also raised the issue of the unequal treatment of economic organisations in the single market.

In this rather unenviable economic ambience, private sector-realised investments in assets during the whole period of 1997-2000 remained unchanged. Beside the decreased scale of economic activities went the decrease in employment and the rise in unemployment and in the number of retired people, as well as the insufficient growth of registered employment in the private sector. Thanks to the sharp reduction in employment, labour productivity between 1997 and 2000 was increased by more than 2 % annually on average. It is worth mentioning that the average wage in Montenegro during 1999 was half as much again as the average wage in Serbia; while, in 2000, this difference was more than doubled (see Table 2).

Table 2 – Employment, unemployment (in 000) and average wages in Montenegro between 1996 and 2001

Indicator	1996	1997	1998	1999	2000	2001
Employment – Economic activity	92.4	85.6	84.4	80.4	77.7	76.6
Employment – Non-economic activity	32.7	33.8	34.1	34.9	36.1	37.5
Total employment	125	121	118	115	115	114
Employment in the private sector	21.9	23	25	26	28.9	30.0
Registered unemployment	60.7	64.8	68.9	79.8	81.1	80.6
Unemployment to employment ratio	41.3	45.5	48.0	56.5	56.8	56.1
Average wage	188	226	194	152	188	218
Number of retired people	78.6	80.8	81.9	83.6	85.0	86.3

Source: Secretariat for Development Statistical Yearbook of Montenegro for the respective year; National Bank of Montenegro; Employment Agency of Montenegro.

The result of foreign trade in this period has a similar trend to the dynamics of economic activity. The revival of foreign trade in 1997 and 1998 (the growth rate in the trade of goods in these two years amounted to 22 % and 26 %, respectively) was cut off by the NATO bombing in 1999 (a drop of 6.5 %), primarily due to a reduction in exports of more than 20 %. During 2000, foreign trade quickly recovered, with exports back to the zone of double-digit growth. At the same time, this was the last year of a very favourable foreign trade balance between Montenegro and foreign countries. Namely, coverage of imports/exports in the trade in goods in 2000 was, on average, 65.5 %; such a high rate of coverage of above 50 % was repeated only in 2004, when it was 52 %.

Except for 1999, when it was cut off by the NATO bombing, exports recorded a rather solid growth rate in the 1997-2000 period, but also an unfavourable structure, considering that the economy had lost its former level of diversification. Exports of-

ferred were characterised by a deficient size, type and assortment of goods which, apart from other limitations, had as a consequence unsatisfactory results in many industrial branches with the exception of light metallurgy, i.e. the export of raw aluminium which made up some 90 % of the structure of exported goods. Other main exports included: residual copper and aluminium products; cattle pelts; timber and other constituents for furniture; wine; and iron and steel). Out of total revenues, based on current transactions with foreign countries, the share of services-related revenues in 2000 was 17.4 %, which is below the real level of possibility. On the basis of the data of the Ministry of Tourism used by the Central Bank of Montenegro, a foreign currency inflow of \$15.8m coming from foreign tourists was realised in 2000.

When it comes to the capital market, between 1994 and 1999 trade on the stock exchange was accomplished only in short-term securities and money from bank accounts. There was only one stock exchange – the Montenegro stock exchange. This was opened the year after the NATO aggression, without making real turnover, being related only to the issuance of new short-term securities with prescribed interest rates aiming at the settlement of debt. Trade realised in long-term securities was insignificant. In 1994, there was no such a trade while, in the following years, with a slight growth tendency, it ranged from 0.02 % to 6.5 %.

An adverse impact of sanctions was also reflected in both scientific and technological progress. This occurred through the interrupted inflow of information, financial and other elements from abroad for the development of science and technology, a decrease in local investment in research and development, and a decrease in research-scientific potential due to the migration of a considerable number of highly-educated staff, including masters and doctors of science.⁵

Once the NATO bombing was over, there was a revival of certain tourist activities but to a considerably lower level compared to 1998 for the reason that most arrangements had been cancelled. The cutting of railway transport between Serbia and Montenegro, as with road transport, also had an impact on the reduction of turnover during 1999. This was, at the same time, the so-called turning point for Montenegrin tourism, since this sector logged considerable growth in the following couple of years. It is interesting that, in 2000, together with a rise in the number of tourist arrivals and overnight stays, the share of foreign visitors was already on the increase.

Macroeconomic aspects of privatisation in Montenegro from 2001 to 2007

This is the period of the essential independence of Montenegro, although this was only confirmed in the 2006 referendum, while the European orientation of the country only became more intensified with the signing of the Stabilisation and Association Agreement in 2007. The new model of voucher privatisation was accepted (in 2002), which included all citizens of majority age, while, by the end of the period, the process of privatisation was nearing its end (thus far, 85 % of state capital had been transformed into private property).

5 Secretariat for Development of the Republic of Montenegro (2005) *Strategy of regional development of Montenegro* Podgorica, March, p. 8.

Privatisation and transition are interdependent processes

Privatisation is one of the main parts of the transition, which has created a new corporate structure and new proprietary ratios, with a direct impact on the change of elements in the economic system and the institutional structure of the country. On the other side, the quality of the business environment itself depends on the progress made in transition, i.e. the interest of investors in privatisation projects, thereby contributing to the performance of privatisation in both quantitative and qualitative terms.

The progress that Montenegro has made in the transition may briefly be presented using the indicators of transition progress published by the European Bank for Reconstruction and Development (*Transition Report*). This report covers several key transition areas, including: transition of companies; transition of market and trade; transition of financial institutions; and transition of infrastructure. In accordance with the total score, which is assessed as lying on a scale somewhere between 1 (extremely bad progress) and 4 (extraordinary progress), with certain sub-degrees (plus and minus), the progress of a specific country could be assessed in each area of the transition. Montenegro's progress indicators are also compared to those of neighbouring countries. The results given in Table 3 relate to 2007.

Table 3 – Main transition indicators in the selected countries in 2007

Indicators	MNE	Alb	B&H	Cro	Mac	Serb	Slov
Private sector share in GDP (%)	65	75	60	70	65	55	70
Large-scale privatisation	3+	3	3	3+	3+	3-	3
Small-scale privatisation	4-	4	3	4+	4	4-	4+
Corporate governance and restructuring of enterprises	2	2+	2	3	3-	2+	3
Price liberalisation	4	4+	4	4	4+	4	4
Foreign trade exchange and foreign-exchange system	4	4+	4-	4+	4+	3+	4+
Competition policy	2-	2	2	3-	2+	2	3
Banking system reform	3-	3-	3-	4	3-	3-	3-
Capital market and non-banking financial institution	2-	2-	2-	3	2+	2	3-
Infrastructure reform	2	2+	2+	3	2+	2	3

Source: European Bank for Reconstruction and Development (2007) *Transition Report 2007*.

In accordance with progress made in the transfer of property, Montenegro is positioned high in the area of small-scale privatisation, considering that the process of the privatisation of small companies and transferable property rights is over. In the area of large-scale privatisation, a grade 3+ implies that a considerable part of the privatisation

of state property has been completed and that the state has approved property rights, but also that corporate governance is not sufficiently developed.⁶

On the other hand, the results in improving the quality of corporate governance and the restructuring of companies lag behind the privatisation achievements, meaning that privatisation does not guarantee, at the same time, and *per se*, greater economic efficiency in privatised companies. This may be confirmed as a rule in transition countries. However, the relationship between the progress made in privatisation on the one side and in the efficiency of corporate governance and company restructuring on the other shows the efficiency of the transition in the area of privatisation. This may be expressed by the coefficient of privatisation efficiency as the relationship between the grades of progress made in the transition within the mentioned parameters. The higher the coefficient, the lower the efficiency of the privatisation, and *vice versa*. Therefore, in this context, it is necessary to consider the grades given in the Report.

The progress made in privatisation has brought the domination of GDP by the private sector. As can be seen, all neighbouring countries have a predominant share of the private sector in GDP. In accordance with the EBRD assessment, it reaches almost 65 % in Montenegro, which is a rather high level compared both to neighbouring countries and to the remaining countries in transition, in particular taking into consideration the environment in which the process of privatisation, i.e. the transition, has been developed in Montenegro. In almost all the countries, most has been done in the areas of price liberalisation and the foreign currency and trade system. Even so, competition policy has not experienced more serious progress, since monopolies do still exist in infrastructure (energy sector, telecommunications (in part), water supply, utilities and the like). The assessments given in the Table point to legislation and competition institutions being established, and that there is a decrease in barriers to new entrants in terms of the actions imposed on incumbent companies, but that time is needed to show the expected outcomes.

The financial sector in Montenegro has experienced a deep transition but, in accordance with the EBRD assessment, it has not moved very far forward in comparison to developed economies. The banking sector has moved the farthest in the transition, but capital markets still lag, so the capacity of the financial system to carry out allocations for development purposes and to create opportunities for the capital mobilisation needed for development is questionable. In Montenegro, there are stock exchanges and lead actors (but not market makers). There is a trade in state securities (albeit unsatisfactory), and there is also an elementary legislative and regulatory framework for the issuance of and trade in securities, but there is no considerable IPO (initial public offering). Protection of minority rights is unsatisfactory, there is a small share of non-banking financial institutions (such as private insurance and pension funds, and leasing companies), and the intermediation of stakeholders is poor.⁷

6 Unlike the circumstances in small-scale privatisation, transition in the area of large-scale privatisation is a continuing issue, even in developed countries which have joined the EU in the meantime, as is the case with Slovenia. This points to transition in the countries in transition not being so rapid; it is, in contrast, a long-lasting process, in particular when it comes to large companies.

7 Central Bank of Montenegro *Report of the main economist for 2007*.

Montenegro was also given a weak grade in the area of infrastructure reform, although this is around the level of the remaining selected countries. This points to other countries in transition having similar problems, including with regard to their complexity.⁸ A lower rating indicates that the business of the energy sector still relies to a great extent on the government. This provides a poor incentive for management to conduct profitable business activities. There is a low level of institutional reform and an almost negligible influence of the private sector; the railway has still not been completely separated from the state and has weak commercial goals, while the share of the private sector is minimal, etc.

Table 4 – Values of the transition indicators for Montenegro in the 2001-2007 period

Indicators	2001	2002	2003	2004	2005	2006	2007
Private sector share of GDP (%)	50	55	55	55	65	65	65
Large-scale privatisation	1.7	2.7	2.7	2.7	3.3	3.3	3.3
Small-scale privatisation	2.0	3.0	3.3	3.3	3.7	3.7	3.7
Corporate governance and restructuring of enterprises	1.0	1.7	1.7	2.0	2.0	2.0	2.0
Price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Foreign trade exchange and foreign-exchange system	2.7	3.0	3.0	3.0	3.7	3.7	4.0
Competition policy	1.0	1.0	1.0	1.0	1.0	1.0	1.7
Banking system reform	1.7	2.0	2.0	2.3	2.3	2.7	2.7
Capital market and non-banking financial institutions	1.0	1.7	1.7	1.7	1.7	1.7	1.7
Infrastructure reform	1.3	1.3	1.7	1.7	2.0	2.0	2.0

Source: European Bank for Reconstruction and Development (2007) Transition Report 2007.

Finally, in accordance with the EBRD assessment, the transition in Montenegro was successfully implemented up to 2005. However, in the last three years, a level of stagnation can be noticed bearing in mind that, other than competition policy and the liberalisation of foreign trade, the values of the other indicators have remained unchanged.

8 It should be kept in mind that this cross-sectional analysis was carried out at the end of 2007 and that there have been considerable changes in the meantime, precisely in the area of infrastructure. Thus, for example, the restructuring of Željezniča CG has been completed, the restructuring of the EPCG is underway; a tender has been announced for its privatisation, etc. Thus these assessments should be considered in the light of these changes.

Macroeconomic framework

The Montenegrin economy in the last couple of years has had the following basic features:

- openness of the economy
- liberalisation of economic developments with foreign countries
- rapid growth in economic activities
- low inflation rate
- budget surplus
- record foreign direct investments intake
- significant drop in the unemployment rate
- reduction in foreign debt
- high current account deficit (more accurately, a strong growth in the deficit in goods).

On the one hand, the Montenegrin economy has recorded a series of positive developments (unemployment rate, stability in prices, etc.) which witness to the achievement of internal balance; while, on the other, due to the imbalance in payments, there are questions of the external bias to the trade structure and of the sustainability itself of the current account deficit. Coming out of the State Union, Montenegro has eliminated a series of the primarily political risks which burdened the State Union, thereby becoming far more attractive for foreign investors. It is obvious that the economic environment is more favourable. However, many things still have to be done when it comes to the elimination of a number of business barriers, in particular taking into account those at the local level. The main findings here are as follows:

- a) gross domestic product has been increasing year-on-year and, in the period from 2001 to 2007, it increased by around 37 %. Growth was especially dynamic in the 2006-2007 period
- b) the substitution of the national currency with a convertible foreign currency decreased the risk premium, i.e. both the risk of the national currency and of the country. Inflation dropped rather rapidly to a single digit number, which stabilised the economy, facilitated investment and created the prerequisites for a more rapid development of the financial system. Inflation as measured by the retail price index recorded a continuous drop until mid-2007, at the end of which year, the inflation rate was 8 %
- c) industrial production stagnated, except for 2004
- d) the valued of imported goods increased in 2007 to €2 134.4m, which is €1.5bn higher compared to 2001. At the same time, exports in 2007 only totalled €599m; thus, import-export coverage was only 29.2 %
- e) the current account deficit has been increasing on an annual basis, reaching 40 % of gross domestic product in 2007
- f) the number of employed people between 2001 and 2007 increased by 15 600, i.e. by 11 %, while the number of the unemployed decreased by 47 900, i.e. 59 %. The unemployment rate has thus decreased, to below 12 % in 2007
- g) the inflow of net foreign direct investment has continuously increased, reaching €525m in 2007; however, a large FDI inflow does not comply with the privatisation process

- h) after 2004, the budget deficit, which exceeded 20 % of gross domestic product at the end of the '90s, has been within the framework envisaged by the Maastricht criteria, while in 2006 and 2007a surplus was realised
- i) during 2001, the Central Bank of Montenegro was founded. This had a key role in the reform of the payment system, i.e. in the establishment of a stable, efficient and regulatory appropriate and arranged system of payments, as well as in the promotion of new standards in the banking sector. Privatisation of the banking system was complete, while the results accomplished in the reform of the system may be assessed as satisfactory.

Table 5 – Selected macroeconomic indicators for the 2001-2007 period

Indicator	2001	2002	2003	2004	2005	2006	2007
GDP, real growth in %	1.1	1.9	2.5	4.4	4.2	8.6	9.7
GDP, €bn	-	-	1 510	1 670	1 815	2 149	2 545
Industrial production	-0.7	0.6	2.4	13.8	-1.9	1	0.1
Export of goods, \$m	198.7	202.0	461.5	452.1	460.6	627.5	599.0
Import of goods, \$m	591	700	711	869	974	1 483	2 134
Current balance, \$m bn	-	-	-0.116	-0.149	-0.192	-0.667	-1.381
Current balance / GDP	-	-	-6.8	-7.2	-8.5	-24.7	-39.6
FDI, €m	-	86.9	43.8	61.9	383	466.6	524.9
Tourist arrivals (000)	555	542	599	703	820	954	1 133
Overnight stays (000)	4 011	3 690	3 976	4 561	5 212	5 936	7 295
Inflation, average	23.7	19.7	7.5	3.1	3.4	2.1	4.2
Inflation, end of year	27.9	9.4	6.2	4.2	1.8	2.0	8.0
Total employment (000)	141.1	140.1	142.7	143.5	144.4	150.8	156.4
Registered unemployment (000)	81.5	80.6	71.7	65.1	54.5	43.2	34.4
Unemployment rate	32.5	30.4	26.7	22.4	18.5	14.7	12
Average net wage (€)	107.8	149.1	173.9	195.4	213.2	282.0	338.0

Source: IMF (2008) *World Economic Outlook October*; Central Bank of Montenegro.

Data from Table 5 show that there was a dynamic growth in gross domestic product between 2001 and 2007, at an average rate of 4.6 % and with a distinct acceleration rate during the second half of this period. Growth was particularly impressive during 2006 and 2007, when the real increase in economic activity was recorded at 8.6 % and 9.7 % respectively. Together with Slovakia (10.4 %) and Latvia (10.3 %), Montenegro

was, in 2007, the most rapidly growing economy in the region of central and eastern Europe.⁹ GDP growth rests upon the expansion of the services sector – tourism, trade and financial intervention.

According to the data of the Central Bank of Montenegro collected in the analysis of financial statements, the Montenegrin economy realised in 2006 for the first time a net profit, amounting to €60m. Compared to 2005, all the analysed indicators were improved (net profit margin, yield on assets and the general liquidity coefficient), although a satisfactory level of economic liquidity has still not been realised. The economy continued to operate in the profit zone during 2007 and, from preliminary estimates, gross and net profit increased by more than 60 %¹⁰ compared to the preceding year. Analysis of financial statements shows that the most rapidly developing activities include those dealing with real estate, financial intervention, transport, trade and agriculture.

It is unquestionable that the positive outcomes realised in the last two years may, to a great extent, be assigned to the privatisation process. This should be considered as the means of activation of those resources accumulated within companies which were supposed to be released upon its completion, thereby contributing to more rapid economic growth and employment. Despite this, analysis of financial statements shows that the business outcomes of privatised companies, while satisfactory in themselves, are still way below the potential of an ‘original’ private sector. This witnesses in favour of state activities reflected in multi-dimensional and strong support for the development of small- and medium-sized enterprises. It turns out that, in order to improve efficiency, or to transfer these companies into competent producers by re-capitalisation, enlargement of activities, re-organisation, the fostering of discipline and the introduction of new levels of entrepreneurship, much more time would be needed than anyone could have supposed, not least their owners. It is likely that a period of at least three years would be required. Consequently, it is not particularly surprising that these very good results were recorded only a couple of years after the beginning of the process of transition.

At the same time, this goes in favour of the numerous open questions faced by all countries at the very beginning of the process of transition, to which they did not respond very well – such as, for instance, whether to save existing state and social enterprises at any price or to transfer focus to the establishment of new ones; whether to restructure companies prior to the privatisation process or leave this job to the new owners; etc.

The privatisation process gave a strong impulse to the development of civil engineering, which demonstrated a rapid growth in the last five years, again with multiplier effects at the level of its associated sectors and the economy as a whole. It can be seen in the data provided that, out of the total amount of foreign direct investment, the most

9 IMF *World Economic Outlook* October 2008.

10 There is some methodological confusion arising from the constitution of the sample, i.e. the coverage of enterprises, considering that some companies which did not submit financial statements in 2006 did so in 2007. Naturally, in any case this by itself does not jeopardise this particular conclusion.

important item relates to resources received by the sale of land and other coastal property. Foreign direct investment in real estate in 2006 amounted to €338m (53 % of gross FDI) and, in 2007, to as much as €514m (51 % of gross FDI). Land and facilities purchased on the coast by foreign owners are mainly intended for the construction of new, tourist facilities. The money from the sale of land on the coast is, at the same time, used for the purchase of flats in Podgorica which, furthermore, contributes to the flourishing of an already dynamic construction industry in the capital of Montenegro. All these have led to the dynamic development of civil engineering in the last couple of years. Thus, the average growth rate of the value of completed construction works in the last five years amounted to an improbable 44 % annually while the growth rate was especially high in 2006, when it stood at 179 % compared to the preceding year.¹¹ In 2007, growth stabilised at the previously-achieved level. In this manner, construction already makes up around 10 % of the total Montenegrin economy.

Privatisation, undoubtedly, has also had positive effects on tourism in Montenegro which is, at the same time, the most important economic sector of the country. Up to mid-2008, 24 hotels were privatised as part of the assets of companies while four hotel companies were sold via controlled packages of shares. In privatised hotels and companies alone, there have been invested over €315m, while it is expected that an additional €190m will be invested by the end of this investment cycle. Privatisation has contributed to the restructuring of a large part of what was the previous outdated offer, as well as the provision and creation of new jobs and the valorisation of some new tourist locations.¹²

The commitment to tourism as a driving force of the economy and a new development cycle is based on Montenegro being able to dispose of resources essential for tourism development as much as this is an activity generating the development of other complementary activities, such as transport, trade, banking, agriculture, construction and the like (those crucial for the realisation of the extraordinary dynamic growth of the whole economy in the last three years). Such a development has a series of positive economic effects, including a decrease in unemployment and an increase in the living standards of the population, and it also makes a contribution to regional rural development.

After 2000, significant growth has been recorded in the tourist economy while, in the last five years, the successive growth rate has been a double-digit number. In accordance with the assessment of the World Travel and Tourism Council, the share of tourism in gross national product in 2007 was 20.7 %, with 28 900 direct and indirect jobs in tourism and its complementary sectors – or 18.7 % of the entire employment base. Profit realised from tourism in 2007 amounted to around €480m, which is a result of the greater number of foreign visitors and their higher purchasing power. In 2007

- 11 Chamber of Commerce of Montenegro (2008) *Glasnik – Official Supplement 16* No. 5, May.
- 12 In this period, some weaknesses of privatisation have also been noticed. For example, 'On the privatisation of the hotel facilities, the owners of the hotels decided to follow the tourist trends related to the diversification and specialisation of their offers. Thus, there is still a need to create hotel capacities for more inclusive content.' Government of the Republic of Montenegro (2008) *Policy and strategy for the development of tourism in Montenegro up to 2020* July, p. 95.

alone, more than €140m was invested in tourism, which is more than one-quarter of total investments. The importance of tourism would be even more distinct if the grey economy was taken into consideration because it also contributes positive economic effects and to job creation. By legalising the grey economy, i.e. by including it into the calculations, the share of the tourist economy in gross national product would reach 30 %.

In the 2003-2005 period, the current account deficit ranged between 6.8 % and 8.5 % of GDP and experienced a considerable increase in the next two years, firstly up to 24.7 % in 2006 and then to a dramatic 39.6 % in 2007. There are two main reasons for this. On the market side, the extraordinarily dynamic economic growth increased purchasing power, which was additionally 'boosted' by large investments. Montenegro could not meet the demand for goods from domestic sources. This leads to the second reason, which lays in the extraordinarily non-competitive local offer of the trading sector, representing what we might term collateral damage arising from the conscious commitment of the creators of economic policy to try to find support for economic development in the service sector, in which Montenegro has rare comparative advantage. It would seem that the trade sector has, for some several years, been completely neglected.

The share of processing industry in GDP has been continually dropping since the beginning of the nineties and, during 2007, it was scarcely above 12 %. In such a case, the existing external bias of the trade in goods should not be so surprising. The current account deficit is presently being covered by foreign savings entering the country to a lesser extent through foreign investment and, to a greater extent, through the credit channel which, as a rule, increases the indebtedness of a country.

The path of development of the capital market in Montenegro can be divided between the period prior to the mass voucher privatisation process¹³ (1994-2000) and the period after 2001, when free vouchers (property) were distributed to all citizens of majority age. Apart from capital diversification in Montenegro, mass voucher privatisation contributed precisely to raising the awareness of citizens about the capital market and about the values of the capital which they possessed.

Voucherisation, i.e. mass voucher privatisation as applied in Montenegro, should be seen as a form of primary privatisation aiming at the transfer of capital from social (or state) ownership to quasi owners, who were supposed to take on the secondary privatisation activities i.e. to find strategic investors. However, the main characteristic of the period following mass voucher privatisation is the large number of temporary shareholders who wanted to sell their shares at the earliest opportunity. A situation in which many shareholders wanted to sell, but only a small number of them to buy, is the main feature of this period. In that manner, shares became an easy catch for institutional investors. In the course of privatisation up to now, institutional investors have

- 13 Total capital in Montenegro has been estimated at €4.6bn. Mass voucher privatisation and the sale through international tenders were assessed as the main privatisation methods. Around 430 thousand of majority age citizens participated in the mass voucher privatisation process, out of which number 248 thousand (almost 60 %) invested their vouchers in the Privatisation Funds, while 150 thousand invested them directly in the privatized companies.

appeared in the form of investment funds. Expectations that these funds would play an important role in the restructuring of the companies of which they took ownership (even majority ownership) were not sufficiently real considering that they were financial investors, not strategic ones focused on the business management of the company. The portfolios of companies that the funds dispose of are most often greatly diversified and it is very difficult to manage them. On top of the frequent lack of knowledge and readiness for corporate restructuring activities in these companies and funds, it is not so strange that the funds have been passive at improving company performance. This is undoubtedly one of the most important defects of the way privatisation has been conducted in Montenegro which, consequently, has made impossible a reflection on the positive effects of privatisation.

After 2001, the Montenegrin capital market has recorded an intensive period of development. Apart from the Montenegro stock exchange, the establishment of one more stock exchange has got underway and the first markets are about to start. At the end of 2004, Telekom Montenegro was taken private by the Hungarian MATAV. Privatisation profit and additional MATAV investment in the purchase of two-thirds of the share package on the stock exchange, amounting to €22.3m, provided the necessary capital for the main market players. At the end of September 2008, the capitalisation of the market (the values of all shares in circulation on both stock exchanges) amounted to around €4.3bn, which is a drop of 40 % compared to the capitalisation value in December 2007, or 60 % higher compared to that of the preceding year. Upon mass voucher privatisation (March 2002), total capitalisation amounted to €37m.¹⁴ This means that, despite the strong reduction in the stock exchange, everyone who acquired shares in this process could have received around 115 times more money for the sale of these shares at the end of September 2008 than they could have received at the beginning of the process.

Dynamic economic growth positively reflected in employment

Unemployment has decreased and there has been a significant growth in the wages and living standards of the population. The total number of employed people in 2007 was 156 408, 11.1 % higher than in 2000. Considering the employment structure in terms of the three basic sectors, it can be noted that the highest number of employed people at the end of 2007 (63 500, or 40 % of total employment) was in the service sector, confirming that the Montenegrin economy is more focused on services than on production activities (28 %). At the same time, there were 34 395 registered unemployed people on the Register of the Employment Agency in 2007, which is 49 700, or 59 %, lower than in 2000. The unemployment rate has been continuously falling since 2000 and is now below 12 %.

The average wage in Montenegro in 2000 was €92.40. By 2007, average net wages reached €338. Wages have seen a constant growth in this period, both nominally and in real terms, except in 2001 when a real drop of 5.7 % was logged. The total nominal

- 14 Janjušević, J (2008) *Stock exchange in Montenegro: expectations and disappointments* Transition afterwards in the region of the former Yugoslavia – Economic Forum, Miločer, Association of Economists of Serbia, p. 436.

growth of average wages in this period was 265.6 %, while prices have increased by somewhat more than 80 %. Therefore, real wages have more than doubled. It is good that average wages have been growing, despite the growth in the employment rate; however, wages were growing more rapidly than productivity, thereby decreasing economic competitiveness and, additionally, deepening the external trade bias (the average growth in the real wage during this period was 11 % while GDP growth was 4.6 %). The growth in wages encouraged excessive aggregate demand, thereby also undermining the internal trade balance, which can clearly be noticed in the growth of inflationary pressures by the end of 2007.

Overall poverty rate more or less unchanged between 2005 and 2006, but the depth and severity of poverty declined slightly

The estimated poverty rate for 2005 was 11.3 % (i.e. around 71 000 citizens) and it remained the same in 2006 although a number of other poverty indicators suggested a slight improvement in the situation of the poorest part of the population. The assessed poverty line was €144.68 per month per equivalent adult, with the population whose equivalent consumption falls below this line being considered poor. The slight improvement related to poverty reduction is also shown in data which show that the average consumption of the poor has increased, measured relative to the average consumption of the population. The poverty gap, measuring the 'depth' of poverty, declined from 2.1 % to 1.9 % in 2006. As suggested by the poverty gap, the poor needed resources to an amount of 17.2 % of the poverty line in order to climb out of poverty in 2006, a somewhat smaller amount than in the previous year. In other words, in spite of the stagnating number of people in poverty, the gap between the actual consumption of the poor and the absolute poverty line decreased during this period. If we are aware that, during 2007, the real rate of GDP was 9.7 %¹⁵ and will stop at around 7 % in 2008, the poverty rate in Montenegro, as per the previous calculation, could have dropped below 7 % by the end of the year.

Bearing in mind that the dynamic growth of the economy is mainly the result of the privatisation which has been conducted, this could lead to the conclusion that privatisation in Montenegro has had a positive impact on the strong decrease in the rate of poverty. However, this hypothesis could be relativised by the statement that, until mid-2007, consumers were facing significant price increases in food and foodstuffs which mostly affect the poorest population strata, on the basis that this relates to the whole set of material and non-material factors with the expressed multiplicative effect. Therefore, this aspect may not be directly marked as a consequence of the process of privatisation.

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