



**THE REPUBLIC OF MONTENEGRO
MINISTRY OF FINANCE**

**MONTENEGRO 2006
ECONOMIC AND FISCAL
PROGRAMME**

Podgorica, November 2006

Contents

INDEX OF TABLES	2
INDEX OF FIGURES	3
INTRODUCTORY NOTE.....	4
1. RECENT MACROECONOMIC DEVELOPMENT.....	7
1.1. ECONOMIC ACTIVITY	7
1.2. LABOR MARKET	9
1.3. PRICES	11
1.4. MONETARY POLICY.....	13
1.5. FISCAL DEVELOPMENTS	15
1.6. EXTERNAL SECTOR	16
2. MACRO-ECONOMIC FRAMEWORK: MID-TERM POLICIES.....	19
2. 1. METHODOLOGICAL REMARKS RELATED TO THE PREPARATION OF THE TABLE “GROWTH AND ASSOCIATED FACTORS”	20
2.2 POPULATION	23
2. 3. EXTERNAL SECTOR PROJECTIONS FOR THE PERIOD 2006 – 2008.....	25
3. PUBLIC FINANCE	31
3.1 FISCAL ARCHITECTURE AND GOVERNANCE.....	32
3.2 THE MEDIUM-TERM FISCAL FRAMEWORK.....	34
3.3 PUBLIC DEBT MANAGEMENT	38
3.4 DEFICIT FINANCING.....	40
3.5 FISCAL RISKS	41

Index of Tables

TABLE 1 REPUBLIC OF MONTENEGRO – MAIN ECONOMIC INDICATORS, 2000-2005.....	8
TABLE 2 GROWTH RATES PER SECTORS OVER THE PERIOD 1-9.2006/1-9.2005	8
TABLE 3 FDI INFLOWS IN MONTENEGRO BY SECTORS IN 2001-2005, IN EUR	18
TABLE 4 GROWTH AND ASSOCIATED FACTORS	23
TABLE 5 EXPECTED POPULATION WITHOUT MIGRATIONS (VARIABLE POPULATION GROWTH/FERTILITY RATE)	24
TABLE 6 LABOR MARKET DEVELOPMENTS.....	25
TABLE 7 EKSTERNAL SECTOR DEVELOPMENT	30
TABLE 8 MACROECONOMIC FRAMEWORK IN % OF GDP	31
TABLE 9 CONSOLIDATED PUBLIC EXPENDITURES 2007 -2009	36
TABLE 10 GROWTH RATES (AS % OF GDP).....	37
TABLE 11 BUDGET TAXES (IN MIL. €)	37
TABLE 12 BUDGET EXPENDITURES (IN MILL. €)	37
TABLE 13 EVOLUTION OF PUBLIC DEBT WITH A MID-TERM PROJECTION UNTIL 2009 ..	40
TABLE 14 DEFICIT/SURPLUS 2005 – 2009	40
TABLE 15 GENERAL GOVERNMENT BUDGETARY DEVELOPMENTS	42
TABLE 16 GENERAL GOVERNMENT DEBT DEVELOPMENTS.....	43

Index of Figures

FIGURE 1 NUMBER OF EMPLOYED PERSONS IN MONTENEGRO, 2004 – JULY 2006	9
FIGURE 2 NUMBER OF UNEMPLOYED PERSONS IN MONTENEGRO, 2004 – SEPTEMBER 2006.....	10
FIGURE 3 CHANGES IN REAL SALARIES; FEBRUARY 2003 – SEPTEMBER 2006	11
FIGURE 4 INFLATION (ANNUAL INCREASE RATE); JANUARY 2004 – SEPTEMBER 2006 .	12
FIGURE 5 RETAIL PRICES; JANUARY 2005 – JUNE 2006.....	12
FIGURE 6 AVERAGE ON YEAR INFLATION RATE.....	13
FIGURE 7 MONEY SUPPLY, EUR THOUSAND.....	14
FIGURE 8 IMPORT/EXPORT COVERAGE, 2004 – Q1 2006, IN %	17
FIGURE 9 QUARTERLY IMPORT AND EXPORT OF GOODS IN 2004 AND 2005, IN EUR THOUSAND	17

Introductory note

As of 2006, countries which are in the process of negotiating a Stabilization and Association Agreement with the EU and countries that have concluded such an agreement but do not have the status of a candidate country, are expected to submit an Economic and Fiscal Programme (EFP) covering the period 2006-2008.

The 2006 EFP should be considered as a preparation for the Pre-accession Economic Programme which has to be submitted once the status of a candidate country has been obtained and in a longer perspective as preparation for the revised Lisbon Strategy as well as for the Convergence Programme as upon Membership.

The 2006 EFP should provide evidence of progress made towards developing the institutional and analytical capacity necessary to participate in the pre-accession surveillance procedures for candidate countries as well as the multilateral surveillance procedures of EMU as much as possible under the current level of their institutional and analytical capacity.

In May 2006, Montenegro became an independent state and in October 2006 the first Government of the newly independent state entered into the office. »Montenegro 2006 Economic and Fiscal Programme« is the first document in recently initiated Economic Dialogue between the EU and Montenegro, in the enhanced economic policy cooperation of Montenegro. The Government of Montenegro expects that the document is a contribution to Montenegro's preparation for membership in the Economic and Monetary Union of the EU, to foster long-term economic convergence and a successful path towards progressive EU integration.

By becoming an independent state, Montenegro faces the task of establishing a number of new institutions and tackling a number of new issues. This concerns also the preparation and quality of the Montenegro 2006 EFP and is related to data bases, macroeconomic forecasting and reconsideration of structural reforms. More precisely:

First part: **Recent macroeconomic development**

It contains macroeconomic indicators and developments for 2005 and first half of 2006. Taking into account that Montenegro is drafting 2006 EFP for the first time it is not possible to make comparative analysis of projections, which were included in the previous program. This part is based on the data and analysis that are available to the Ministry of Finance and Central Bank of Montenegro.

Second part: **Macroeconomic framework**

Apart from forecasting in the Ministry of Finance and Central bank, which is concentrated on fiscal and external sector projections, at the moment, there is no model for macroeconomic forecasting available in Montenegro. This is reflected in section 2 of the document where, apart from external sector, only projections of the really main macroeconomic aggregates are given. Projections of basic indicators of growth and related factors have been done on the basis of estimates done by the IMF, in accordance with the consultations held pursuant to the Article 4 of the Agreement on Cooperation and on the assumption that the initiated reforms would be continued.

These estimates were corrected only in the part that is related to the trend of import and export growth rates, because final data on import and export in 2005 were announced in the meantime, while IMF used preliminary data for these items in its projections. Total estimate is based on the prospects of economic activity made by the agency Standard & Poor's in its second credit rating review.

The Central Bank of Montenegro is now in the process of creating a model for macroeconomic projections. The results of the model will be available for the next year's Montenegro's EFP. This will enable the full preparation of Section 2 along the lines contained in the Consolidated Outline.

Third part: **Public finance**

Description of the main priorities in the area of public finances for the period 2006-2008. The maintenance of financial stability through a balanced budget policy within recommendations of International Monetary Fund is preserved as main priority, while at the same time the possibilities to alleviate the tax and social security burdens on citizens and businesses are utilized.

Fourth part: **Structural reforms**

After the new Government entered into the office in October 2006, it started immediately with the preparation of a new comprehensive economic development program which will consider period 2007- 2010. This program will be based on the existing strategic documents and will reflect fully the new government's policy orientations, including its full commitment for intensified EU accession process. In addition, the document will be structured so that it corresponds to the concept of 2006 Economic and Fiscal Programme having in mind the necessity of usage of data to serve the needs of 2006 EFP and later Pre Accession Economic Programme. As this document is currently in the process of preparation, new economic development orientations will be fully reflected in the next year's Montenegro Economic and Fiscal Programme. Instead of that »Economic Reform Agenda for Montenegro, 2002-2007 – Report and Recommendations« will be provide as an Annex. Namely, in 2002, the Government of Montenegro adopted a broad reform document »Economic Reform Agenda for Montenegro, 2002-2007 – Report and Recommendations«. The document presents a comprehensive view on the reform process in Montenegro. In 2005, the Government updated this document by summarizing the results of the reforms implemented in 2003 and 2004, and by outlining key reform activities until the end of 2007.

In accordance with the aforementioned, it is important to point out that reforms of the statistical system of Montenegro are underway. Statistical Office of Montenegro – MONSTAT has overtaken full responsibility for organization and realization of Programme of statistical surveys, both from the methodological side and processing of statistical surveys. The reforms process is being continued, and has been intensified by adoption of the new Law on Statistics and Statistical System of Montenegro. Taking into consideration that the reform measures implementation is still in progress, it is expected that in the future Montenegro will dispose of adequate statistical data, which will be based on modern methodologies and recommendations.

Representatives of the Ministry of Finance, Secretariat for European Integration, Central Bank of Montenegro, Statistical Office of Montenegro – MONSTAT, independent Institute for Strategic Studies and Projections from Podgorica were involved in drafting this document.

1. Recent macroeconomic development

Major trends which marked the year 2005 and the first six months of 2006 are the growth of economic activity, the fall of the inflation rate below 2%, an extremely dynamic growth of financial market, negotiations towards the conclusion of the Stabilization and Association Agreement with the European Union, better credit rating, but also the decline of industrial production growth. Based on the existing data for 2005 and the preliminary data for 2006 it may be seen that macroeconomic trends in Montenegro are to develop until the end of the year as envisaged by the economic policy for 2006, which takes the focus away from macroeconomic stability towards more dynamic economic growth and development and inclusion into regional and international integration processes.

The economic policy priorities for the upcoming period will be to accelerate the privatization and restructuring of large companies, reduce public expenditures, further enhance the business environment and deregulate administrative procedures, suppress grey economy, increase judicial efficiency etc. At the same time, we need to continue with the policy of international integrations regarding the organizations to which Montenegro has not acceded yet, primarily the European Union and the World Trade Organization. Therefore, one of the most significant tasks of economic policy-makers in 2006 will remain to be further alignment of national regulations with those of the given two international institutions.

1.1. Economic activity

Montenegro has been recording positive real growth rates since 1996. It comes as a result of increased activity in all sectors. In 2005, GDP increased for 4.3%, as a result of the economic activity growth in almost all branches of the economy, in particular in tourism, construction industry and forestry, and such a trend continued in the first six months in 2006. The most significant economic features of the second quarter this year are: high economic growth rate, high inflow of foreign direct investments, continuation of positive trends in the banking and financial market, high growth rates in tourism, transport and construction industry, with somewhat slower growth of industrial production. By far the single most significant event that marked this quarter was the referendum decision in favour of Montenegrin independence, providing opportunities for accelerated economic development, but at the same time posing great challenges.

Table 1 Republic of Montenegro – Main economic indicators, 2000-2005

	2000	2001	2002	2003	2004	2005
GDP in mil euro	1,022.2	1,244.8	1,301.5	1,329.0	1,565.1	1,690.0
Real growth (% GDP)	3.1	1.0	0.8	2.5	4.2	4.3
Inflation rate	-	22.8	17.8	7.9	3.4	1.8
Unemployment rate	32.7	31.5	30.5	25.8	22.6	18.4
General state balance (% GDP)	-	-1.6	-2.1	-3.3	-2.15	-2.1
Trade balance (% GDP)	-45.1	-49.4	-35.5	-26.1	-28.6	-29.9
Current transactions balance (%GDP)	-14.9	-18.6	-13.0	-7.3	-9.5	-9.1
External debt (%GDP)	65.7	64.3	73.2	34.4	34.1	30.3
External debt (billion of euros)	0.671	0.674	0.894	0.472	0.502	0.513
Debt – export ratio (%)	-	260.6	191.3	102.2	80.7	-
FDI (%GDP)	-	1.0	7.1	3.2	3.3	22.6
FDI – net in billion	-	10.6	86.9	43.8	51.8	382.8

Source: Central Bank of Montenegro

*/ Compared to the same period of the previous year

According to the assessment of the Secretariat for Development, the attained GDP in the first nine months 2006 amounted to 1,262 million euros, or had real growth of 6.3% compared to the same period last year. If the trend of increasing macroeconomic stability continues, through the increased economic activity and financial sector activities it is expected to have real GDP growth of some 6.5% in 2006, and some 6% in 2007.

For the first nine months in 2006, the growth rate of industrial production in comparison to the same period last year was 1.5%. Lower growth rates were attained in the greatest number of cases in those branches with prevailing companies which have not been privatized or restructured yet, with obsolete technologies, high levels of illiquidity, surplus of workforce, etc. Such a tendency was mostly pronounced in the electric energy complex in Pljevlja and Steel Plant in Niksic due to pending privatizations. However, considering that privatization processes in these companies are closing, the growth of both investments and production is expected in future.

Table 2 Growth rates per sectors over the period 1-9.2006/1-9.2005

Industry	1,5
Agriculture	6,0
Forestry	23,8
Construction	62,7
Transport and postal services	5,5
Trade	11,8
Tourism	14,1

Tourism is a sector with the most dynamic development which has been recording two-digit growth rates for several years already. The arrivals to Montenegro increased for some 16.6%. Increased international arrivals are particularly encouraging. Compared to the previous year the number of such visitors increased for some 44.6% and now they make up one third of the total arrivals. Despite the results achieved, there is still room for improvement in tourism sector. This is best proven by the difference in the total number of arrivals to Montenegro in 2005 which was 820,457

and in 2000 when it was 448,187, or an increase of 83%. In order to increase competitiveness in tourism, the Government passed the decision to reduce taxes in this sector, and thus as of 2006, tourism is subject to reduced VAT rate (down from 17.0% to 7.0%) which gave a strong impetus to further tourism development in Montenegro. Most of envisaged future activities relate to improving infrastructure, upgrading the accommodation facilities, extension of the season, increased share of other types of tourism, other than the sun & sand one, improved service quality, attracting renowned hotel chains, etc.

An extremely high economic activity growth rate was effectuated in construction industry (the number of effective work hours increased 18%) and forestry (production of wood assortments increased 14%), while in transport sector very diverse results have been achieved depending on the mode of transport considered. Negative growth rates were achieved in land transport and passenger railway transport, due to the train crash, while positive rates were achieved in railway transport of goods and in air transport. The results achieved in transport are greatly influenced by the actual condition of the transport infrastructure; nevertheless, a number of activities on the reconstruction of road and railway network have already been taken, as confirmed by the Transport Development Strategy.

1.2. Labor market

The growth of economic activity reflected positively on the labor market trends. The average number of employees in 2005 was 144,358 or 0.6% more than a year before. The average number of employees in the first six month of 2006 was 148,044 or 4% more than in the corresponding period in 2005. The number of employees in 2006 has been on a continuous increase, thus in June it was 152,088, being 4.7% more than at end-2005. The trends in the number of employees within individual years show a strong seasonal dimension. An increase in the summer months is usual because of tourism.

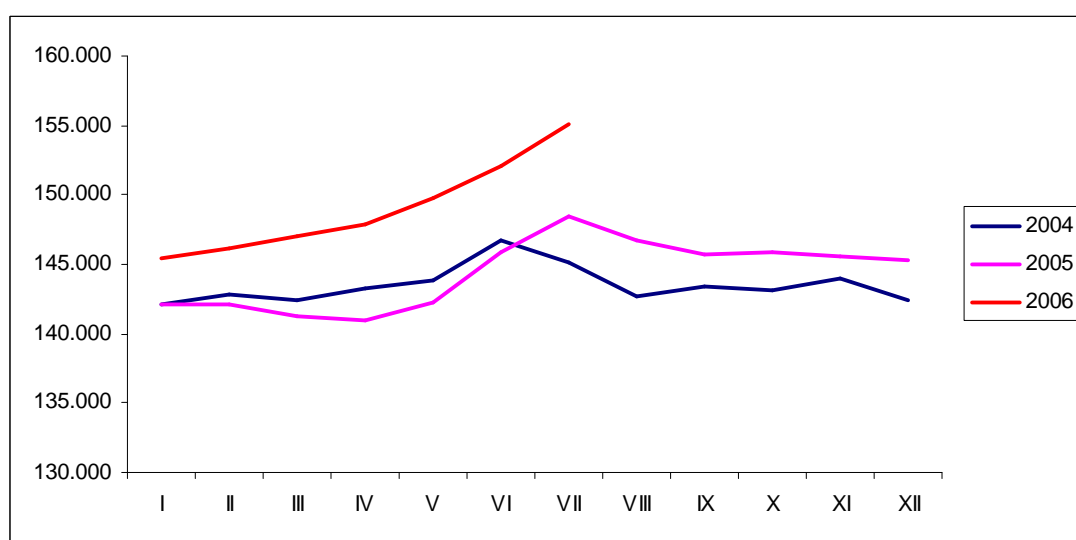


Figure 1 Number of employed persons in Montenegro, 2004 – July 2006

Source: Monstat

Increased economic activity and Government reforms in the field of labor market affect constant reduction of the number of registered unemployed persons in Montenegro.¹ The average number of unemployed people on the Employment Bureau's records was 54,457 in 2005 and 47,256 in the first six months of 2006; in December 2005 the number was 48,825, while at end-June 2006 it was 42,560. This is the lowest level in the last few years. Unemployment rate, seen as a ratio of the number of unemployed and active population was 32.8% in 2000, 30.4% in 2002, and in late 2005 18.4%, while in late June 2006 it was 16.1% with the tendency of further decrease. The unemployment rate among the young amounted at the same time to 20.3%.

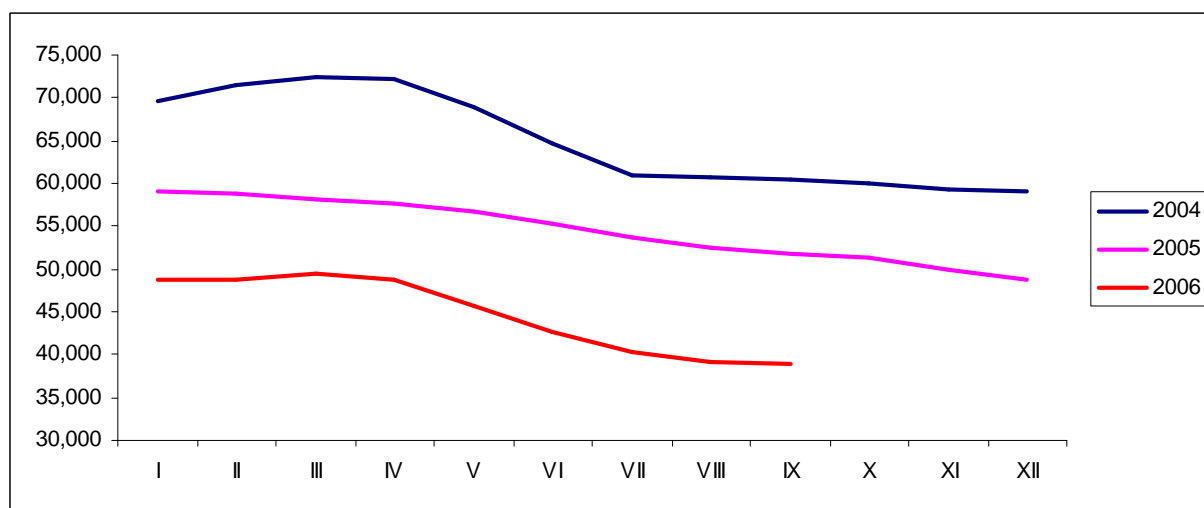


Figure 2 Number of unemployed persons in Montenegro, 2004 – September 2006

Source: Employment Bureau of Montenegro

The reduction of the unemployment rate is the result, inter alia, of a number of measures undertaken by the Government of Montenegro through the Program of Ongoing Incentives to Employment and Entrepreneurship (9,530 new jobs), the Program for Legalization of Existing and Generating New Jobs (1,500 new jobs), the Program for Employing Interns (6,277), the 'Opportunity for the Young' Program (525 interns employed) and the Program to Encourage Entrepreneurship and Employment (envisaged employment over 1700 people in SME)

One of the largest problems of the Montenegrin labor market is the structural inadequacy of the workforce to the labor market needs. To illustrate this, there is no demand for as many as 563 occupations enlisted with the Employment Bureau of Montenegro, while there are no registered persons for 331 occupations requested in

¹ Unemployment in Montenegro and trends referring to unemployment, at this point, may be monitored solely by official records of unemployed persons kept by the Employment Bureau of Montenegro, while best records of employed persons, used also by the Government of Montenegro, are obtained through the Methodology for determining the number of employed, which is based on the records of Health Fund. These are fiscally included employed persons. Currently, MONSTAT is preparing for monitoring unemployment and employment pursuant to ILO definitions. It has been envisaged to start applying the new methodology to monitor unemployment and employment as of October 2007, whereas in a certain transitional period we should have an analytical assessment of the quality of obtained data.

Potentially the biggest risk for price increase in the second half of 2006 might be the increase of oil price in the world market. Almost half of this year's inflation was caused by the increased oil prices, and the rest was caused by the increase in agricultural produce prices. For the first six months, somewhat higher growth rates compared to retail prices were achieved by the cost of living index (an increase of 2.3%) and manufacturer's prices index (an increase of 2.6%).

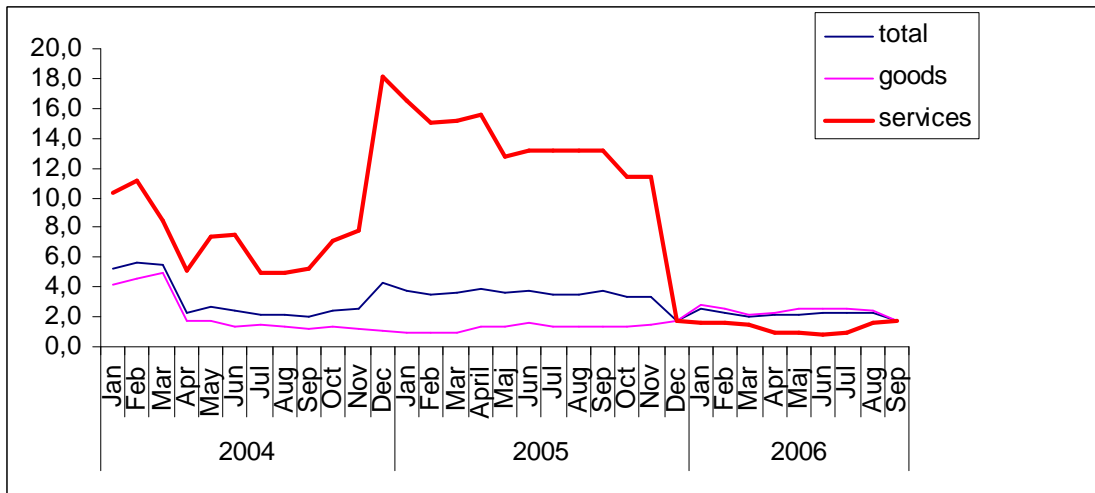


Figure 4 Inflation (annual increase rate); January 2004 – September 2006

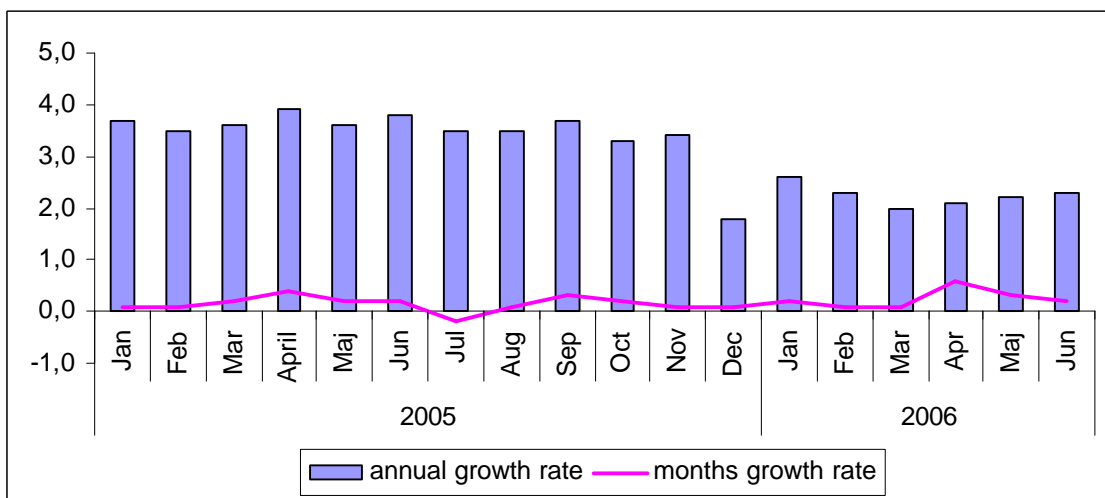


Figure 5 Retail prices; January 2005 – June 2006

Source: Monstat

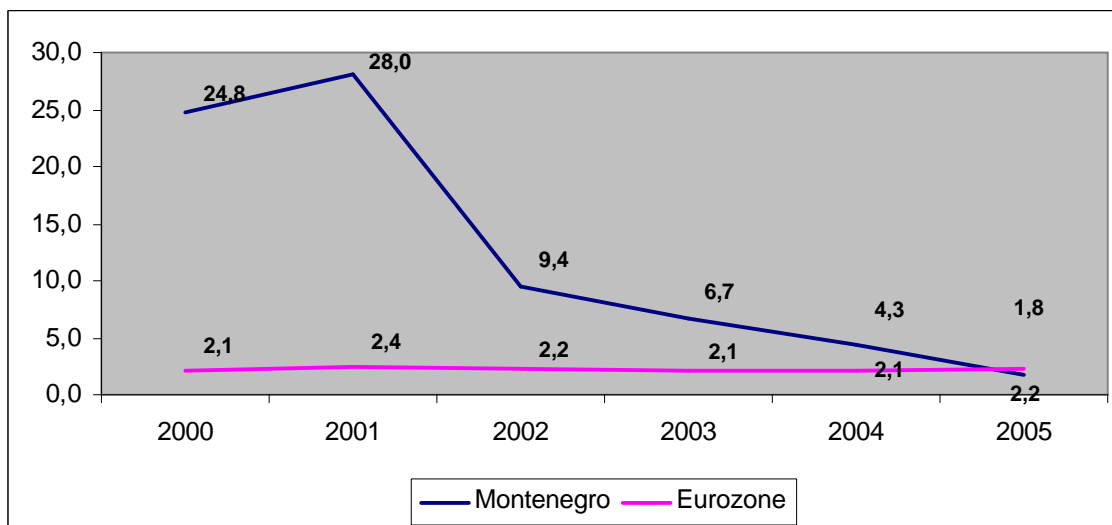


Figure 6 Average on year inflation rate

The stand of the Government of Montenegro is to enable free formation of prices of products and services and to maintain their stability with measures and instruments based on economic principles. In that sense the Law of cessation of the Law on social control of prices was adopted in 2006. The reasons for adopting this law were also because number of laws that regulated the free formation of prices were adopted in frame of regulatory bodies (the Law on energy, the Law on telecommunication, the Law on postal services, the Law on tourism, the Law on medicines), as well as the Law on protection of competition that give the basis for taking over the measures for combating the monopoly and unloyal game in the market.

1.4. Monetary policy

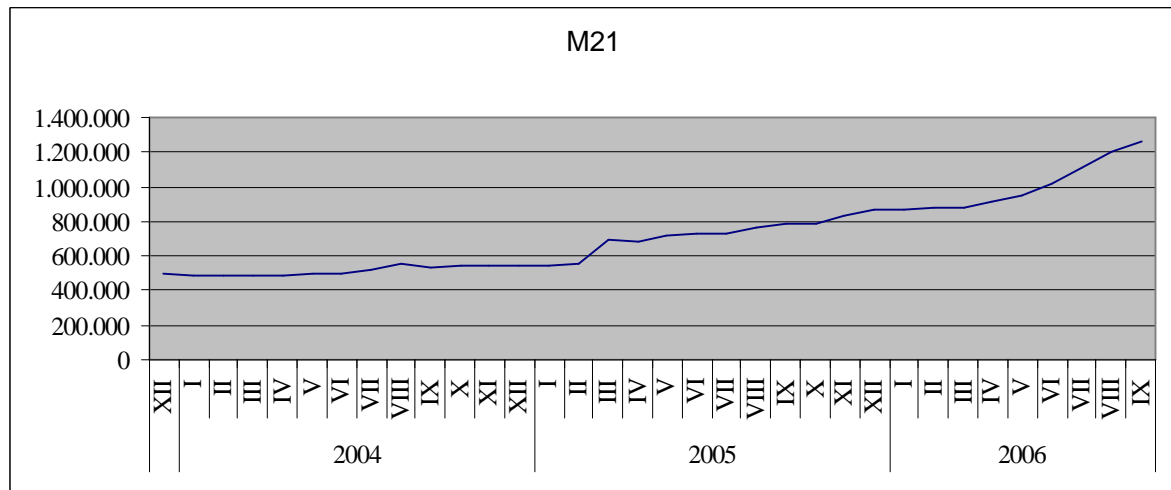
The framework of the monetary policies of the country is provided by the euroization that means that Montenegro uses a foreign currency as a legal tender. The only realistic instrument of monetary policies represents the policy of reserve requirements² whereas fiscal discipline and stability of banking system gain on its significance.

The money supply M21³ rose continuously during 2005, reaching the amount of EUR 865.1 million. In 2005, the M21 increased by 58.3%.⁴ The re-monetization process is

² In April 2006, a new Decision on Reserve Requirement for banks to be held with Central Bank of Montenegro has been adopted. The base for calculation of reserve requirement consist of demand deposits and time deposits with maturity of less than one year. Demand deposits of local banks – interest bearing and non-interest bearing and time deposits over year are not included in the calculation of reserve requirement.

³ Monetary base (M0) is comprised of banks` deposits with the CBM-Payment Operations (banks` giro accounts and allocated reserve requirements, excluding the part banks keep as treasury bills)

still in progress, therefore the increase in monetary aggregates represents a positive trend. The main reasons for their increase were the high growth in deposits by households and a notable inflow of privatization funds.⁵ At end-June 2006 broad money M21 further increased to EUR 1.012,5 million, which is an increase of 16.7% in comparison with end- 2005. In the structure of M21, narrow money M11 remained the main contributor, amounting to EUR 739.3 million or 73%, and time deposits accounted for the rest 27% of the money supply, i.e. EUR 273.1 million.⁶



Simultaneously, a substantial growth in the money supply M2 was recorded, 49.4%, but it did not affect price increases, which verify that the re-monetization process has not yet ended.

1.5. Fiscal developments

In the conditions of euroization stability of public finance and fiscal policy have an even greater importance than in the countries with their own currency and monetary policy. Balance in public finance is improving in recent period, state budget deficit of 2.77% of GDP in 2004 has turned into a surplus of 0.44% of GDP (estimate) in 2006. Consolidated public expenditures have increased in the period 2004 – 2006 from 42.62% to 43.32%. These data can be explained by the fact that in the area of public expenditures in past years there were expenditures which were not recorded through unified treasury system. However, public expenditures projections for next years show optimistic movements and its further decreasing on amount of 35% until 2011.

Increase in budgetary revenues in 2005 was higher than the increase in expenditures. Collection of original revenues in the budget of the Republic in eight months of the year 2006 was 13.8% higher than what was planned for that period. Collection of taxes is higher than planned by 17.8%. The highest increase as compared to the plan was experienced with the value added tax – 28.72%. In eight months of the year 2006, surplus in the budget was 19.6 mil. EUR. Instead of the planned borrowing in the amount of 21 mil. EUR, and due to the better collection of budgetary revenues, 19 million EUR of foreign and domestic debt was repaid. The expenditures have been 95% realized as compared to the plan. Repayment of unpaid obligations is 60% higher than planned, and transfers for social protection are 12.4% higher. As compared to the same period of last year, current revenues are 29.4% higher, out of which taxes are 29.4% higher. Revenues from customs duties are 72% higher than in the same period of last year. In the situation of macro-economic stability and safety of business undertakings, fiscal discipline has improved, and through the activities of the Tax administration, besides the regular collection tasks, there has been a high level of collection of the old tax obligations. In this way progress has been achieved in fighting grey economy, as well. There is also a positive tendency of reducing the level of indebtedness of the state on the basis of T-bills and bank loans.

Interest rates on T-bills are still falling in the second quarter of 2006, which results from the higher demand as compared to supply by 5.3 million EUR. Real interest rates achieved in the auctions in the second quarter of this year were negative or very low, not exceeding 1%. The reason for the fall in interest rates is, on one hand, the reduced supply of T-bills, and on the other hand the increasing credibility of the state. It is realistic to expect that the fall in interest rates on T-bills will affect the movement of bank interest rates in the same direction.

The estimated public debt of Montenegro, according to the data from the Ministry of Finance, at the end of 2005 was 700.4 million EUR, and its share in GDP is 41.4%. External public debt in the end of 2005 was 513.3 million EUR. Having in mind a successful implementation of the arrangement with the IMF during 2006 and the remaining part of the foreign debt towards the Paris club, Montenegro belongs to the group of countries with low indebtedness. Taking into consideration that Montenegro will be at the upper limit of low indebtedness, it would be necessary to take into

account all relevant facts in case of future borrowing. It would be especially dangerous to borrow in the form of loans that would be indexed to Swiss Franc and Yuan, as it is expected that these currencies will grow faster than Euro in the upcoming period. Also, having in mind the expected increase in interest rates, it would be useful if the loans taken had a fixed interest rate at the level of the currently prevailing interest rates.

1.6. External sector

In 2005, the current account deficit of the balance of payments was 9.1% of GDP. Increase in the current account deficit as compared to 2004 happened due to the increase in foreign trade deficit. The total value of exchange of goods in 2005 was 1.375 billion EUR, or 4% more than in 2004. Foreign trade deficit was 505.9 billion EUR (29,9% of GDP), and coverage of imports of goods with exports was 46,2%. The surplus achieved in sub-accounts of services, income and transfers has covered 72.2% of the foreign trade deficit in 2005. According to preliminary data, current account deficit for the first two quarters of 2006 amounted to EUR 283.4 billion, what is EUR 126.5 billion more than in the same period of 2005, mainly because of increasing of foreign trade deficit. Data for the first two quarters of 2006 are the following: (i) trade deficit was EUR 353.4 billion or 41.6% more than in the same period last year; (ii) surplus in services amounted to EUR 6.5 billion or EUR 14.4 billion less than in the same period of 2005. This is primarily due to sub-balance of construction services; (iii) the net balance of income amounted to EUR 9.3 billion; (iv) the net balance of transfers increased by EUR 11.1 billion in comparison with the same period of 2005 and amounted to EUR 54.2 billion. The reason for this is new methodology, which has moved some items of income to transfers.

Calculation of exchange of goods in 2006 is now the responsibility of Monstat, and common review of data regarding imports and exports of goods create a dilemma regarding the validity of the data, thus, the above-mentioned data cannot be taken with full certainty. Still, it is realistic to expect that in 2006, as compared to the previous year, the share of current account deficit of the balance of payments in GDP will be approximately 2 percentage points higher. There are several reasons that support this statement. First of all, there is an exceptionally high degree of civil works, which were undertaken by foreign construction companies in the country. Then, a very high influx of foreign direct investments affects the increase in imports, as the owners of the companies purchase the equipment necessary to modernize the companies, for interior design, raw materials to start the production process, etc. One should also take into consideration that the prices of oil derivatives are very high the world stock exchanges, and they are significantly higher than in the previous year.

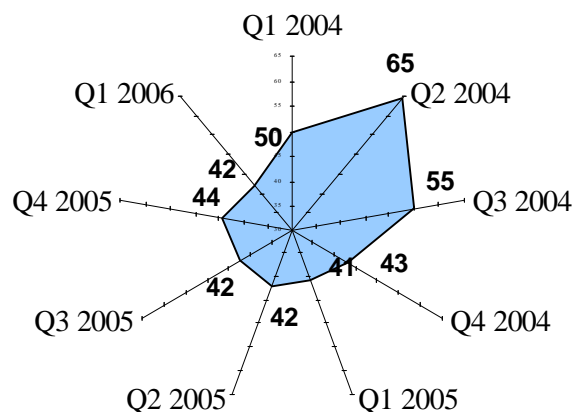


Figure 8 Import/export coverage, 2004 – Q1 2006, in %

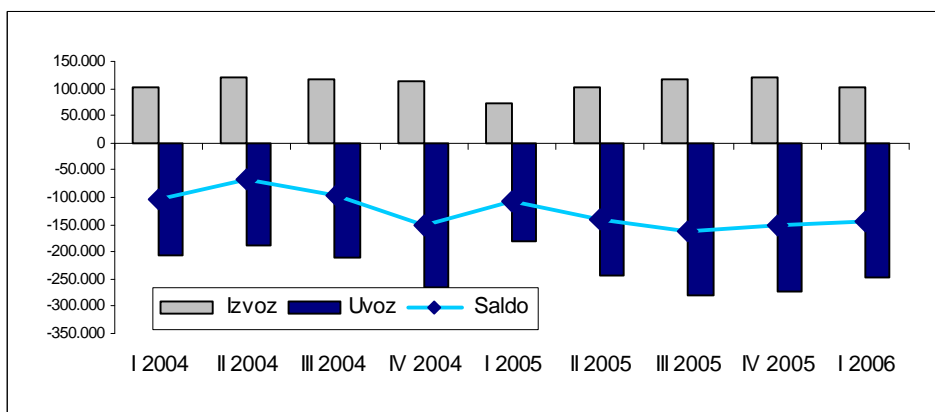


Figure 9 Quarterly import and export of goods in 2004 and 2005, in EUR thousand

The main reason for a high current account deficit of the balance of payments is low level of competitiveness of the Montenegrin economy, which is reflected in the fact that by far the highest part of the deficit occurs in only one sub-balance of the balance of payments, which is the balance of exchange of goods, while the surplus in all the other sub-balances is not sufficient to compensate for a very high deficit in the exchange of goods. Due to the inadequate record of the exchange of goods, it is not possible to draw certain conclusions regarding the structure of exchange of goods, but there is no doubt that it is unfavorable, because the export is dominated by the products with a low processing level, and in the imports the good for general use prevail. We should also be aware of the fact that increase in deficit in 2005 is largely the consequence of the factors that have no direct connection with the competitiveness of the Montenegrin economy: oil imports have increased to 25 million EUR, foreign assistance has fallen by 13 million EUR, and electricity imports have grown by 4.9 million EUR.

Having in mind all of the above, as well as the suggestions and proposals presented in the World Bank document (World Bank report No. 32623-YU »Republic of Montenegro: Economic Memorandum – A Policy Agenda for Growth and Competitiveness«, October 27, 2005) regarding the problem and reasons for low competitiveness of the Montenegrin economy, the Government of the Republic of Montenegro has initiated a set of activities to overcome the problems. Namely, Export Incentives Strategy has been created, on the basis of which the measures have been defined to stimulate exports, substitute imports, create a competitive export product, accept international standards and promote comparative advantages.

One of the most favorable data in the external sector of the Montenegrin economy is the data regarding the movement of foreign direct investments. The influx of foreign direct investments in 2005 has reached a record level of 383 million EUR, being above all expectations. The main reasons for FDI increase are as follows: attractive privatizations, macroeconomic stability, liberal economic regime, relatively cheap labor force, low profit tax rate, national treatment of foreign investors and others. After a very high increase in the influx of foreign direct investments in 2005 (5.5 times more than in 2004), it would be realistic to expect their significant reduction in 2006. However in the first nine months of 2006, the FDI influx was 273.4 million EUR. This is a very high level, having in mind that in this period there were no significant privatizations. This means that there is a higher amount of the so-called “Greenfield” investments, which are considered exceptionally important as a trigger of economic growth. Planned FDI amount for this year was 180 million EUR and it has been exceeded significantly already in the first nine months of this year. The outflow of foreign direct investments from Montenegro in the first nine months of 2006 was 50.3 million EUR, thus the net FDI inflow was 223.1 million EUR. This suggests that in the eyes of the foreign investors Montenegro is positioned as an attractive destination. By rule, positive effects of foreign direct investments do not appear in the year when the investments were made, but after a time distance ranging from one to two years. This means that in the upcoming years it can be expected that Montenegro will experience a dynamic economic growth, as a consequence of higher level of foreign investments in Montenegro.

Table 3 FDI inflows in Montenegro by sectors in 2001-2005, in EUR

	Production activities	Service activities	Financial organizations	Real estate sale	Total
2001	426,600	3,335,994	1,812,906	-	4,722,300
2002	3,504,037	70,941,851	3,674,952	-	78,120,840
2003	2,169,429	24,744,434	12,337,255	5,366,207	44,617,325
2004	2,984,789	49,357,869	2,456,073	14,318,377	69,117,107
2005	68,582,364	193,695,167	50,214,757	70,333,387	382,825,675
TOTAL	76,814,019	342,075,315	70,495,943	67,617,972	579,403,247

Source: Central Bank of Montenegro (CBCG), 2006

Total foreign debt of Montenegro in the end of 2005 was 30.3% of GDP, which is 1.1 percentage point lower than in the end of 2004. External debt participates with 73.3% in the structure of the public debt.

2. Macro-economic framework: Mid-term policies

In the previous period macroeconomic policy enabled the achievement of the macroeconomic stability and initiated economic growth. Basic goal of the economic policy in the upcoming period will be to speed up the economic activity and increase the living standard of the population. Macroeconomic framework, on the basis of which this scenario was created, starts from the results achieved in 2004 and 2005, as well as the views, opinions and forecasts of the experts of the international financial institutions (IFI), most often the IMF, expressed in their official documents.

It should also be mentioned that the statistics in Montenegro are still in the process of transition, and the estimates presented in this document that are based on the official indicators should be carefully used. The comprehensiveness and quality of certain statistical indicators is not at a satisfactory level and represents a limiting factor in making the forecasts and recommendations on how to manage the economic policy. These limitations relate especially to the national accounts statistics and the trade exchange statistics.

Real GDP growth in the period 2006-2008 is expected to be at the level of 5-6% annually. These expectations regarding the increase in the economic activity in the Republic are based on the high influx of foreign direct investments in the previous period and expectations that this trend will continue in the future. High level of investments is expected in the performance of civil works in tourism and improvement of the public infrastructure, thus, tourism and civil works stand out as the two sectors in which very dynamic growth rates will be achieved. Development of tourism is followed by the influence on the related economic sectors, such as transport, agriculture and food industry, which will continue to contribute to the achievement of the projected growth. Another element that supports the positive expectations regarding the increase in economic activity is the fact that the banking sector fully recovered its credibility and became one of the key actors in speeding up the economic activity in Montenegro. A significant progress is obvious in this field in recent years – which is reflected through a substantial increase in the private sector deposits, introduction of new international standards, as well as the progress in strengthening the risk-based oversight and monitoring of the observance of regulations. Credit activity of the banks becomes a factor that additionally boosts growth and development of the economy.

In the upcoming, mid-term period, it is expected that the growth of industrial production will be slower, due to the still low level of competitiveness of the Montenegrin products. Having in mind the future plans for privatization and restructuring of the remaining state owned companies in this sector, faster growth of the industrial production is expected only after the end of these processes.

In a small, highly open and euro-based economy, such as the Montenegrin one, high level of flexibility in the labor market is extremely important. In the current circumstances it is not possible to use the foreign exchange policy as an instrument for the adjustment to the potential shocks, so the alternative that remains is a high level of flexibility in the labor market. Labor market in Montenegro is still not flexible (low price elasticity and labor force mobility), thus, according to the forecasted faster

growth of the economic activity and high influx of foreign direct investments, in the upcoming period it is expected that there will be a mild increase in employment, as well as flexibility. Improvement of statistical data related to the labor market will provide for a more complete monitoring of employment, hidden employment, seasonal and temporary employment, as well as productivity.

Price stability achieved in the previous period is expected to continue in the upcoming three-year period, as well. The level of retail prices⁷ is expected to remain at the level of approximately 3%. Increase in electricity prices, oil prices in the world market and possible influence of the monopolies in the domestic market all represent the potential risks for the price stability in Montenegro.

Expectations in the field of trade account deficit continue in the future period. The negative foreign trade exchange balance will continue to be guided by the demand created by the foreign direct investments and increase in the economic activity in the country. Positive tendencies in the sub-balance of services represent the way to finance this deficit and thus, reduce the potential risk and problems that could possibly occur.

The road to achieve these forecasts is further creation of the favorable and encouraging business environment, which will enable the development in accordance with the concept of sustainable growth.

2. 1. Methodological remarks related to the preparation of the table “Growth and associated factors”

Projections of the basic growth indicators and related factors have been based on the assessments prepared by the IMF, in accordance with the Cooperation Agreement - Article 4 consultations, and under the assumption that the initiated reforms will continue. These assessments have been corrected only in the part related to the movement of the exports and imports growth rates, because in the meantime the final data regarding the exports and imports in 2005 have been published, while the IMF used for its projections the preliminary data. The overall assessment is based on the prospects for economic activity presented by the Standard & Poor's agency in the second review of the credit rating.

Basic preconditions for the preparation of the GDP growth forecast in the respective period are based on the consumption method in calculating GDP, according to which GDP is calculated as a difference between the domestic demand and net exports. GDP structure was calculated on the basis of the current prices (GDP deflator not available).

Net exports are calculated on the basis of the estimated annual export and import growth rates in the given period. Growth rates of these variables, which the IMF

⁷ Although in the previous period the inflation indicator used was the retail price index, as of next year the Central Bank of Montenegro will use the movement of the cost of living index as the inflation indicator. In this way, a better possibility to compare the data with the inflation rate in EMU will be created, as EMU uses the harmonized consumer price index, which represents one type of cost of living index. The conditions have been created to start using this concept, as in the beginning of this year Monstat reviewed the weight for the calculation of consumer basket.

projected on the basis of the preliminary data regarding exports and imports in 2005, have been reduced in the preparation of the Economic and fiscal program for the Republic of Montenegro, because the final values of these variables have been somewhat higher than the preliminary data. Increase in exports is projected on the basis of the planned increase in the prices of aluminum and organic food, i.e. on the basis of re-exports, as well as the increase in revenues from tourism and transport. It is expected that exports growth in the period 2006 - 2008 shall be at the average rate of 14.67% (from 14.20% to 15.00%). It is expected that the growth of imports will be supported by the increase in final demand, oil price increase in the international market and change in the exchange rate of the basic exchange currencies. It is expected that imports growth in the period 2006 - 2008 shall be at the average rate of 14,27% (from 14,00% to 14,50%).

Domestic demand consists of the personal and public consumption, reserve and investments. Personal consumption at the annual level is forecasted on the basis of the estimated growth in employment, as well as the estimated growth in the average net salaries per employee. It is expected that employment will grow at the rate of 4.33%, while the average net salary will grow at the average rate of 11.91%. Growth in both of these values is expected on the basis of improvements in the business climate in the Republic, planned continuation of tax burden reductions, and improved credit rating of Montenegro. These positive trends should stimulate the growth in domestic and influx of foreign investments, and thus, the growth of the overall economic activity. It is expected that the projected growth in salaries will be affected less by the forecasted inflation rate growth, and more by the increase in revenues of the Montenegrin economy.

In order to assess the public expenditure levels in Montenegro, the IMF estimates regarding the increase in budgetary revenues, that is, regarding the share of fiscal deficit in GDP have been used (public expenditures have been calculated as a derived value), which the IMF prepared in cooperation with the Ministry of Finance.

To assess the value of reserves in the period 2006 – 2008, the value of reserves calculated at the level of the Republic taken from the financial reports of the Montenegrin companies for 2004 and 2005 has been used. Reserves growth rates for the upcoming years have been calculated on the basis of the reserves growth rate in this period. It is expected that there will be a moderate increase in reserves by approximately 4.6% annually, in accordance with the increase in economic activity in the Republic, as well as a relative reduction of their share in GDP (from 1.31% to 0.92%). A more significant increase in reserves should be compensated by the introduction of modern techniques of reserve management.

IMF projections have been used to assess the investments growth rate (gross fixed capital formation). According to that assessment, the investments will grow by 12.48% on average.

GDP values for the period 2006-2008 were calculated on the basis of the projected growth rates of the above-mentioned variables.

Domestic consumption will contribute to the GDP growth, as the reserves will gradually be reduced, and the nominal growth of consumption and GDP growth will

have foreign trade deficit increase as a residual item, which includes goods and services (external balance of goods and services).

Table 4 Growth and associated factors

	2004	2005*	2006**	2007***	2008***	2009***
GDP level at current prices (mill. of euro)	1565	1690	1829	2004	2184	2334
CPI change (annual average)		1,8%	2.1%	3,4%	3,0%	3,0%
Employment growth		0,6	4,0****	4,5	4,5	4,0
Investment ratio (% of GDP)		23.7	24.6	25.2	26.1	27.2
	Working table					
Gross fixed capital formation	350.3	400.5	449.9	505.0	570.0	634.8
Fiscal balance as a % of GDP	-2.77	-2.44	-0.11	0.10	0.76	0.37
Fiscal balance in mil. euro	-43.4	-41.2	-2.1	2.1	16.6	8.7
Budget revenues	655.29	724.2	823.2	899.1	943.0	965.4
Government consumption expenditures	-698.7	-765.35	-825.3	-897.0	-926.4	-956.7
Government consumption expenditures as a % of GDP	-44.6	-43.6	-43.3	-42.8	-40.6	-38.7
Export of goods and services	701.6	790.4	913.9	1,086.1	1,253.6	1,427.9
Import of goods and services	969.9	1108.5	1,276.0	1,449.0	1,651.2	1,938.0
External balance of goods and services	-268.3	-318.1	-348.9	-399.8	-455.2	-496.0
Final domestic demand	1833.3	2008.1	2,177.9	2,403.8	2,639.2	2,830.0
Private consumption expenditures + inventories	802.3	897.8	961.6	1,097.2	1,210.8	1,296.6
Private consumption	372.3	421.8	461.6	572.2	665.8	731.6
Inventories	430	476	500	525	545	565
Changes in inventories as a % of GDP		2.7	1.3	1.2	0.9	0.9
	Percentage change at current prices					
Private consumption expenditures		13.3	9.4	24.0	16.4	9.9
Government consumption expenditures		4.3	8.0	4.6	7.1	4.7
Gross fixed capital formation		14.4	12.3	12.2	12.9	11.4
Changes in inventories as a % of GDP		2.7	1.3	1.2	0.9	0.9
Export of goods and services		12.7	15.6	18.8	15.4	13.9
Import of goods and services		14.3	15.1	13.6	14.0	17.4
	Contribution to GDP growth					
Final domestic demand		174.8	169.8	226.0	235.3	190.8
Of which changes in inventories		46	24	25	20	20
External balance of goods and services		-49.8	-30.8	-51.0	-55.3	-40.8

* Official data; ** Estimate *** Projections **** Percentage change August 2006/December 2005

2.2 Population

The change of the number of inhabitants is affected primarily by the mortality and fertility rates, as well as their difference and the rate of migrations of the population. A positive fertility rate increases the number of inhabitants and vice versa – negative fertility rate reduces the number of inhabitants. A positive migration balance (higher number of persons who moved in) increases the number of inhabitants, and the negative migration balance (higher number of persons who moved away) reduces the number of inhabitants.

If we start from the above-mentioned theoretical assumptions, we face the realistic situation, and that situation can be described by the following:

Number of inhabitants as a starting point may be presented in two ways:

Number of inhabitants defined on the basis of the population estimates. Population estimates have been made on the basis of the census results in 2003, the annual fertility rate and migrations balance. Thus, in 2005, Montenegro had 622,978 inhabitants, but without the displaced persons from Kosovo and Metohija.

Number of inhabitants from the 2003 Census, increased for the annual fertility rate and migrations balance and increased for the number of displaced persons from Kosovo and Metohija, thus, it is equal to $622,978 + 13,840 = 636,818$, and in the opinion of Monstat, this is a more realistic approach to calculating the factual number of inhabitants present in the country. Although the official data regarding Montenegrin population, according to the 2003 census, is 620,145, it is recommended to use this number increased for the number of displaced persons from Kosovo and Metohija, which was also defined in the 2003 census, and is equal to 636,818. This is supported by the fact that the above-mentioned displaced persons can be considered refugees from the moment of proclamation of the Montenegrin independence, and according to the international standards refugees are considered part of the total population of a country. It is recommended to use the number of inhabitants with the displaced persons from Kosovo and Metohija included, because they already represent domicile population, employed, consuming electricity, working and factually living in Montenegro.

Having in mind that Montenegro will experience the period of stable political and economic situation in the future, it is considered that the departure of inhabitants will be reduced to a minimum, if not totally stopped.

The estimate is that the migration balance will be close to zero, thus, it is recommended to use the estimates without migrations.

Table 5 Expected population without migrations (Variable population growth/fertility rate)

	2005	2006	2007	2008
Without displaced persons	622978	624743	626097	627036
With displaced persons	636818	638622	640006	640966

Population in the working age group (it includes the population between 15 and 64 years of age) in the 2003 census participated with 66.5% in the total population in the country.

On the basis of the estimated number of inhabitants each year and the relative share of the working age population in the total population in 2003, the estimates were prepared for 2005, 2006, 2007 and 2008.

Table 6 Labor market developments

Percentages unless otherwise indicated	2005	2006	2007	2008
1. Population (thousands) with refugees	623	625	626	627
without refugees	637	639	640	641
2. Population (growth rate in %)	0,3	0,3	0,3	0,1
3. Working-age population (thousands)*	423	424	425	426
4. Participation rate *	66,4	66,3	66,4	66,5
5. Employment level (thousands) *	144,4			
6. Employment (growth rate in %)	0,6			
7. Public sector employment (thousands)	32,98 ⁹			
8. Public sector employm. (growth rate in %)				
9. Unemployment rate (ILO definition)	18,4			
10. Average real wage (growth rate in %)	7,8			
* 15 to 64 years				

2. 3. External sector projections for the period 2006 – 2008

The external sector projection is based on forecasted growth of the GDP components in the period 2006 – 2008¹⁰, which was calculated on the basis of the consumption method (Table 1, Growth and associated factors). Besides, to calculate the value of exports and imports in that period we have used the IMF assessments, which have been corrected for the above mentioned reasons. The foreign direct investment projections are based on the planned privatizations in 2006 and 2007. It is expected in 2008, after the privatization is completed, Montenegro will become an attractive country, especially for green-field investments.

Projections are structured as shown in the table below

1. Current account balance as a percentage of GDP

On the basis of the expected growth in the segments of final consumption, i.e. GDP growth, as well as the expected growth rates of the foreign trade balance and other segments of GOP, it is estimated that the share of the current account balance in GDP will also grow from 9.2% in 2006 to 9.4% in 2008. This projection is based on the expected growth of the economic activity that will have to be supported by the

⁹ This data does not contain number of employees in Fund for pension and disability insurance

¹⁰ On the basis of the later GDP projection for 2004, prepared by Monstat, the new GDP estimates for the period 2005-2008 have been calculated, using the growth rates of this indicator projected in the Economic Reforms Agenda for the period 2002. – 2007. GDP estimate for 2008 was created by the use of real GDP growth rate of 6% as compared to the GDP projection for 2007.

increased imports (due to the still high import dependency of Montenegro, that is, insufficient domestic consumption). Despite the expected growth of exports, it can be said that the foreign trade deficit will still be more under the influence of the increase in imports, than under the influence of the increase in exports.

2. Export of goods

Final data on exports and imports for 2005, published by Monstat, have been used for the projections. Based on this data for 2005, it is expected that exports growth in the period 2006 - 2008 shall be at the average rate of 14.67%. Somewhat higher growth is expected in 2006 (15.00%), with the slower paces following in the next two years (14.20% and 14.80% in 2007 and 2008, respectively).

The anticipated increase in exports was primarily based on the forecasted increase in the prices of aluminum in the respected years, led mainly by demand from China and other Asian growing economies. (aluminum prices affect the growth in the value of both exports and imports, as the raw materials for the production of aluminum products of a higher level of processing is imported). Another expected important source of growth is visible re-export because China has transferred its exports to Balkans and South East Europe from port Kopar (due to Slovenia's joining the EU) to port Bar. Additionally, the Serbian company Sartid and some other relevant importers and exporters from Serbia have announced that they plan to transport their exports/imports goods over port Bar. It is also expected that Montenegro will be closer to the EU with regard to its meeting the production quality standards in the following years, which will create the conditions for an increase in the export of ecological products (primarily food), i.e. organic food.

3. Import of goods

The projection of visible imports started from the assumed average growth of final consumption in Montenegro, global movements of prices, and the exchange rates of the main currencies of trade

An annual GDP growth of 5.7%, on average, for the following period will be led primarily by increases in those sectors where the privatization process has been completed. The highest growths are expected in tourism and civil engineering. Investments in modernizing privatized companies will induce an increase in the import of goods not produced in Montenegro (hotel equipment, construction material). Substantial capital investments in the public sector are also planned in the projection period, primarily in roads, and they should support the development of transportation and tourism, also causing increased imports.

Another source of imports increase will be the purchasing of household equipment and luxury goods (cars). Namely, privatization revenues to be received by households will lead to an increase in their demand for luxury goods and those for apartment equipping. Additional sources of increased demand by households will be income generated in the capital market (private individuals are getting more and more involved in trading at Montenegro's stock exchanges) and loans received from Montenegrin banks (supported by an increase in domestic deposits and loans granted to domestic banks by international banks). Besides, growth of this part of demand is also expected because of the FDI growth, especially in the field of real estate – sale of land in the attractive locations for tourism.

Increases in global prices will affect an increase in prices in Montenegro, primarily through oil price rises that are also expected in the observed period. After the upsurge in the price of oil in 2006 in comparison with 2005 (of which one share, when observed in the EUR, referred to the change in the EUR/USD exchange rate), it is expected that oil price rises in 2007 and 2008 will be around 7.5%, on average. Based on growth in economic activity, the projected oil price increase, and the anticipated USD/EUR exchange rate movement, it is expected that the value of oil imports will rise from EUR 146 million in 2005 to EUR 160.0 million in 2006, and that in 2007 and 2008 will be EUR 190 million and EUR 220 million, respectively.

4. Trade balance

The movements of imports and exports served as the basis to estimate the trade deficit increases, the average rate being 13.91%; somewhat higher rate in 2006 (14.05%), and more moderate in the next two years (13.82% and 13.85%, respectively).

5. Export of services

An increase in the export of services is expected to be primarily induced by an increase in income from tourism and transport. Substantial foreign investments in tourism for remodeling and modernizing tourist capacities are expected to result in an increased number of tourists and better quality of tourist services. The creation of these prerequisites will have an effect on an increase in income, primarily from foreign tourists. Growth in tourism, and that in the re-export activities, will affect an increase in transport revenues. The forecasted strengthening of the USD, i.e. the EUR depreciation, is expected to support a growth in tourist demand in tourist-emitting countries. Therefore, it is expected that an increase in income from services will be at the average annual rate of 12.93%.

6. Import of services

It is estimated that expenditure for services will grow at relatively high rates, a bit lower than those in the export of services, an average annual rate being 8.49%. Such a high projected rate is due to an increase in expenditure for software licensing, and transportation and tourism expenditure (due to the growing number of business and tourist trips from Montenegro to other countries).

7. Balance of services

Due to the higher nominal growth in income from services than that in service expenditure, it is estimated that the balance of services will be positive, growing at the average annual rate of 15.89%; somewhat higher being in 2006 (21.17%), followed by more moderate increases in the next two years (12.66% and 13.86%, respectively).

8. Net interest payment towards other countries

Taking into account the existing levels of the public debt and net interest payments to other countries in 2005, it is estimated that in 2006 and the next two years this item will be –EUR 24 million, that is, -EUR 20.4 million and –EUR 19.6 million. This reduction is based primarily on the assumption that there will be a lower amount of new loans (it is expected that the influx of foreign investments, growth in economic activity – broadening of the tax base and related increase of domestic revenues in the budget, as well as the involvement of the private sector in projects and business activities of a public interest, financing of public projects through concessions). Even if the projections on the increase of interest rates at the international financial markets

becomes true, the reduced level of new loans taken abroad, as well as the influence of the expected improvement of Montenegro's credit rating in the future, will mitigate the effects of the increase in the interest rates in the market.

9. Other factor income, net

The main share in the estimated growth in other net factor income is expected to be that of compensations to employees, primarily seafarers. This amount has been increasing over the years as the result of GDP growth and the global inflation rate increase, as well as the USD/EUR exchange rate.

10. Net current transfers

It is estimated that the current transfers to Montenegro from abroad will continue to fall due to the economic strengthening of the country. In that sense it is expected that by the end of 2008 they will be reduced to the level of 50 million EUR.

11. EU share in current transfers

EU share on the revenue side of the current transfers is EUR 4.6 million, and that on the expenditure side is EUR 8.1 million, resulting in the net amount of –EUR 4.6 million. Most of the income from the EU Montenegro receives for assistance programs, whereas expenditures refer mainly to remunerations to foreign experts. Although further increase in these expenditures is expected, due to the EU accession process, other forms of assistance from the EU will also increase, which will lead to the balancing of these two values. At the same time, a fall in assistance provided by other countries is also expected, affecting a fall in total net current transfers.

12. Current account balance

The current account balance is the result of the balances in trade, services, income, and current transfers. It is estimated that it will remain negative in the forecasted period, but with a tendency towards a decline.

13. Foreign direct investments

As it has already been said, a high level of FDI is expected in both 2006 and 2007, primarily due to the ongoing privatization process. It is anticipated that the interest in investing in Montenegro will continue to grow even after the completion of privatization, primarily investments in tourism.

14. Foreign exchange reserves

Montenegro, being a euroized economy, does not have the same concept of establishing foreign exchange reserves, i.e. the Central Bank's assets held abroad. The balance of net foreign assets of the Central Bank at end-2005 served as the basis for the projections for the period 2006-2008. The main assumptions for an increase in these reserves are based on the state budget privatization revenues, as well as on the planned transfer of the budget deposits from commercial banks to the account with the Central Bank. Therefore, it may be expected that Central Bank's net foreign assets will increase.

22. Domestic private savings

Considering the previous increase in savings by the population, based on the re-established trust in the banking sector, and lead by the increase in revenues of the population from privatization, it is estimated that the savings of the population will

grow at the average annual rate of 16.86%, a bit more intensive in 2006 (22.16%), and at the rates of 18.60% and 9.80% in 2007 and 2008 respectively.

Table 7 Eksternal sector development

Euro mill. unless otherwise indicated	2005	2006	2007	2008	2009
GDP	1690	1829	2004	2184	2334
GDP nominal rates		0.0822	0.0957	0.0898	0.0687
1. Current account balance (% GDP)	9.1	9.2	9.5	9.4	
2. Export of goods	460.6	529.7	604.9	694.4	779.85
3. Import of goods	974.3	1,115.6	1,271.8	1,453.6	1,617.87
4. Trade balance	- 513.7	- 585.9	- 666.8	- 759.2	- 845.0
Trade balance in GDP	-0.304	-0.320	-0.333	-0.348	-0.362
5. Export of services	329.8	375.0	421.0	475.0	530
6. Import of services	134.2	138.0	154.0	171.0	188
7. Service balance	195.6	237.0	267.0	304.0	342.0
Export of goods and services	790.4	904.7	1,025.9	1,169.4	1,309.8
Import of goods and services	1,108.5	1,253.6	1,425.8	1,624.6	1,805.9
Balance of goods and services	- 318.1	- 348.9	- 399.8	- 455.2	- 496.0
8. Net interest payments from abroad	-23.5	- 24.0	- 20.4	- 19.6	
9. Other net factor income from abroad	41.0	44.0	46.0	49.0	
10. Current transfers- net	57,0	55,0	53,0	50,0	
11. <i>Of which</i> from EU					
12. Current account balance	- 154.0	- 168.3	- 191.1	- 205.6	
13. Foreign direct investment	392.7	300.0	250.0	250.0	
14. Foreign reserves					
15. Foreign debt					
16. <i>Of which: public</i>					
17. <i>O/w: foreign currency denominated</i>					
18. <i>O/w: repayments due</i>					
19. Exchange rate vis-à-vis EUR					
(end-year)					
20. Exchange rate vis-à-vis EUR					
(annual average)					
21. Net foreign saving					
(lines 21-25: percentages of GDP)					
22. Domestic private saving	176	215	255	280	
23. Domestic private investment					
24. Domestic public saving					
25. Domestic public investment					

3. Public finance

Public expenditure estimates in the Republic of Montenegro for the years 2006 and 2007 have been made on the basis of the estimated data on GDP movement, as well as the data regarding the public expenditure trends in the period 2001-2006. Public expenditure policy in 2006 and 2007 is based on the assessment of the fiscal potential of Montenegro and the macro-economic trends defined in the Economic Reforms Agenda for Montenegro. In accordance with the goals of the economic policy and the goals defined the Economic Reforms Agenda, it is forecasted that the Budget will be balanced in 2007. Besides, the basic fiscal policy parameters are harmonized with the frameworks and goals agreed with the IMF and the World Bank, and their harmonization with the EU Directives was also secured.

Average level of public expenditures in the Euro-zone was 47.5% in 2005 (in Belgium 50,1%, the Czech Republic 43,7%, Denmark 53,1%, Greece 46,2%, Hungary 50,7%, Cyprus 44,7 % etc.)

Table 8 Macroeconomic Framework in % of GDP

Macroeconomic Framework (% GDP)	2005	2006	2007	2008	2009
Consolidated Public Expenditures	43.60	43.32	43.08	40.82	38.86
Deficit/ Surplus	-2.44	0.44	0.1	0.76	0.37
Deficit/ Surplus without Project Loans	-1.13	1.10	0.56	1.31	0.92
Primary Deficit/ Surplus	-1.16	1.66	1.11	1.71	1.28

Macroeconomic indicator estimates for the period 2007-2009 show an increase in real GDP, a stable and low level of inflation, as well as the reduction in the overall public debt. The estimates have been harmonized with the IMF estimates, and are consistent with the Economic Reforms Agenda for Montenegro. Economic reforms in the period 2007-2009 should be directed towards the reduction of the overall debt, reduction of the tax burden on the citizens and the economy, increase in GDP and in employment, as well as a flexible economy lead by a strong private sector.

Estimates for the mid-term macroeconomic framework show that if the reforms do not continue, positive trends will turn into stagnant situation or reduction: lower growth of the real GDP, higher level of inflation, stagnation and increase in the overall public debt and reduction in the exports rate. The reforms involve reform of the tax system through the reduction of tax rates, which will make the overall economic environment more attractive for foreign investments and private entrepreneurship (e.g. reduction in personal income tax rate and setting the upper limit for the local communal fees).

The continuation of reforms requires also the reduction in the number of employees in the public sector, with a parallel increase of the overall employment at the level of the national economy, and what is very important – reduction in the overall level of the public debt, which will reduce the fiscal burden for the state and improve the credit rating. Another important factor for the continuation of reforms is a restrictive budgetary policy and further reduction of the share of public expenditures in GDP.

Recommendations of the relevant international financial institutions (IMF, World Bank, etc) are directed towards insisting on the further reduction of the share of public expenditures and public debt in GDP. In recent years Montenegro respected these recommendations in their major part, and that can be seen from the relevant macroeconomic indicators. Economic reforms in the period 2007-2009 should be aimed at reducing the overall debt, reducing the tax burden on the citizens and the economy, increasing GDP and employment, and establishment of a flexible economy lead by a strong private sector.

3.1 Fiscal architecture and governance

The structure of public finance in Montenegro consists of the following:

- Budget of the Government of the Republic of Montenegro
- Fund for pension and disability insurance of the Republic
- Fund for health insurance of the Republic
- Employment Agency of Montenegro
- Fund for reparations/ compensations
- Development Fund of the Republic of Montenegro
- Local self-governments budgets (city of Podgorica and 20 municipalities)

Budgets of the Government of Montenegro and the above-mentioned funds are defined at the central level. Sources of finance of the funds are as follows: own sources (revenues from contributions, fees and revenues from privatization), transfers from the Budget of the Republic and loans.

Local self-governments are financed from the following: own sources (local taxes, fees and charges), delegated revenues from the republican budget (10% of the personal income tax, 50% of the real estate sales tax and 30% of the concession charges), Equalization fund, borrowings and loans and revenues from privatization.

Financial settlement, that is, equalization in municipal financing is done through the Equalization fund. Assets of the Equalization fund are secured from the revenues from personal income tax in the amount of 10% of those revenues. Assets are allocated to the special account of the Equalization fund. Assets of the Equalization fund are used in the form of equalization and incentive subsidies in the proportion 90% / 10%.

The right to use the assets of the Equalization fund on the basis of equalization subsidies is granted to every municipality in which the revenues from personal income tax, VAT and profit tax per capita is below the average revenues from the same sources per capita for all municipalities. The right to use incentive subsidies is granted to a municipality which achieves increase in revenues from own sources in the current year as compared to the previous fiscal year.

A municipality may borrow by issuing securities or taking loans, and it cannot borrow abroad, except on the basis of the law. It may take long-term loans only in order to finance capital investment expenditures or in order to purchase capital assets in accordance with the approved multi-year investment plan.

Budgets of the extra-budgetary funds are agreed with the Ministry of Finance and are submitted for insight to the Parliament of the Republic of Montenegro, with the proposal of the Law on Budget of the state. Budgets of the local self-governments are sent for insight to the Ministry of Finance. Extra-budgetary funds and local self-governments must report to the Ministry of Finance about the execution of their budgets, in accordance with the law.

In 2001, the “organic” Budget Law was adopted, which regulates the public finance management in a more qualitative manner. Consumption of any amount of funds or their use in the way different from what is planned in the adopted annual Budget Law for the respective year is prohibited, and the use of funds above the permitted level is considered a criminal offense.

Budget planning of the state is based on the projections of economic development, macroeconomic stability, economic policy, laws and other regulations.

- In June, the Ministry of Finance prepared and submitted to the Government a Report on the implementation of macroeconomic and fiscal policy for the current year and proposed goals and guidelines of the fiscal policy, on the basis of which it planned the main categories of incomes and expenditures, with the estimates for the three upcoming fiscal years.
- In July, the Ministry of Finance, on the basis of the Government decision regarding the goals and guidelines of fiscal policy, issued an expert manual for the preparation of the budget in the consumption units for the upcoming fiscal year. On the basis of the estimated revenues and submitted requests for allocation of budgetary assets, the Draft Budget Law of the state is prepared.
- In October, the Ministry of Finance submitted to the Government a prepared Draft Budget Law of the state.
- In November, the Ministry of Finance prepared the Proposal of the Budget Law of the state, which is approved by the Government and in November it was sent to the Parliament. The overview of planned revenues and expenditures for the following three fiscal years is submitted together with the Budget Law.

Assets of the Republican Pension and Disability Insurance Fund, Republican Health Insurance Fund and Employment Agency, as well as the funds of the municipalities are subject to the parallel control by their authorized bodies. The Ministry of Finance performs internal audit of the consumption units, extra-budgetary funds and municipalities and prescribes the manner and procedure of performing the internal audit.

According to the organic Budget Law, extra-budgetary funds may take short-term loans, and local self-governments can take long-term and short-term loans, with the consent of the Government. The Government has an unlimited authority to pay out the funds related to guarantees, payment of interest and principal, thus providing additional security to the creditors that the debt will be repaid in accordance with the defined conditions.

The Budget of the Republic of Montenegro contains the current and capital budget, defines the establishment and maintenance of the Consolidated Treasury Account, through which all payments are made, defines the use of budgetary surplus and sources of finance of the budgetary deficit, etc. It is also projected that the budget planning of the state will be based on the projections of economic development, macroeconomic stability, economic policy, laws and other regulations.

The Minister of Finance is responsible for the execution of the budget, and the budget executor is responsible for the lawful use of funds in the consumption units. Besides, the principles are prescribed for redirecting the funds planned in the budget up to the amount of 5%, manner of use of funds from the current and permanent reserves, etc.

The Ministry of Finance is preparing the Draft Law on the final statement of the state budget and will submit it to the Government. In all that, the final statement contains the Report of the State Audit Institution regarding the final statement, opening and closing position of the Consolidated treasury account, an overview of the executed deviations from the planned amounts, report on the loans taken, report on the expenditure of the budgetary reserves and report on guarantees.

The Ministry of Finance has implemented significant reforms in previous years, with good results, which include the new tax regime, the new law on public procurement, the new system for cost management and the new budget law. In the upcoming years it is necessary to fully implement the new tax regime, to institutionalize the Public Procurement Law and to finalize the activities related to the establishment of the treasury system.

An organizational unit for internal audit has been established in the Ministry of Finance, which should influence the improvement in responsibility and in the efficiency in the management of the state funds. The system for efficient planning and management of the state debt is of a key importance for the achievement of fiscal balance.

3.2 The Medium-term fiscal framework

According to the mid-term framework of public expenditures, it is planned that the level of public expenditures will be reduced to 38,8 % of GDP in 2009, with the tendency of reducing this amount to 35% by the end of 2011, which is a significant reduction in public expenditures. The reduction of the relative share of state expenditures in GDP will mostly be achieved through the increase in real GDP. In nominal terms, there will be an increase in public expenditures on the basis of the need to finance social, capital, health, educational and administrative expenditures, but economic growth will lead to reducing the share of public expenditures in GDP in relative terms. By segments, it is planned to reduce the percentage participation of wages in GDP, to initiate the reform of the pension system, to continue with the reform of state administration system, to restructure and sell the companies with majority state ownership.

The main goals of fiscal policy in the mid-term framework 2007-2009 are as follows:

- Maintaining the overall public debt at the level of 35 % of GDP annually – it is planned to repay the foreign debt at the average level of 30 mil € annually, with the aim to reduce it below 30 % of GDP.
- Average real GDP growth of 5,5 %
- Average inflation rate up to 3 %
- Pension system reform – introduction of the second pillar,
- Reduction of the tax burden on the citizens and the economy – through the reduction of personal income tax, profit tax, limitation of the level of the local communal fees, abolishment of the capital gain tax, tax relieves for the newly employed workers, reduced contribution rate on gross salaries, etc.
- Significant investments in infrastructure – through the introduction of the Capital budget in the Republic of Montenegro in 2007 and further increase of allocations for capital investments
- Full transfer from the line to program budget – basing it not on expenditure, but on the results and performance indicators
- The final goal of this process is to reduce the share of consolidated current public expenditures in GDP to 35% in 2011. This will have additional positive influence in encouraging the development of the private sector through the lower state redistribution of GDP and reduced role of the state in the economic life of the country, which will result in a higher level of competitiveness of the private sector. In the end of the process there should be an increase in the economic welfare of the population through the increase of the overall employment and real wages.

Table 9 Consolidated public expenditures 2007 -2009

CONSOLIDATED PUBLIC EXPENDITURES 2007-2009			
DESCRIPTION	2007 % GDP	2008 % GDP	2009 % GDP
Current revenues	44,86	43,17	40,73
Taxes	28,37	27,14	25,25
Contributions	10,98	10,51	10,07
Fees	1,58	1,58	1,48
Charges	2,31	2,31	2,31
Other revenues	1,14	1,14	1,14
Revenues from the repayment of loans and funds transferred from previous year	0,48	0,48	0,48
Expenditures - I level of consolidation	44,76	42,41	40,37
Expenditures - II level of consolidation	43,08	40,82	38,86
Capital budget RoM	1,69	1,69	1,69
Current consolidated expenditures	41,39	39,13	37,17
Current expenditures	22,78	21,64	20,65
Gross wages and contributions paid by employer	12,67	11,97	11,37
Other personal incomes	1,49	1,41	1,34
Expenditures for material and services	4,76	4,58	4,44
Current maintenance	1,35	1,30	1,26
Interests	1,01	0,95	0,91
Rent	0,27	0,26	0,25
Subsidies	0,80	0,76	0,72
Other expenditures	0,42	0,40	0,38
Transfers for social protection	13,62	12,87	12,22
Transfers to institutions and individuals in the non-governmental and public sector	2,51	2,37	2,25
Capital expenditures	5,06	4,78	4,53
Borrowings and loans	0,31	0,29	0,27
Payment of guarantees	0,11	0,10	0,09
Reserves	0,39	0,37	0,35
DEFICIT / SURPLUS	0,10	0,76	0,37
FINANCING	-0,10	-0,76	-0,37
Domestic financing	-1,04	-0,98	-0,93
Foreign financing	0,09	0,28	0,27
Donations	0,05	0,05	0,05
Project loans	0,55	0,55	0,55
Revenues from privatization or deposits	1,30	1,01	0,65
Increase/reduction of deposits	-0,45	-1,07	-0,36

Fiscal reforms project the reform of the tax system through the reduction of tax rates, thus making the overall economic environment more attractive for foreign investments and private entrepreneurship (e.g. reducing personal income tax rates and setting the upper limit for the amount of local communal fees).

Another important factor for the continuation of reforms is the restrictive budgetary policy and further reduction of the share of public expenditures in GDP. Controlled growth of the wage fund, with a relative reduction of their participation in GDP, represents the basic precondition for the implementation of the stable concept of financing public expenditures and reduction of budgetary deficit. It is also planned to significantly reduce the number of employees in state administration (700 employees in 2007).

Table 10 Growth Rates (as % of GDP)

Growth rates (as % of GDP)	2005	2006	2007	2008	2009
Real GDP growth	4,3	5,5	6,0	6,0	5,5
Inflation	1,8	2,1	3,4	3,0	3,0
Public debt	42,7	37,1	36,8	36,2	32,5

Table 11 Budget Taxes (in mil. €)

Budget Taxes (in mill. €)	2005	2006	2007	2008	2009
Personal Income Tax	67,09	69,95	66,11	72,73	63,13
Tax on Profits of Legal Entities	21,29	13,07	15,03	16,53	17,94
Value Added Tax	193,38	269,35	293,13	301,92	310,98
Excises	65,60	72,80	79,35	87,28	94,70
Tax on International Trade	41,10	53,45	56,65	62,32	67,62

Mid-term projections of the changes in the basic republican taxes show a stable growth of all taxes, except for the personal income tax. The reason is the commitment of the Government to reduce the fiscal pressure on economy by reducing the flat tax rate from 15% in 2007 to 12% in 2009 and 9% in 2010. In 2006, the profit tax rate was reduced to 9%. Expected positive effects are the incentives for the private entrepreneurship, through the reduction of fiscal burden and expansion of the tax base.

Table 12 Budget Expenditures (in mill. €)

Budget Expenditures (in mil. €)	2005	2006	2007	2008	2009
Gross salaries	156,45	157,83	179,79	186,98	192,13
Expenditures for supplies and services	58,89	59,35	72,45	76,30	78,59
Capital outflows	30,79	32,73	69,25	72,02	78,15
Transfers	73,90	120,76	121,88	126,76	137,53
Repayment of Debt	105,59	81,62	35,29	36,71	38,17

Projection of budgetary expenditures also shows the tendency of stable growth of all expenditures, but at a slower pace than the increase in GDP. One exception are the capital expenditures that are emphasized and for which faster growth is planned in 2007. The reason is introduction of the Capital budget of the Republic of Montenegro

in the amount of 33,91 mil € and which will be separated from the current budget starting from 2007.

In the structure of the total planned expenditures, the highest shares goes to current expenditures, which participate with 51.14% in the total planned budget for 2006, while the transfers for social protection participate with 7.08%, transfers to institutions, individuals and non-governmental sector with 19,87%, capital expenditures with 11,29%, repayment of debts with 5,75% , provided borrowings and loans 0,9 % reserves with 0,97%.

A more intensive privatization process reduced also the needs regarding the provision of loans to the big industrial systems by the Government of the Republic of Montenegro, while the reduction in the number of unemployed persons shows that the assets dedicated to financing small and medium size enterprises were used efficiently in 2006 and that it is necessary to repeat the cycle of loan provision, but of a smaller scope.

Project loans from abroad have provided the sources of finance for strategic infrastructure projects, thus, the capital expenditures were projected at a level which is higher than the planned one for 2006. The funds planned for capital expenditures will secure completion of the transportation infrastructure and adequate investment maintenance of the railway and the roads.

The budget secures a high level of social protection, as well as adequate transfers necessary in order to finance the duties in the field of pension and disability insurance, health protection and unemployment. Current expenditures have been increased due to the planned increase in funds allocated for the salaries of the employees and other personal incomes, while the expenditures for material and services are a bit higher as a percentage of GDP, as compared to what was planned for 2006.

3.3 Public debt management

Reduction of the share of overall public debt in GDP represents the most important goal in the mid-term framework. The reduction should include the foreign and domestic debt of the budget of the Republic, local self-governments, extra-budgetary funds and all companies where the state has majority ownership at the republican and local level.

Legal regulations related to public debt in Montenegro consist of the four laws: Budget Law, Law on regulation of duties and liabilities on the basis of the foreign debt and foreign exchange savings of the citizens, Law on borrowing and the public sector debt management and Law on recovery of ownership rights and compensation of damage.

The Budget Law from 2001, in the part related to loans and guarantees, defines that the public debt may arise by taking a loan (domestic and foreign), short-term borrowing and issuance of securities, while the Budget Law defines deadlines, conditions and limits for the annual increase of the state debt, including loans and

exceeding the account limit, short term borrowing and debt on the basis of realized guarantees. It also defines the total amount of guarantees provided by the state.

In accordance with the Budget Law, the Government decides on taking a loan and short term borrowing, on budgetary expenditures, and provision of guarantees, on the basis of a fiscal plan proposed by the Minister of Finance. The Government also gives consent to loan taking, short-term borrowing and provision of guarantees by municipalities and short term borrowing of the extra-budgetary funds.

The Government also has an unlimited authority to repay the interest and principals on the basis of the state debt and guarantees from the assets kept in the Consolidated Treasury Account, in accordance with the conditions and deadlines that it contracted.

The Law on borrowing and public sector debt management (from 2004) regulates the manner and procedure of state borrowings; establishes borrowing limits, defines operations and responsibility of the public sector authorities for the public debt management; regulates the manner of provision of state guarantees; regulates data keeping and reporting regarding the public sector debt.

In accordance with this Law, public debt is defined as the total debt of the public sector of the state that consists of the internal and external debt created through borrowing on behalf of the state or by taking over the debt from a foreign country, as a result of provision of guarantees or other acts on the basis of which the state explicitly accepts the debt. In all this, the public sector includes: state authorities, public enterprises founded by the state, local self-governments, extra-budgetary funds and all domestic legal entities in which the state has minimum 51% of ownership.

In accordance with the provisions of the Law, the Ministry of Finance manages the public debt, and, among other things, it participates in the activities related to coordination, contracting and formalization for each new state borrowing and performs supervision, analysis and assessment tasks related to public sector debt.

One of the priorities is to reduce the overall public debt below 30% of GDP, which will happen, according to the projections, in 2010 with the implementation of reforms.

Public debt of Montenegro was 644,9 mil. € or 35,7 % of GDP on 30.09.2006. The domestic debt was 170,4 mil. € or 26,09% of the total debt, while the foreign debt was 482,7 mil. € or 73,91% of GDP.

Primarily due to the inability to quantify explicit obligations accepted in accordance with the Law on recovery of property rights and compensation of damage, this amount was not fully defined. According to the current assessment, there should be no bigger changes.

The table shows the evolution of public debt with a mid-term projection until 2009:

Table 13 Evolution of Public Debt with a Mid-term Projection until 2009

Mid-term projections	2005	2006	2007	2008	2009
Gross domestic product in mil. of €	1,690	1,829	2,004	2,184	2,370
Consolidated Public Consumption in % of GDP	43.60	43.32	43.08	40.82	38.86
Total Public Debt in % of GDP	41.40	37.10	36.80	36.20	32.50
Domestic Public Debt in % of GDP	11.40	9.70	9.62	9.46	8.50
Foreign Public Debt in % of GDP	30.30	27.40	27.18	26.74	24.00

In 2005, the Government of the Republic of Montenegro, in its document “Debt strategy of Montenegro 2005-2007”, defined, among other things, the basic guidelines and policy of debt management in the Republic of Montenegro. The next strategy will include the following three-year period and it will also define the basic guidelines in mid-term debt policy management, primarily taking into consideration the costs and risks of new borrowing.

In the upcoming period, according to the Strategy, it is defined to eliminate the most expensive categories of domestic debt, bank loans and notes, although the tendency of reduction of interest rates for these types of duties continues, as well as full repayment of the old budgetary obligations, while it is planned to have an increase in obligations on the basis of restitution.

With regard to the foreign debt, the loans will be used to finance, primarily, priority infrastructure projects defined in the Economic Reforms Agenda of the Government for the period 2002-2007, and in case of non-concession loans this amount will be approximately 30 mil. € annually. The plan is also to look into the possibility of issuing Euro bonds of the Republic of Montenegro and the expectation is, depending on whether these are five-year, seven-year or ten-year bonds, to have an interest rate below 5%.

For the strategy of going out to the international market, the new credit rating for Montenegro provided by Standars & Poors will surely be important, and it is expected in the beginning of 2007, as well as the credit rating from another renowned company – Moody or Fitch.

3.4 Deficit financing

Consolidated deficit in the period 2005-2006 shows the tendency of reduction and is financed from loans, donations, project loans and privatization proceeds and deposits. In the period 2007-2009 it is forecasted that there will be a slight surplus in public expenditures, thus, there is not a strong need to issue an additional amount of state securities. The surplus of public expenditures also enables the reduction of the public debt.

Table 14 Deficit/Surplus 2005 – 2009

	2005	2006	2007	2008	2009
Deficit/ Surplus	-2.44	0.44	0.1	0.76	0.37

3.5 Fiscal risks

Risks for the implementation of sustainable budget of the Republic of Montenegro are reflected in the following:

- Excessive dependency of budgetary revenues from the sources dependant on imports – value added tax and tax on international trade and transactions. The ratio between the import and internal gross VAT is approximately 70% / 30% in favor of import VAT, and in case of a significant reduction of imports, fiscal sustainability of the budget could be endangered.
- Dependency on the movements in the international market of tourist services and movements in the world aluminum market. International market of tourist services is very exposed to unpredictable influence and, thus, Montenegro as a tourist destination is also exposed. The Aluminum factory (KAP) with its reproduction chain constitutes one half of the Montenegrin economy and thus significantly influences the state revenues.
- Fiscal sustainability of the budget may be endangered with the legal obligations of the Restitution fund. In 2007, the expected obligations of the Fund towards the former owners, according to the decisions received so far, are equal to 2.15 mil €, and the total amount of obligations according to effective decisions of the court as of 1.10.2006 is equal to 28.5 mil €
- Certain pressures to increase the state budget should be expected due to acceptance of the additional obligations in the process of EU integration. However, there is a strong commitment of the Government to further reduce the share of public expenditures in GDP. Instead of an absolute increase in consumption, it is necessary to introduce organizational measures of state administration reform and pay more attention to the strengthening of administrative capacities in Montenegro, through a smaller, but more efficient state administration.

Table 15 General government budgetary developments

Percentages of GDP	ESA code	2005 Execution	2006 Estimation	2007 Estimation	2008 Estimation
Net lending (B9) by sub-sectors					
1. General government	S13	0,69	0,51	0,31	0,29
2. Central government	S1311	0,	0,32	0,27	0,26
3. State government	S1312	/	/	/	/
4. Local government	S1313	0,00	0,00	0,00	0,00
5. Social security funds	S1314	0,1	0,19	0,04	0,03
General government (S13)					
6. Total receipts	ESA	40,1	46,79	44,86	43,17
7. Total expenditures	ESA	41,9	46,91	44,76	42,41
8. Budget balance	B9	-1,8	-0,12	0,10	0,76
9. Interest	D41	1,2	1,22	1,01	0,95
10. Primary balance		0,6	1,1	1,11	1,71
Components of revenues					
11. Taxes	D2+D5	26,0	28,83	28,37	27,14
12. Social contributions	D61	10,1	12,11	10,98	10,51
13. Other		4,0	5,85	5,51	3,08
14. Total receipts	ESA	40,1	46,79	44,86	40,73
Components of expenditures					
15. Collective consumption	P32	12,6	14,23	14,16	13,38
16. Social benefits in kind	P31	0,00	0,00	0,00	0,00
17. Social transfers other than in	D62	14,3	14,76	13,62	12,87
18. Interest	D41	1,2	1,22	1,01	0,95
19. Subsidies	D3	0,6	0,79	0,80	0,76
20. Gross fixed capital formation	P51	4,50	4,31	5,06	4,78
21. Other		8,70	11,60	10,73	9,67
22. Total expenditures	ESA	41,9	46,91	43,76	42,41

Table 16 General government debt developments

Percentages of GDP	ESA code	2005	2006	2007	2008
1. Gross debt level		42,7	37,1	36,8	36,2
2. Of which: repayments due		8,45	3,75	1,98	1,67
3. Change in gross debt		/	-5,60	-3,79	-0,60
Contribution to change in gross debt					
4. Primary balance	B9	0,6	1,1	1,42	2,00
5. Interest	D41	1,2	1,22	1,01	0,95
6. Nominal GDP growth	B1g	7,0	5,5	9,56	8,3
7. Other factors influencing the debt					
8. Of which: Exchange rate change		/	/	/	/
9. O/w: Privatisation receipts		0,8	1,2	1,30	1,01
10 .p.m .implicit interest rate on debt (%)					

GDP 2005 – 1,690 mil. €

GDP 2006 – 1,829 mil. €

GDP 2007 – 2.004 mil. €

GDP 2008 – 2,184 mil. €