

MANAGEMENT OF ECONOMIC AND TRADE RELATIONS BETWEEN MONTENEGRO AND THE EUROPEAN UNION (Keynote paper)

Pregledni članak

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Abstract: Primary aim of is to identify a set of arguments to show continual justness of the integration process of the Western Balkans to the European Union, despite of skepticism among the most member countries of the EU due to the financial crisis. Montenegro has been and still is open to investors, it has also become a country with a fast-growing tourism industry, the minimum wage has been raised and the privatization of state-owned enterprises has started. At the same time, there is a presumption that joining the European Union and the North Atlantic Alliance will improve not only the country's political but also its economic position. The result of analysis is the assessment of the key factors, which affect the development of EU-Montenegro relations. The European Union has been Montenegro largest investor and trading partner for the last few years. In addition to investment co-operation, simultaneously it is developed adequate business environment, where principles of the market economy are applied. Montenegro has also become a desired destination for business companies, which carry out their business intentions on the territory of Montenegro.

Keywords: development, economic relations, trade, Montenegro, foreign direct investments.

1. INTRODUCTION

Montenegro is the smallest country in the Western Balkans, and on May 21, 2006, in a referendum, it chose the path of independence from Serbia. The official name of the country is Montenegro, and the capital is Podgorica. The total population of Montenegro is 618,197, the Republic of Montenegro is the ninth smallest country in the world with an area of 13,812 km². The official currency in Montenegro is the euro, which is unique given that the country is not a member of the European Union. Montenegro borders Serbia, Kosovo, Croatia, Bosnia and Herzegovina and Albania, one third of which borders the Adriatic Sea.

Montenegro is making rapid progress on its path to the EU. The World Bank has helped Montenegro strengthen its banking system, which is currently governed by a modern legislative and regulatory framework and central institutions that are much more resilient to economic shocks in the future.

2. ECONOMIC RELATIONS OF MONTENEGRO

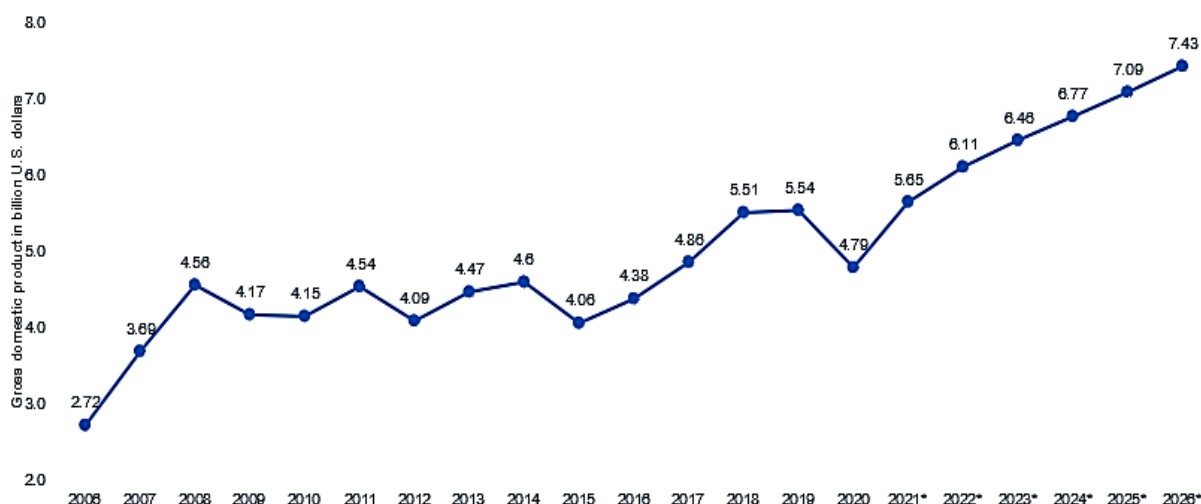
Economic development in Montenegro was marked by war conflicts, but also by economic and political sanctions during the Federal Republic of Yugoslavia. From independence in 2006 to

the spread of the global economic crisis in 2009, the country has made economic progress. During this period, Montenegro has proven to be a secure, politically stable and economically viable country with the potential for rapid growth. In countries and tourist destinations that have a developed tourist economy, significant multiplier effects of the impact of tourism can be observed. Tourism can and should play a particularly important role in the overall socio-economic development of underdeveloped countries and regions, such as the Western Balkans region and especially of the Montenegro. [8] Since gaining independence, Montenegro has been trying to position itself as an ecological, tourist destination and a leader in the Western Balkans region in this area.

The independence of Montenegro has begun to conceive and implement the new concept of agrarian policy and rural development, aligning it with the EU concepts. Among all the Montenegrin economists and agro economists, there is a consensus about the importance of agriculture in the economic development of the country, as well as on the necessity of the establishment of new concept of development. [9]

Montenegro is a small, open economy that does not have its own currency, it is overly sensitive to external shocks emanating from major trading partners that ensure the inflow of capital into the country. The expansion of European banks and international capital inflows have provided economic growth until 2008. In the period 2005 - 2008 economic prosperity through foreign direct investment and rapid government expenditure growth. The peak of economic prosperity was reached in 2008, this year's inflow of foreign capital accounted for 46% of gross domestic product. It increased due to investment demand in the tourism, real estate and banking sectors. Since 2012, the growth rate has continued to grow, and the main driver is private consumption and investment. Important factors in increasing investment were government spending on highway construction, as well as private investment in tourism and energy equipment. Economic growth is conditioned by the successful implementation of privatization, thanks to which the financial market and functional stock exchanges have been created.

Montenegro: Gross domestic product (GDP) in current prices from 2006 to 2026

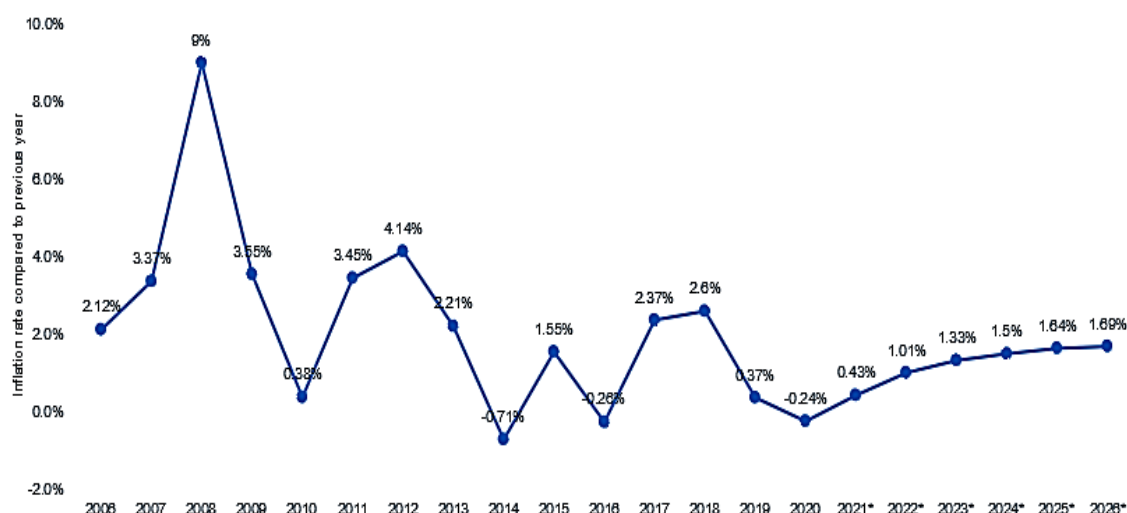


Source: IMF. (April 6, 2021). Montenegro: Gross domestic product (GDP) in current prices from 2006 to 2026. Retrieved November 05, 2021, from <https://www.statista.com/statistics/528667/gross-domestic-product-gdp-in-montenegro/>

The statistic shows gross domestic product (GDP) in Montenegro from 2006 to 2020, with projections up until 2026. Gross domestic product (GDP) denotes the aggregate value of all services and goods produced within a country in any given year. GDP is an important indicator of a country's economic power. In 2020, Montenegro's gross domestic product amounted to around 4.79 billion U.S. dollars.

Montenegro: Inflation rate from 2006 to 2026 (compared to the previous year)

Inflation rate in Montenegro 2026



Source: IMF. (April 6, 2021). Montenegro: Inflation rate from 2006 to 2026 (compared to the previous year) [Graph]. In *Statista*. Retrieved July 05, 2021, from <https://www.statista.com/statistics/528675/inflation-rate-in-montenegro/>

This statistic shows the average inflation rate in Montenegro from 2006 to 2020, with projections up until 2026. In 2020, the average inflation rate in Montenegro amounted to about -0.24 percent compared to the previous year.

The openness of the economy and dependence on imports will greatly affect price fluctuations. We can notice that the development of inflation in Montenegro followed the development of the EU in the period 2002-2013, i.e. after the introduction of the euro. This gradual convergence is the result of the fact that the eurozone is the second largest trading partner, right after the countries of the Balkan region.

3. AGREEMENTS ON THE MUTUAL PROMOTION AND PROTECTION OF INVESTMENTS

These agreements seek to ensure a stable framework for investment and better use of economic resources. They define the conditions for investments, allowing free transfer of funds, the right of subrogation, compensation in the event of expropriation and settlement of disputes between investors and countries, including the settlement of disputes between the countries themselves. Since re-gaining its independence, Montenegro has signed 26 agreements on the mutual promotion and protection of investments. Agreements are in place with: Austria, Slovakia, the Republic of Serbia, the Czech Republic, the Republic of Finland, the Kingdom of Denmark, the State of Qatar, the Belgium-Luxemburg Economic Union, the Republic of Macedonia,

Malta, France, the Hellenic Republic, the Netherlands, Israel, Cyprus, Romania, Ukraine, Hungary, Germany, Poland, Spain, the Republic of Turkey, the Swiss Confederation, the Republic of Azerbaijan, Moldova, and the United Arab Emirates.¹⁶

3.1. Foreign Direct Investment in Montenegro

Thanks to extensive privatization, significant foreign investment has begun to flow into the country, which has had a positive impact on private sector development in all areas and increased the unemployment rate. Foreign investors were also attracted by the very favorable tax system, which created many opportunities for investors. Income tax is equal to 9%, and value added tax 17%, which makes the tax system of Montenegro the most attractive in the region. The most promising investment opportunities in Montenegro include the development of energy, infrastructure and the service sector (tourism, trade and transport).

Foreign direct investment is crucial to the development of the world economy. Permanent reforms in Montenegro have been effective in attracting private investment, stabilizing public debt, and raising household incomes. Montenegro has recorded a foreign investment inflow of around € 4,5 billion since 2013-2018, of which 55% are investments from the Member States of the European Union and the countries of the European Economic Area, which further confirms the high degree of economic bond between Montenegro and the European Union.

In 2008, the situation did not change significantly. The most successful year so far has been 2009, when foreign direct investment reached 1.223 billion euros. The crisis hit hard in 2010, and foreign direct investments fell to 692 million euros. The worst year so far was 2011, when foreign direct investment amounted to 389 million euros, which is 29.5% less than in 2010. In 2012, foreign direct investment was higher by 15% and reached 450 million euros. Foreign direct investments (FDIs) amounted to € 1.3 billion in 2013-2015. FDIs amounted to € 757.4 million in 2015. In addition, total projected planned investments amount to € 610 million in 2016, € 961.3 million in 2017 and € 1,010.6 million in 2018.

Support for the development of investment relations is related to the establishment of institutions which have an investment policy and the introduction of measures conferring certain advantages and above-standard treatment.

Investments include, in particular, movable and immovable property, all rights established on them (mortgages, guarantees and similar rights), shares, bonds, deposits in companies or any other form of participation, monetary claims, intellectual property rights, or contractual arrangements, licenses or permits issued under the Act, including concessions for the extraction of natural resources, etc.

At the same time, the transition to a market economy requires a reduction in the state's footprint in the economy. Creating a favorable environment for private sector development requires restructuring state-owned enterprises (SOEs) and rationalization of public spending to reduce the cost of the state. Montenegro started negotiations with the EU in June 2012 and strives to join by 2020, ahead of the other countries in the Western Balkans. Of the 35 negotiations chapters, two have been provisionally closed and 22 have been opened. In the latest European Commission (EC) Progress Report on Montenegro, the importance of maintaining macroeconomic stability was stressed, noting that the rapidly rising public debt and high fiscal deficits, together with high external imbalances and high unemployment, are of particular concern.¹⁷

¹⁶ <https://investmentlocations.me/en/investment-environment/>

¹⁷ <http://www.worldbank.org/en/country/montenegro/overview#1>

Foreign capital dominates in Montenegro in order of size from Norway, Russia, Italy, Slovenia, Azerbaijan, Hungary, Switzerland, Luxembourg, Netherlands, Germany, Cyprus and Turkey. Approximately half of the foreign investment is directed to the coast and 44% in Podgorica and the surrounding area. 28% of foreign investment goes into the financial sector, 22% in tourism, 14% in construction, 11% in services, 5% to 2% of transport and agriculture.

Table 1. The following Table 3 shows the analysis of foreign direct investment by EU country operating in Montenegro:

Italy	Malta	Latvia
Germany	Austria	Azerbaijan
Cyprus	Netherlands	Great Britain
Spain	Croatia	Luxembourg
France	Sweden	Czech Republic
Slovenia	Poland	Belgium

3.2. Decree on Fostering Direct Investment

The Decree outlines the financial incentives for new investment in Montenegro and aims to improve the business environment and enhance the competitiveness of the economy. The Decree aims to attract new investors, increase employment, in particular in the less developed areas, and balance out regional disparities. Availability of adequate incentives will directly influence the investment-related decisions of the potential investors considering positioning themselves on the Montenegrin market.

The investors implementing investment projects in Montenegro are eligible for the financial incentives approved by the Government of Montenegro.

The funds to incentivize investments are allocated following a public announcement. Eligible investment projects include those of minimum worth of €500,000 which generate at least 20 new jobs over the course of three years, from the date of signing the agreement on the use of funds (in the Capital City and the southern region), or those worth at least €250,000 which generate at least 10 new jobs (in the northern and central region, excluding the Capital City). The incentives range from €3,000 to €10,000 per new job. In addition, any capital investment in excess of €10 million and generating at least 50 new jobs is eligible for incentives of up to 17% of its worth. The Decree also envisages the possibility to reimburse the costs of construction of the infrastructure required to implement the investment project.

According to the Decree, foreign investors become eligible to access the funds if they set up a company in Montenegro.

The stages of the procedure for allocation of the funds to foster foreign investment:

The amount is set at up to 50% of the eligible costs of implementation of the investment project in case of large companies, up to 60% for medium-sized companies and up to 70% for small companies.

Funds amounting to up to 17% of the total value of the investment project may be allocated for capital investments without prior scoring procedure, in line with the Decree.

4. AREAS WHERE EU INVESTORS INVESTED IN MONTENEGRO

We must recall that the most important motive for foreign investors in Montenegro is cheap labor, tax holidays and other government financial incentives, which in some cases reach a relatively high percentage of the total value of the investment.

Areas where EU investors invested in Serbia are:

- food industry;
- automotive industry;
- power;
- information technologies;
- agriculture;
- tourism;
- construction;
- financial sector;
- pharmaceutical industry;
- telecommunications;
- trade.

Table 2. shows business entities which operate in Montenegro as a consequence of entrance on Montenegro market through foreign direct investments.

	Title	State	The area
1.	Terna	Belgium	Trade
2.	Hellenic petroleum S.A.	Deutschland	Pharmacy
3.	Moslon Coors	Austria	Telekomunikácie
4.	Starbev	Belgium	Brewing
5.	BancaIntesa - Delta Banka	Italy	Finance
6.	Salford Investment Fund	England	Food and agriculture
7.	Eurobank EFG	Greece	Finance
8.	Raiffeisenbanka	Rakúsko	Finance
9.	Agrokor	Croacia	Food and agriculture
10.	National Bank of Greece - Vojvodjanska Banka	Greece	Financie
11.	Mercator	Slovenia	Food and agriculture
12.	CréditAgricoleSrbija	France	Financie
13.	Fondiaría SAI	Italy	Turizmus
14.	Pepsi Co Marbo	Netherlands	Food and agriculture
15.	Bosch	Germany	Electrical engineering
16.	Siemens	Germany	Electrical engineering
17.	Swarovski	Austria	Trade and goldsmithing

The planned investment in infrastructure – the motorway section, reconstruction and investment in local roads – will help remove the barriers to growth and harnessing of the economy’s potential.

A number of activities have been implemented to enhance competitiveness and attract FDIs: adoption of the Decree on Business Zones and designation of nine Business Zones of Local Importance (in Kolašin, Berane, Nikšić, Bijelo Polje, Podgorica, Cetinje, Mojkovac, Ulcinj and Rožaje); adoption of the Decree on fostering direct investments; state subsidies schemes within the Cluster Development Programme and Programme for Enhancing Regional and Local Competitiveness through Harmonization with the International Business Standards 2014-2016; amendments to the Law on Foreign Investments (Official Gazette of MNE 18, dated 1 April 2011, 45/14), largely facilitating better investment climate.

5. THE EUROPEAN UNION'S TRADE RELATIONS WITH MONTENEGRO

Montenegrin business and economic space is of interest to companies, especially from the countries of the former Yugoslavia, Slovenia, Croatia, Serbia and the countries of Central and Western Europe. Through facilitated privatization and capital investment, they want to gain a prominent position in important manufacturing sectors - energy, telecommunications, banks, transport, industry, tourism and agriculture. Montenegro has several free trade agreements.

European Union, Trade with Montenegro

Total goods: EU Trade flows and balance, annual data 2010 - 2020

Source Eurostat Comext - Statistical regime 4

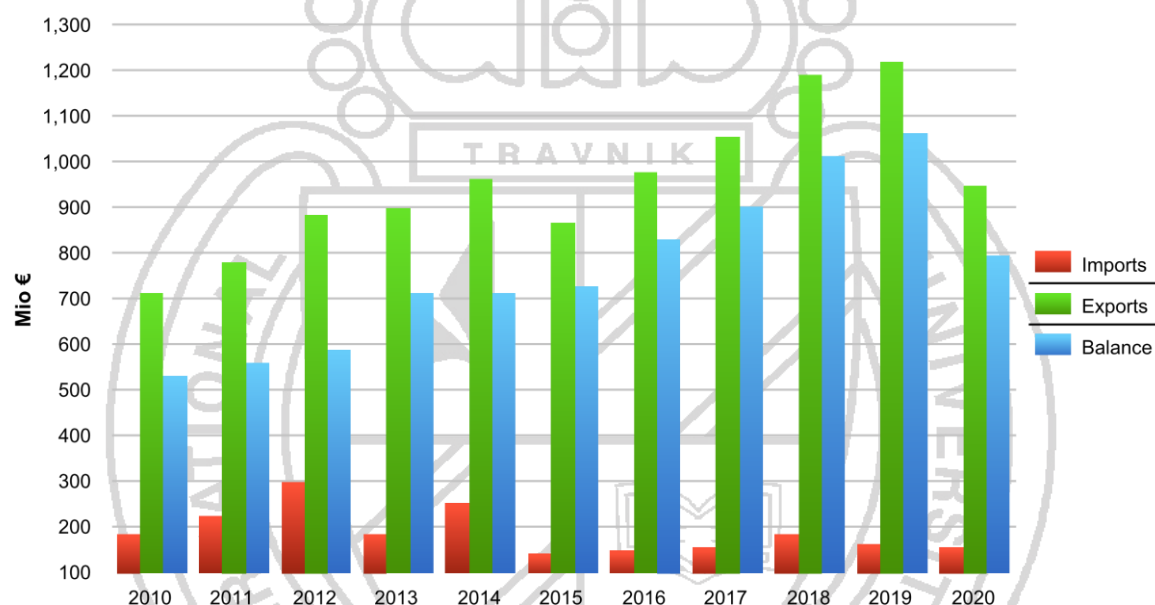


Figure 1. Total goods: EU Trade flows and balance, annual data 2010 - 2020

Source: Eurostat Comext - Statistical regime 4

Total goods: EU Trade flows and balance

Period	Imports			Exports			Balance		Total trade
	Value Mio €	% Growth	% Extra- EU	Value Mio €	% Growth	% Extra- EU	Value Mio €	Mio €	Value Mio €
2010	182		0.0	709		0.0	527		891
2011	221	21.3	0.0	778	9.7	0.0	557		998
2012	294	33.3	0.0	880	13.2	0.1	586		1,174
2013	183	-37.7	0.0	894	1.6	0.1	711		1,077
2014	249	36.0	0.0	959	7.3	0.1	710		1,208
2015	139	-44.0	0.0	863	-10.0	0.0	724		1,002
2016	146	4.8	0.0	974	12.9	0.1	828		1,120
2017	152	4.1	0.0	1,052	7.9	0.1	900		1,204
2018	180	18.3	0.0	1,189	13.0	0.1	1,009		1,368

	Imports Value Mio €				Exports Value Mio €			
	2017	2018	2019	2020	2017	2018	2019	2020
Total	152	180	159	155	1,052	1,189	1,218	945
0 Food and live animals	3	4	3	4	158	171	182	148
1 Beverages and tobacco	1	2	2	1	21	26	24	14
2 Crude materials, inedible, except fuels	33	35	32	27	14	22	26	22
3 Mineral fuels, lubricants and related materials	0	0	0	26	153	198	198	125
4 Animal and vegetable oils, fats and waxes	0	0	0	0	2	2	2	3
5 Chemicals and related prod, n.e.s.	6	7	7	11	86	94	120	107
6 Manufactured goods classified chiefly by material	56	84	76	65	136	148	144	111
7 Machinery and transport equipment	46	35	33	16	358	380	372	295
8 Miscellaneous manufactured articles	5	6	5	4	118	137	139	105
9 Commodities and transactions n.c.e.	1	7	0	1	2	6	3	2
Other	0	0	0	0	4	6	6	13
2019	159	-11.6	0.0	1,218	2.4	0.1	1,059	1,377
2020	155	-2.7	0.0	945	-22.4	0.0	790	1,100

% Growth: relative variation between current and previous period

% Extra-EU: imports/exports as % of all EU partners i.e. excluding trade between EU

Trade flows by SITC product grouping 2017 - 2020

Member States

Trade flows by SITC product grouping 2017 - 2020								
SITC Rev. 3 Product Groups	Imports Value Mio €				Exports Value Mio €			
	2017	2018	2019	2020	2017	2018	2019	2020
Total	152	180	159	155	1,052	1,189	1,218	945
Primary products	77	103	93	110	353	426	440	317
- Agricultural products (Food (incl. Fish) & Raw Materials)	8	11	9	8	188	207	219	173
- - Food	4	6	6	5	181	199	209	165
- - - of which Fish	0	0	0	0	9	10	11	5

- - - Other food products and live animals	4	6	6	5	172	189	198	160
- - Raw materials	4	5	4	2	7	8	10	7
- Fuels and mining products	69	92	84	102	165	219	221	144
- - Ores and other minerals	29	30	28	24	6	14	16	14
- - Fuels	0	0	0	26	153	198	198	125
- - - of which Petroleum and petroleum products	0	0	0	0	149	193	194	93
- - Non ferrous metals	40	62	56	52	5	7	7	5
Manufactures	75	69	65	44	692	749	767	612
- Iron and steel	12	14	15	10	8	9	13	8
- Chemicals	6	7	7	11	86	94	120	107
- - of which Pharmaceuticals	5	3	5	9	30	35	59	51
- Other semi-manufactures	4	7	5	2	115	124	117	93
- Machinery and transport equipment	46	35	33	16	358	380	372	295
- - Office and telecommunication equipment	1	2	1	1	42	46	52	48
- - - Electronic data processing and office equipment	0	0	0	0	10	12	12	10
- - - Telecommunications equipment	1	1	1	1	32	34	39	37
- - - Integrated circuits and electronic components	0	0	0	0	0	0	0	1
- - Transport equipment	40	25	23	8	174	208	187	130
- - - of which Automotive products	23	23	16	4	116	129	126	75
- - Other machinery	5	8	8	7	142	125	133	116
- - - Power generating machinery	0	0	1	0	4	3	15	5
- - - Non electrical machinery	4	7	6	6	86	76	78	71
- - - Electrical machinery	1	2	1	0	51	46	41	41
- Textiles	0	0	0	1	7	7	7	5
- Clothing	1	1	1	0	30	30	33	22
- Other manufactures	5	5	4	4	88	106	106	82
- - of which Scientific and controlling instruments	0	1	0	0	10	16	13	11
Other products	1	7	1	1	3	7	4	3
Other	0	0	0	0	4	6	6	13

Source: Eurostat Comext - Statistical regime 4

6. ECONOMIC COOPERATION AGREEMENTS

Since re-gaining its independence, Montenegro signed 20 agreements on economic cooperation, aiming to establish the institutional framework for cooperation through reinforced and enhanced economic interests. The agreements are in place with Romania, the Republic of Austria, the Republic of Bulgaria, the People's Republic of China, the Republic of Hungary, the Republic of Serbia, the State of Qatar, the Republic of Turkey, the Republic of Macedonia, the Republic of Slovenia, the Hellenic Republic, the Republic of Croatia, Germany, Spain, the Republic of Azerbaijan, the United Arab Emirates, the Czech Republic, the Slovak Republic, the Republic of Albania, and the Abruzzo Region in the Republic of Italy. The agreements identify the areas of mutual interest and focus on the following: industry, agriculture, forestry, water management, energy, research and development, construction industry and infrastructure, transport and logistics, environmental protection, tourism, investment promotion, SME cooperation, ICT and services.

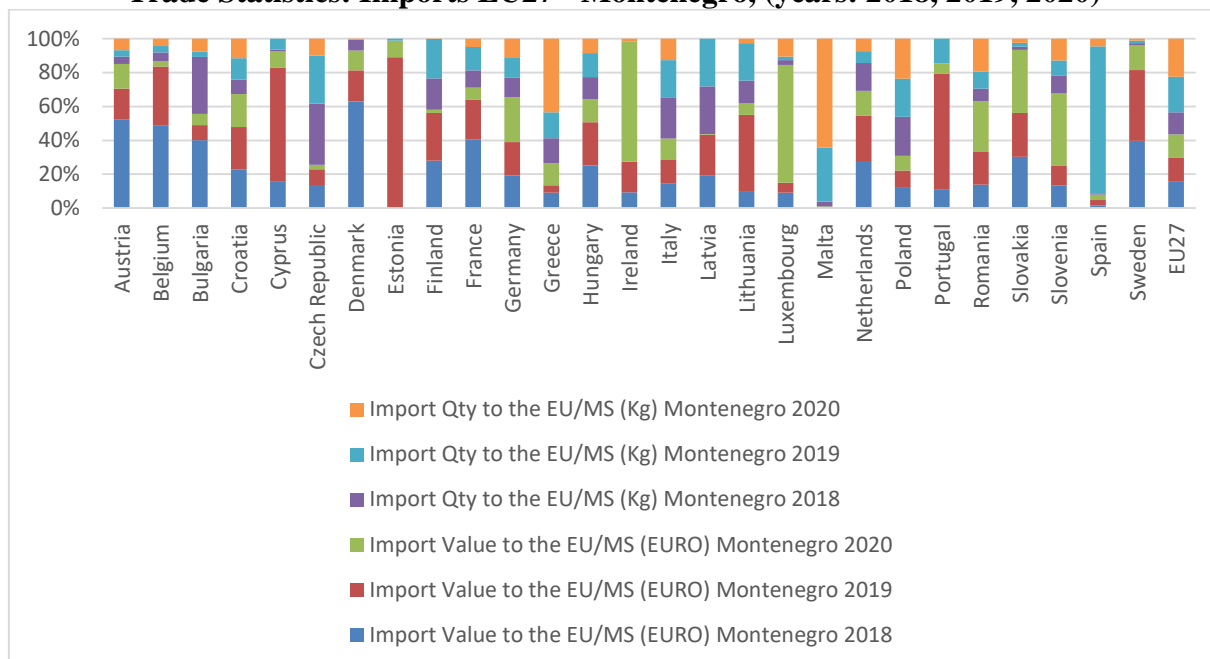
Through its rules, the European Union creates a fair room for the development of trade in goods and services and for this purpose introduces uniform rules applied by the Member States of the European Union. Negotiations between the European Union and Montenegro on the conclusion of the Stabilization and Association Agreement started on 15 October 2007 and ended on 1 May 2010. Under the Stabilization and Association Agreement and the Interim Agreement on Trade and Trade-Related Matters, appropriate conditions for the development of trade cooperation and several barriers, in particular quantitative measures and measures having equivalent effect to customs duties have been removed. In the mutual development of relations, the principles of the internal market of the European Union are applied. The SAA's entry into force marked a new phase of integration, which made it formally binding on Montenegro to align its legislation with the EU acquis, as well as to align positions and policies in all areas of cooperation.

Globalization is a process that requires business partnerships in particular to reduce costs and risks. Dynamics of investment and innovation in transforming economies is basically not possible without mutual co-operation between different trading companies.

Entrepreneurship and entrepreneur in Serbia are indispensable attributes of a market economy based on the principles of free enterprise, based largely on private ownership, competition and profit motivation.

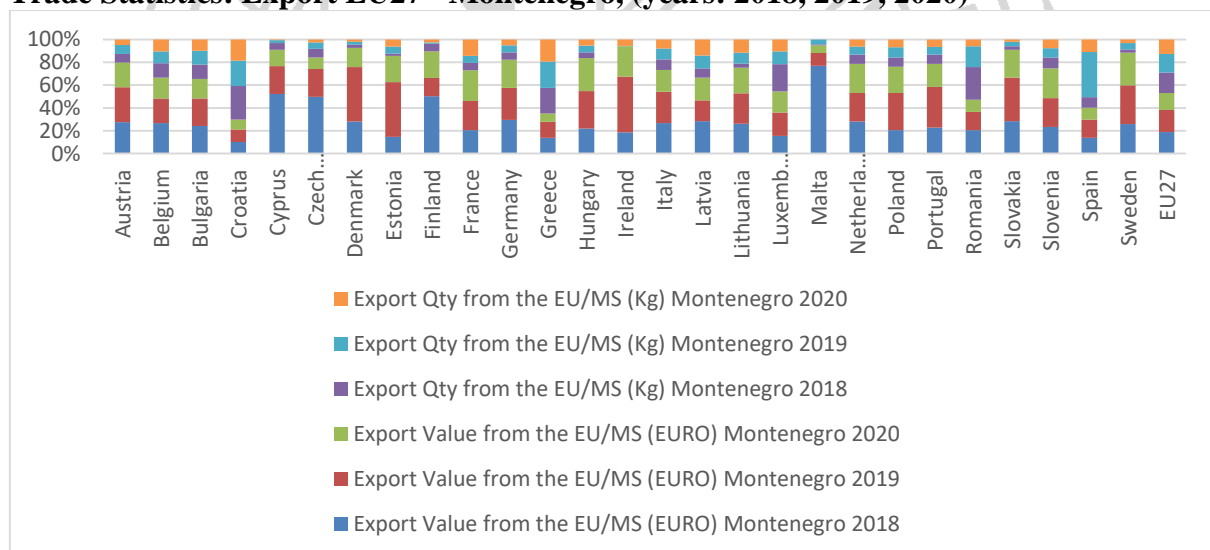
The EU is Montenegro traditional trading partner, accounting for more than 66% of Serbia's total exports and around 63% of Montenegro total imports.

Trade Statistics: Imports EU27 - Montenegro, (years: 2018, 2019, 2020)



Source: own and data-<https://trade.ec.europa.eu/access-to-markets/en/statistics>

Trade Statistics: Export EU27 - Montenegro, (years: 2018, 2019, 2020)



Source: own and data-<https://trade.ec.europa.eu/access-to-markets/en/statistics>

7. CONCLUSION

The European Union assumes that Montenegro will be a small country after Croatia, which will become a full-fledged member of the EU. Montenegro was and still is open to investors, it has also become a country with a fast-growing tourism industry, the minimum wage has increased. In Montenegro, the number of foreign investors in the country increased after independence, which was a positive consequence especially of the opening of the economy to free enterprise. The country, which before independence became a substantial part of its income through

activities on the black market, changed its economic orientation and focused on privatization, foreign trade or tourism.

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