

SM/07/388
Supplement 1
Correction 1

January 30, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of Montenegro—Staff Report for the 2007 Article IV
Consultation—Informational Annex**

The attached corrections to SM/07/388, Supplement 1 (12/17/07) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 5, para. 6, line 3: for “about €275 million” read “about €290 million”

Page 10, para. 5, line 1: for “MONSTAT (current account) and the Central Bank of Montenegro (capital and financial accounts)” read “MONSTAT (trade statistics) and the Central Bank of Montenegro (other current account elements, capital and financial accounts).”

Page 12, line 6: for “Consumer price index” read “Cost of living index”

Questions may be referred to Mr. Justice (ext. 38600) and Mr. Gagales (ext. 38849) in EUR.

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institutions and the rule of law; and (iii) improve the standard of living of citizens, through efficient education, health and social protection systems.

5. Coordination with the IMF has been strong, with cooperation having focused on macroeconomic issues and sectoral ones with a potentially strong macroeconomic impact—more important still after the government’s decision not to request a Fund-supported program and in light of the increased risks to macroeconomic stability. The Bank, through its ongoing and planned operations, as well its complementary economic and sector work, will continue to provide input on issues such as (i) labor market reforms; (ii) energy sector reforms; (iii) public expenditure, pension and health reforms, with a view to streamlining service delivery, and (iv) an appropriate framework to regulate concession arrangements and potential public/private partnerships, with a view to encouraging investment in a way that would ensure that the government does not accumulate significant contingent liabilities.

6. Total outstanding debt of Montenegro towards the various part of the Bank was about US\$401.5 million on November 7, 2007 (US\$56.9 million for IDA and US\$344.6 for IBRD), at the current exchange rate about €275290 million. In September 2007, the government prepaid €20 million, with further prepayments foreseen during the fourth quarter of 2007. With these payments, Montenegro has considerably reduced per-capita exposure ratios, which had previously been among the highest for any Bank borrower.

World Bank Activities

7. The 2007 CPS envisages a total lending envelope of US\$70–90 million. Following the successful completion, in 2006, of the *Second Structural Adjustment Credit (SAC 2)*, the government decided not to request a follow-up development policy credit, largely because of Montenegro’s strengthened fiscal position. Investments aim at fostering private-sector activities and streamlining social services, while maintaining a quality environmental infrastructure that is required for sustainable growth in tourism (a key industry).

8. Streamlining social services is a particular challenge given the relatively large cost of social services as a proportion of GDP, even when compared to neighboring countries with similar income levels. The *Montenegro Education Reform Project* aims at strengthening the capacity of the education system to make continuous improvements, especially in the quality of teaching and learning in schools and in the efficient use of budgetary resources. There is a high degree of government ownership and no problems in project implementation.

Montenegro: World Bank Lending Envelope, FY07-FY10

Lending envelope FY07-FY10	89
Fiscal year 2007	19
Energy ¹	9
Sustainable tourism ¹	10
Fiscal year 2008	15
Sustainable tourism	5
Land administration	10
Fiscal year 2009	25
Energy efficiency	10
Rural and regional development	15
Fiscal year 2010	30
Improved social services	10
Transport infrastructure ²	20

¹ On IDA terms; IBRD terms otherwise.

² In high-case lending scenario.

Source: World Bank, 2007, *Country Partnership Strategy for the Republic of Montenegro*, Report No. 39800-ME.

9. The *Healthcare System Improvement Project* seeks to put in place first steps toward a reformed healthcare system to increase the capacity for policy, planning, and regulation, stabilize healthcare financing, and improve primary healthcare service delivery. The implementation is proceeding well, and government ownership is strong. The Health Ministry has succeeded in securing CIDA grant funds to co-finance the project.

10. The *Energy Community of South East Europe-APL3 Montenegro Project* is awaiting effectiveness. Procurement activities for the projects have started. The General Procurement Notice is prepared and about to be published, while EPCG is finalizing the technical specifications for the projects and is planning to issue tender documents of some of these projects by end-December 2007. In addition, Bank teams have discussed an *Energy Efficiency Project*, planned for FY09, to support financing related projects in the public sector, especially in the education and health sectors. The Bank team has agreed with government representatives on next steps for further assessment of prospects and scope of energy efficiency investments in public sector buildings.

11. The *Montenegro Sustainable Tourism Development Project* is to help Montenegro to better design and implement an integrated coastal zone management approach. With this, coastal degradation is to be reduced and environmentally sound tourism development fostered by supporting activities aimed at (i) enhancing spatial development, the use of natural resources, regulatory policy, institutional capacity and governance of the coastal zone, and (ii) initiating priority investments to improve environmental conditions and foster development of high-quality tourism. These objectives will be achieved through (i) improvements in land-use planning and protection to guard against uncontrolled construction and development; and (ii) investments for the Continental and Southern part of the Regional Water Supply Scheme with the capacity to provide water from Lake Skadar/Shkodër to the municipalities of Bar and Ulcinj/Ulqin and the tourist areas of Valdanos and Velika Plaža. This phase of the MSTDP will only finance the investments from Lake Skadar/Shkodër to Bar.

12. The *Montenegro Environmentally Sensitive Tourist Areas Project* is to create ecological and commercially sustainable solid waste collection and disposal services in Montenegro coastal municipalities, needed to maintain a clean, environmentally attractive coastal area. This is to be achieved through the (i) development of the sector's institutional, policy and regulatory framework; (ii) rehabilitation of municipal disposal sites to function as properly designed regional sanitary landfills; (iii) closing existing disposal sites in an environmentally acceptable manner; (iv) provision of modern collection equipment; (v) initiating a pilot recycling campaign; and (vi) strengthening multi-municipal joint companies (MJC) that will be created to operate the two regional solid waste disposal systems.

13. Current Bank involvement is restricted to policy dialogue and an application to the *Public-Private Infrastructure Advisory Facility* trust fund, which is currently awaiting approval. The government wishes to improve competitiveness and has major development

ANNEX III. MONTENEGRO: STATISTICAL ISSUES

1. While data are broadly adequate for surveillance, weaknesses hamper economic analysis and policy making. Following the creation of the State Union between Serbia and Montenegro in 2003, statistical institutions were split and Montenegro, being the smaller partner and with a capital located far from Yugoslav institutions, lacked sufficient resources and qualified personnel, and lost institutional memory and know-how. The quality and timeliness of reporting vary across sectors. For monetary and balance of payments statistics, international reporting standards have been adopted, while the adaptation of national account data has been slower. Reporting of fiscal data has recently improved but coverage is limited. A page for Montenegro in *International Financial Statistics* (IFS) was introduced with the March 2007 issue.
2. The authorities have created a statistical council to coordinate efforts to improve data quality and requested technical assistance from foreign partners. In response, the Fund has provided a series of technical assistance missions to improve the quality of macroeconomic statistics and support policy formulation, often jointly with TA provided to Serbia. Over the period 2001–04, STA conducted six missions to the State Union, including a mission on monetary and financial statistics, separate balance of payments statistics missions to Serbia and to Montenegro, and a multi-topic mission covering national accounts statistics. The status of the statistical base, as reflected in these missions, can be summarized as follows:
 - (i) there is a critical need to improve the quality of existing macroeconomic statistics by developing comprehensive data sources and improving statistical methodologies;
 - (ii) informal activities are inadequately recorded in the national accounts, especially in the expanding service sector; and
 - (iii) the principles for compiling monetary statistics are broadly consistent with MFSM 2000. A 2006 monetary statistics mission and a 2007 real sector statistics mission were undertaken to assist the authorities in improving the quality of the compiled data.

A. Real Sector

3. Real sector data are compiled by the Statistical Office of Montenegro (MONSTAT). MONSTAT has started to adopt the *1993 System of National Accounts* as a framework for compiling national accounts estimates. However, the scope of the accounts is limited to compiling annual production account in current prices, and only aggregate GDP in previous year prices. The accuracy of the data sources needs to be improved. The business statistics are still following the material system product concepts, collecting data mainly on quantities produced. The national accounts estimates depend solely on bookkeeping data. There is no business register to be used for statistical surveying, although work has started with Statistics Sweden. On the expenditure side, there are no data on changes in inventories, and the quality of investment and merchandise trade data is unsatisfactory. The exhaustiveness of the national accounts data is seriously undermined by the lack of sound techniques to incorporate unobserved activities. Some work has been done on ad-hoc basis, but the estimates produced

are not included in the regular compilation practice. The techniques for deriving volume measures of GDP are constrained by the lack of suitable price and volume indices.

4. MONSTAT compiles and disseminates retail price indices (RPI), and cost of living indices, and producer price indices. A proper consumer price index is planned to be introduced in 2008. In all price indices, the “carry-forward” technique for treatment of seasonal goods, new goods, and missing items are not following international standards. The quality of the labor and wage indicators is good.

B. Balance of Payments

5. Balance of payments statistics are compiled by MONSTAT (~~current account~~) (trade statistics) and the Central Bank of Montenegro (~~capital and financial accounts~~) (other current account elements, capital and financial accounts). Significant improvement is needed in data compilation, in particular in external trade, where MONSTAT uses the special trade system for imports but general trade system for exports. This inconsistency may have resulted in the overestimation of imports. In addition, the classification used by MONSTAT is the Harmonized System (HS), but data are disseminated according to the Nomenclature générale des Activités économiques dans les Communautés Européennes (NACE), on highly aggregated groups, and with a significant time lag. Some components are likely under-recorded, since a significant proportion of foreign exchange transactions occur through informal channels.

6. Data on private external debt are weak. While the Central Bank of Montenegro (CBM) has continuously maintained a record of flows of private external debt in recent years, there is no data on stock of external debt. The authorities’ program includes strengthening the monitoring of private external debt by CBM and MONSTAT.

7. A June/July 2004 mission to the CBM assisted with adoption of compilation methodologies consistent with the fifth edition of the *Balance of Payments Manual (BPM5)* and provided recommendations to improve international trade and external debt statistics, as well as Montenegro’s international transactions reporting system (ITRS). The authorities have implemented many of the recommendations of the 2004 mission. Following the authorities’ request for further assistance, a mission visited Montenegro in September – October 2007. Although it noted substantial progress, inadequate data sources continue to constrain progress in improving balance of payments data.

C. Government Finance

8. Fiscal data are compiled by the Ministry of Finance (MOF) based on a new GFS institutional classification, and since early 2006, include data for the social security funds and local governments. The chart of accounts introduced in 2001 has been implemented at the local level from mid-2005. Fiscal data reporting suffers from frequent re-classifications, especially, at the level of local governments and social funds. The MOF has recently created a unit responsible for data collection for state-owned enterprises (SOE), but a satisfactory

compilation of the public sector fiscal balance requires significant further efforts. Data on stock of local government arrears need to be strengthened.

D. Monetary Accounts

9. Monetary and financial statistics are compiled by the CBM, broadly following the institutional coverage, classification, and valuation methodology set forth in the *Monetary and Financial Statistics Manual*, 2000. Dissemination practices meet GDDS recommendations with respect to the periodicity and timeliness for financial sector data. Beginning in early 2006, the CBM publishes detailed monetary statistics in its monthly *Statistical Bulletin*, which includes tables on monetary statistics, balance sheets and surveys for the CBM and the commercial banks.

10. Significant progress notwithstanding, there is need for further improvement. The 2006 monetary and financial statistics mission made recommendations to the CBM on methodological issues concerning: (i) the exclusion of two banks in bankruptcy from financial reporting (the mission proposed that if these institutions are excluded from the coverage of the monetary survey, a separate table on their monetary accounts could be included in the CBM's *Statistical Bulletin*); and (ii) treatment of interest accrued but not yet due (which is maintained in aggregate on separate accounts rather than incorporated in the outstanding amount of the financial asset or liability).

11. The CBM does not yet report monetary data in the format of Standardized Report Forms (SRFs). To avoid duplication of effort, the CBM will need to decide whether to adopt the European Central Bank's framework for collecting, compiling and reporting monetary data or the STA-developed SRFs, either of which will provide monetary data that accord with international standard.

MONTENEGRO: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE*AS OF OCTOBER 31, 2007*

	Date of Latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶
International reserve assets and reserve liabilities of the monetary authorities ¹	Sep.2007	Oct.2007	M	M	M
Reserve/base money	Sep.2007	Oct.2007	M	M	M
Central bank balance sheet	Sep.2007	Oct.2007	M	M	M
Consolidated balance sheet of the banking system	Sep.2007	Oct.2007	M	M	M
Interest rates ²	Aug.2007	Oct.2007	M	M	M
Consumer price index Cost of living index	Sep.2007	Oct.2007	M	M	M
Revenue, expenditure, balance and composition of financing ³ – general government ⁴	Sep.2007	Oct.2007	Q	Q	Q
Revenue, expenditure, balance and composition of financing ³ – central government	Sep.2007	Oct.2007	M	M	M
Stocks of central government and central government-guaranteed debt ⁵	Sep.2007	Oct.2007	Q	Q	Q
External current account balance	Jun.2007	Sep.2007	Q	Q	Q
Exports and imports of goods and services	Jun.2007	Sep.2007	Q	Q	Q
GDP/GNP	2005	Apr.2007	A	I	A
Gross external debt	Jun.2007	Sep.2007	Q	Q	Q

¹Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

²Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³Foreign, domestic bank, and domestic non-bank financing.

⁴The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments. General government reporting is incomplete; local government expenditure data are available only after a six-month lag.

⁵Including currency and maturity composition.

⁶Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Semi-annually (SA), Annually (A), Irregular (I); or Not Available (NA).