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NET ERRORS AND OMISSIONS

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LIST OF ACRONYMS USED

GDP	Gross Domestic Product
CBMN	Central Bank of Montenegro
CDC	Currency and Documentary Control
DEM	Deutschmark
EU	European Union
ITRS	International Transactions Reporting System
JCI	Customs declaration (<i>org. Jedinstvena carinska isprava - JCI</i>)
MF	Ministry of Finance
DPF	Deposit Protection Fund
IMF	International Monetary Fund
FDI	Foreign Direct Investments
SFRY	Socialist Federative Republic of Yugoslavia
FRY	Federative Republic of Yugoslavia

CONTENTS

INTRODUCTION	7
1. ERRORS AND OMISSIONS – DEFINITION AND PURPOSE.....	7
2. NET ERRORS AND OMISSIONS AND INTERNATIONAL PRACTICE.....	11
3. MONTENEGRO AND NET ERRORS AND OMISSIONS.....	14
4. ANALYSIS OF SINGLE POSITIONS OF THE BALANCE OF PAYMENT OF MONTENEGRO	18
4.1. Goods	18
4.2. Services	32
4.3. Current transfers and factor income.....	35
4.4. Foreign direct investment.....	38
4.5. Other investments - Cash and deposits	40
4.6. Foreign exchange reserves	41
5. CONCLUSION.....	43
6. BIBLIOGRAPHY	45

INTRODUCTION

The aim of this working paper is to examine the errors and omissions position both from a theoretical (methodological) and practical (sources of origin) aspect and to try to draw a conclusion of what *Net errors and omissions* mean in practice. What level of *Net errors and omissions is acceptable?* i.e. Is it only the explanation of their existence or is it also their amount that is important? Can a direct link between the quality of the balance of payments statistics and the level of errors and omissions be established? May the current methodology be applied to countries that do not have their own currency? What are the origins of discrepancy between the credit and the debit side of the balance of payments? Is it justified to reduce the deficit of the current account by the amount of *Net errors and omissions*? These are only some of the questions this working paper will try to give an answer to.

1. ERRORS AND OMISSIONS – DEFINITION AND PURPOSE

In order to find the answers to the questions posed in the introductory part, it is indispensable to understand the methodology on which the balance of payment statistics is based. The balance of payments methodology, given by the IMF, is defined in the Balance of Payment Manual and the Balance of Payments Compilation Guide, according to which "The balance of payments is a statistical statement that systematically summarizes, for a specific time period, the economic transactions of an economy with the rest of the world"¹.

The basic principle applied to this statistical statement is the double-entry bookkeeping principle where each transaction is recorded twice: once on the credit side and a second time on the debit side.

Let us take a look at this in an import of goods example. When you purchase goods abroad, you give a certain amount of money as the counter-value of the goods. In the balance of payments, the import of goods is entered in the current account under the position *Goods* where the increase in import by the value of such goods is recorded. At the same time, your bank account is reduced by the value of the goods, which is entered in the financial account of the balance of payments:

¹ IMF, "Balance of Payment Manual" 5th edition, Washington D.C., USA, 1993

NET ERRORS AND OMISSIONS

	<u>CREDIT</u> ²	<u>DEBIT</u>
Import of goods/Current account	5,000	
Outflow of funds/Financial account-deposits		5,000

So, in this case, the credit side matches the debit side i.e. the difference between the credit side and the debit side is zero.

The sum of all transactions on the credit side must equal the sum of all transactions on the debit side (with the opposite sign). Thus, in order for this rule to be literally applied, the following must be done:

1. Each transaction must be included and entered (recorded) twice — once on the credit side and a second time on the debit side.
2. The value of each transaction must be the same on both sides.
3. The transaction must be recorded on both sides at the same time.

If these three, at first glance very simple rules, are met, there will not be any difference between the credit side and the debit side, i.e. the credit sum will equal the debit sum.

In practice, the credit side rarely (almost never) equals the debit side due to a great number of transactions³ involved that, first of all, cannot possibly be entirely included or included at the same time or measured in the same way. As it is the case with other statistical areas, the task of a statistician is to collect and process data as efficiently as possible and to timely present them to their user. Even the most precise and accurate data are not useful if provided too late.

Although everything may seem so simple to the point that one may wonder what is so complicated about entering a transaction in a table under two positions, a better knowledge of data collection and recording technology reveals a series of reasons why an error can be made. All balance of payment transactions refer to different fields of economy, they are recorded on different sides and therefore the sources of data on the same transactions are different as well. For example, the data on transactions of goods are obtained on the basis of customs data (physical flow of goods) and on the basis of data on money paid in return for such transactions provided by the banks. Data on the same transaction obtained from two sources do not necessarily have to be the same in terms of value⁴. Consequently, a certain difference between the credit and the debit is created. Given that the double-entry bookkeeping principle requires that these two sides are numerically equal,

² "Credit" and "Debit" (in English) have already become customary terms (in the Montenegrin language) denoting the income and the expenditure side of the balance of payments, so they shall also be used as such from this moment on.

³ The scope of the balance of payment statistics covers all transactions between the residents of Montenegro and non-residents, from the smallest transaction of one euro which is enough, perhaps, to buy newspapers abroad, to staggering amounts, for the purchase of a ship or similar. This involves millions of transactions, depending on the size of the country compiling the statistics and its openness, i.e. dependence on other economies.

⁴ The reasons will be given later in the text in the form of examples.

NET ERRORS AND OMISSIONS

the *Errors and omissions* position which equals the difference between the credit and the debit was introduced. One may say that this is a balancing position of the balance of payment account.

As its name indicates, the *Errors and omissions* position includes all errors and omissions made in a certain period of time while compiling the balance of payments statistics. Entering a transaction on one of the sides, either credit or debit, or entering the same transaction on both account sides but with different value, or entering the same transaction in different account periods, generates differences that are mutually added, subtracted or partly set off one against the other. This is precisely why the correct denomination of this position is *Net errors and omissions*. Furthermore, for the same reason (possibility of cancelling — offsetting the value of errors made on the credit and the debit side) the size of the position is not always an indicator of accuracy or the quality of the balance of payments data.

For example, we have imported goods worth 100 EUR. The event was recorded by the foreign trade statistics and we recorded the increase in value of goods under the position Goods in the current account. However, what we do not know is that the goods were purchased on credit and that only the first instalment of 30 EUR was paid at the time of import.

	<u>CREDIT</u>	<u>DEBIT</u>
Import of goods/Current account	100	
Outflow of funds/Financial account-deposits		30
Net errors and omissions		70

A difference of 70 EUR has been generated — this should automatically mean that our Net errors and omissions changed by these 70 EUR. Let us imagine, though, that a foreign national (more precisely, a non-resident) spent some time in Montenegro as a tourist in the same accounting period, that they paid 70 EUR cash for their stay and that the owner of the accommodation facility spent that money directly in domestic grocery stores. So, the tourism statistics tells you that the foreign national stayed in this country and spent that money but, in contrast, no inflow of such money has been recorded in the financial account (the money was not received via a bank account, nor was it deposited on any bank account).

	<u>CREDIT</u>	<u>DEBIT</u>
Tourism services/Current account		70
Inflow of funds/Financial account-deposits	0	
Net errors and omissions	70	

Again, the difference of 70 EUR appears. Nevertheless, the final amount has been balanced as a result of error cancellation.

NET ERRORS AND OMISSIONS

	<u>CREDIT</u>	<u>DEBIT</u>
Import of goods/Current account	100	
Tourism services/Current account		70
Inflow of funds/Financial account – deposits	0	
Outflow of funds/Financial account – deposits		30
Net errors and omissions	0	0

This example shows that the *Net errors and omissions* position is not a measure of statistics quality even though it amounts to zero. Thus, the aim of every statistician in the field of the balance of payments is to reduce this position to the lowest amount possible. A complete equality of these two sides is difficult to achieve, especially nowadays when everyone aspires to total liberalisation of international flows of goods and finances⁵.

Net errors and omissions ought to be taken as an indicator that certain matters have not been recorded well or at all, so one primarily needs to investigate what they might be. Then, they should be paid attention to in order to see if they are constant during a longer period of time and if they have the same sign. If that is the case, it will already be an indication of a constantly repeating systematic error. For example, if the value of this position is positive, it will tell us that the sum of the current account, capital and financial account balance is underestimated, i.e. that we have underestimated certain income and/or overestimated expenditure on the current account and/or underestimated the credit and/or overestimated the debit side of the capital and financial account.

The essence of the *Net errors and omissions* position is finding the cause of its existence and pointing the search for anomalies in the right direction rather than reducing its value to zero. By finding the reason, i.e. the origin of the existence of this position, an important requirement for further improvement of the quality of balance of payments statistics will be met. The direction one should move towards in order to enhance data comprehensiveness and quality becomes clear. However, the reasons of significant values of errors and omissions do not necessarily have to be linked to a correct application of the stipulated methodology. This position can also tell us something about the imperfection of the methodology itself and the need for its modernisation. Besides, the movement of errors and omissions may be a sign to the economic policy creators that

⁵ *At first glance, this is a case of diametrically opposite standpoints coming from the same house. IMF and other international entities require from the countries to open themselves to a greatest extent possible and to liberalise their current and financial transactions more, while referring to that as "lowering business barriers" for the sake of a more rapid development of economies and achievement of a higher life standard and welfare. Such liberalisation is often identified with the desire to reduce every control to a minimum. In contrast, they require from the countries to keep the best statistics possible of all these flows (which is something that the countries themselves definitely want). Nevertheless, the problem is that many a time research methods which are very important for the statistics itself for the first reason are abandoned in practice because, on the one hand they represent "business barriers" while on the other hand they lead to the loss of significant data (an example is the CDC Department at the CBMN - see below for details). It is obvious that a measure meeting both requirements must be found. The international financial crisis we have been facing in the recent years, the origins of which should be looked for both in too broad an understanding of liberalisation and in poor statistical data, is telling us to head towards a better control.*

a considerable part of economic flows is illegal⁶, which deprives the state of a certain amount of taxes due to various forms of tax evasion.

Consequently, one may say that all these reasons clearly indicate that net errors and omissions are an economic indicator of the steps we need to take in general, not only in the field of statistics.

2. NET ERRORS AND OMISSIONS AND INTERNATIONAL PRACTICE

Little work on the topic of net errors and omissions can be found in economics-related international publications, i.e. not much analysis of the origins of net errors and omissions and their impact on the quality of the balance of payments has been performed. Furthermore, there is no clearly-defined ceiling, level or proportion suggesting what degree of *Net errors and omissions* is acceptable. A parallel may be drawn with the term "current account deficit sustainability" as well. In the past, a generally accepted limit with regard to the current account deficit sustainability was 5% of GDP. Everything exceeding that limit was deemed unsustainable. However, this criterion has been confuted by the practice, so nowadays this limit is considered to vary from country to country. It depends on many reasons, but ultimately the creditors are the ones who decide until when they wish to finance the deficit, drawing, thereby, the line of deficit acceptability and sustainability. A permitted net errors and omissions level has not been precisely defined either but, unlike the above, in this case the acceptability depends on the quality of statisticians' arguments when explaining the origins of unbalance between the credit and the debit side of the balance of payments.

When determining an acceptable level of net errors and omissions, a dilemma of what to compare it with appears – whether with total movements on the current and capital accounts, with the current account of financial account deficit (surplus) or with a third indicator. An argument in favour of the first proposal is the fact that all transactions, both credit and debit on the capital and financial account, have an impact on the occurrence of errors. However, in practice, the comparison is made with the balance of the balance of payments current account.

Table 1 shows an example of net errors and omissions and the current account balance expressed as percentage of GDP in some European countries and in Montenegro. The table reveals that not only is the net errors and omissions position often equal to or higher than the current account balance but its value is also, at the same time, ranging from -1 to 1 per cent of GDP in case of these countries (as well as in case of most European countries). An interesting fact is that, compared to other countries of the group observed, Greece has low *Net errors and omissions* (a maximum of

⁶ Whether all sorts of contraband, cross-border smuggling or trafficking of goods, or just a high share of grey economy e.g. in tourism sector.

2.8% of GDP between 1997 and 2011). If this criteria is applied, Spain is better than Greece since in the period from 1993 to 2011, its net errors and omissions ranged between -0.6 to 0.2% of GDP, making it the Eurozone champion. In contrast, Sweden, a country that prefers the use of credit cards over cash, plans to completely switch to non-cash payments soon and on top of that has its own currency (the Swedish krona), recorded *Net errors and omissions* in the amount of 13.5% of GDP. In Island, which uses its own currency as legal tender (the Island krona), *Net errors and omissions* of -54.7% GDP were recorded in 2008, but already in the following year they reached +28.5% of GDP. In Slovenia, *Net errors and omissions* ranged from -1.6 to 1.2% of GDP between 1994 and 2011, while in Croatia they ranged from -2.1 to -4.3% of GDP between 1999 and 2011. As far as Montenegro is concerned, the highest value of *Net errors and omissions* was 14.8% of GDP in 2001.

This short overview also includes countries that use their own currency, countries that use the euro, countries with a high rate of non-cash payments, countries with a relatively high rate of cash payments as well as countries in a deep economic crisis and countries that have only been slightly affected by the same. Should all of this be observed from the perspective of the balance of payments statistics quality manifesting itself through the net errors and omissions position, a general conclusion that may be drawn is that there is neither one nor just a few reasons for the existence of balance of payments discordances. In some cases, the reasons can be found in the use of foreign currency while in others it is a large amount of transactions that bypass bank channels and cannot be covered, either due to a high rate of grey economy or poor application of methodology and methods of obtaining necessary data. One may look for the reasons in the methodology itself as well as in all legislation that constitutes the backbone of this sector etc. There are many reasons, perhaps even as many as there are positions in the Standard Components Table of the balance of payments given by the IMF, because each position is a potential source of discordance.

As it can be observed, each country has its peculiarities and it is really difficult to generalise the reasons of the existence of balance of payments discordances. Nevertheless, if one tried to define the basic requirements for achieving good balance of payment statistics (and not only this kind of statistics) then they would be as follows:

1. A decision to have a good quality statistics must be made at all levels affecting the statistics in any way. This decision must rest upon the awareness of general social usefulness of such data, both with respect to individuals and to the society.
2. Laws and their application (especially those concerning criminal policies) must be clearly defined in all sectors of economic life as well as in all sectors directly linked with statistical research.
3. Methodology must be accurate and its application coherent in terms of education of statisticians.
4. Source of data must be selected well.

NET ERRORS AND OMISSIONS

Table No. 1 - Net errors and omissions (NEO) and current account balance (CAB), % of GDP, 1995 - 2011

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Austria	CAB	-2.9	-2.9	-2.5	-1.6	-0.7	-0.8	2.6	1.6	2.1	2.0	2.8	3.5	4.9	2.7	3.5	0.5	
	NEO	0.1	0.8	-0.5	-1.0	-1.5	-0.8	-1.3	-1.5	-1.6	-1.9	0.5	0.7	0.5	0.8	-2.3	0.9	
Finland	CAB	4.0	3.9	5.4	5.7	6.2	9.7	8.9	5.2	6.6	3.3	4.2	4.3	2.5	1.9	1.5	-1.2	
	NEO	-1.1	-0.3	-1.3	-4.2	-1.3	-1.2	-0.6	-3.7	0.0	-1.3	-1.5	-1.8	-4.5	-6.8	-4.7	0.1	-2.7
France	CAB	0.7	1.3	2.7	2.6	3.1	1.5	1.2	0.7	0.5	-0.5	-0.6	-1.0	-1.8	-1.4	-1.6	-2.0	
	NEO	-0.2	0.1	0.3	0.7	-0.4	0.6	0.3	-0.1	-0.9	-0.1	0.5	-0.7	-0.6	0.8	0.1	0.1	-1.0
Germany	CAB	-1.2	-0.6	-0.5	-0.7	-1.3	-1.7	0.0	2.0	1.9	4.7	6.3	7.5	6.2	6.0	6.1	5.6	
	NEO	-0.1	0.0	0.2	0.1	1.9	-0.4	0.6	-0.1	1.0	0.9	1.3	1.3	1.3	0.8	0.7	-0.1	0.3
Greece	CAB	-2.2	-3.3	-3.6	0.0	-5.5	-7.9	-7.2	-6.6	-6.6	-5.9	-11.3	-14.6	-15.0	-11.2	-10.4	-9.9	
	NEO	-0.2	0.1	0.2	0.0	0.0	-0.4	0.8	-1.1	0.1	0.2	0.0	0.1	0.3	0.3	-0.2	-0.2	0.0
Italy	CAB	2.2	3.2	2.7	1.6	0.7	-0.5	-0.1	-0.8	-1.3	-0.9	-2.6	-2.4	-2.8	-1.9	-3.6	-3.1	
	NEO	-1.9	-1.6	-1.3	-2.1	-0.1	-0.1	0.2	0.1	-0.2	0.2	0.1	0.7	0.6	0.9	-0.3	-2.0	-1.6
Holland	CAB	6.2	5.1	6.5	3.2	3.8	1.9	2.4	2.5	7.6	7.3	9.3	6.7	4.4	5.2	7.8	9.7	
	NEO	-1.8	-4.7	-3.2	-0.1	-2.5	0.2	-0.8	-1.4	-0.6	0.1	-1.1	1.0	-2.1	-0.1	1.9	-4.1	-0.9
Norway	CAB	3.5	6.8	6.3	0.0	5.6	14.9	16.1	12.6	12.3	12.7	16.4	12.6	16.1	11.0	12.5	14.5	
	NEO	-2.7	-1.8	-2.8	-4.2	-0.6	-3.9	-0.7	-3.6	-2.8	-2.0	0.6	-3.2	-7.7	1.0	4.3	-2.7	3.7
Poland	CAB	0.7	-2.7	-5.0	-5.6	-9.9	-8.8	-4.9	-4.2	-3.4	-3.8	-6.5	-11.4	-13.9	-7.3	-10.6	-10.5	
	NEO	-0.5	0.3	1.1	-0.4	1.7	0.6	1.9	-0.7	-1.2	2.6	-0.4	0.1	-1.4	-4.8	-4.3	-4.6	-3.9
Portugal	CAB	-0.4	-13.9	-18.8	-19.9	-30.8	-32.9	-30.9	-23.7	-17.6	-20.5	-17.6	-13.9	-15.9	-15.9	-14.1	-8.6	
	NEO	-9.0	-3.3	-1.6	1.6	-0.9	-1.3	0.8	0.4	0.7	0.3	0.2	0.7	0.4	0.0	-0.3	-0.2	-0.7
Sweden	CAB	1.9	2.1	2.9	3.5	3.8	4.0	5.5	4.8	7.1	6.8	8.6	9.3	9.4	7.1	6.4	6.5	
	NEO	-0.6	-0.8	-1.5	-2.4	-0.2	-2.5	-3.5	-1.9	-0.5	0.0	0.4	0.9	-7.3	-13.5	-5.4	1.2	1.4
Montenegro	CAB						-15.4	-12.9	-6.8	-7.2	-16.6	-31.3	-39.5	-49.8	-27.9	-22.9	-17.7	-17.7
	NEO						14.8	6.3	5.7	3.6	0.7	3.3	-6.0	2.2	6.4	6.4	4.9	7.5

Source: <http://data.worldbank.org/indicator/BN.KAC.EOMS.CD>.

3. MONTENEGRO AND NET ERRORS AND OMISSIONS

In the previous section, indispensable existence of good conditions in the environment where the statistics is developed has been identified as the most important prerequisite for a good quality statistics of balance of payment and every statistics in general. The term *environment* is used here as a synonym of all factors influencing the development of a certain event, i.e. the balance of payments statistics in this case. Apart from the resolution, a certain amount of time is also needed to create good conditions for the development of good quality statistics. It is a process that may be longer or shorter, depending not only on the complexity of the statistics concerned but also on other social conditions in which the statistics is developed.

The balance of payments statistics is highly complex if considered from the aspect of what it encompasses and how the necessary data are collected. An additional problem are constant and rapid changes in the financial sector (new financial instruments, greater liberalisation of these flows, etc.) which constitute important positions in the balance of payments statistics and which are becoming more and more difficult to entirely cover.

In the next section, the events that took place in Montenegro in the last two decades will be shortly presented in order to allow for a better understanding of the significance of environmental conditions required for a good-quality statistics (prerequisites 1 and 2 must be met). It is a very dynamic process requiring a lot of pieces to fit in order to get good statistical data as a final result. There are no shortcuts and one should bear in mind the quality of such data at all times since bad, biased or "adjusted" data will take their toll one day or another. Perhaps Greece is a good example of that.

The level of social development, life standard, evolution and respect of legal framework are other, but not less important, environmental factors. A man fighting for his existence is hardly interested in filling out a statistical form; having "papers in order" is not in the interest of a firm operating in a high tax evasion environment and a country actually threatened by war and fighting for its sovereignty and international recognition is not focused on adopting and implementing certain legal and other rules concerning statistics.

The 1990s were marked by hyperinflation, the dissolution of SFRY and war events. On the one hand the hyperinflation made realistic evaluation of economic flows completely impossible, regardless of the good legal framework in force until then. On the other hand, expecting someone to deal with statistics in the middle of all those events was illusory. At that time, as well as in the period before that, Montenegro's statistics relied in most sectors on the statistics made in Belgrade. Most of the time, data were only collected in Montenegro and then sent to Belgrade for processing. Such practice also continued in the postwar period, in then existing FRY. In 2002, new Customs Act and secondary legislation defining the operation of the customs service were adopted. Instructions for filling out the basic document for foreign trade statistics, i.e. the cus-

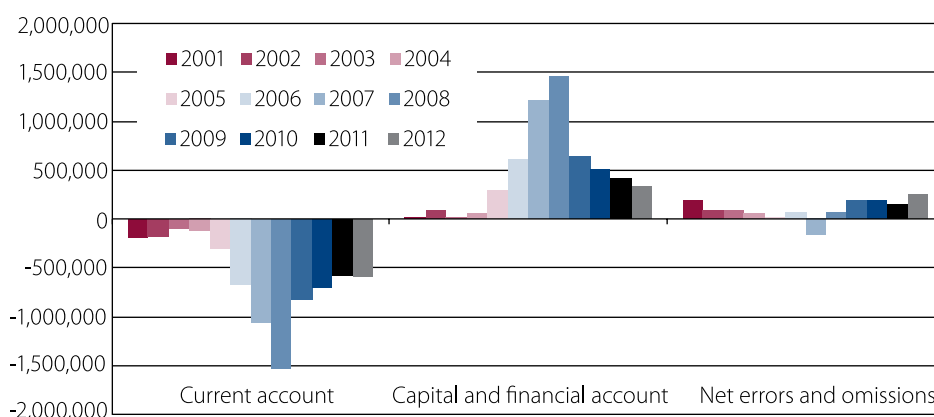
toms declaration, were changed several times causing significant implications for data quality. A particular impact on the balance of payments statistics was exercised by a radical move from the beginning of 2003 when the decision to stop processing customs declarations in Belgrade was adopted. Statistically speaking, a transitional period in which someone from Montenegro would undergo a training in statistical processing of foreign trade data sourced from customs declarations, would have been a much happier solution. Customs declaration processing was taken over by the Central Bank in April 2003 and conducted until 2005 when Monstat, that in the meantime bought the necessary data processing software and trained people for that purpose, assumed the responsibility for this kind of statistics. Meanwhile, the former Foreign Currency Act and the entire secondary legislation relating to this field were superseded by the new Foreign Current and Capital Transactions Act that liberalised foreign trade transactions to a great extent. Currency control and the obligation of reporting all loan transactions to the Central Bank were abolished, giving rise to the loss of important statistical data and mechanisms ensuring good quality of data. From the aspect of statistics, liberalisation has sometimes been wrongly interpreted. If you asked a natural person or a legal entity about the purpose of certain transactions or how much money they spent during their stay abroad as tourists, you would hear, almost on daily basis (and today's situation is similar), "it's my business", or some other statistically futile answer. Grey economy was booming. Bearing in mind that it was a period of constant tensions in a non-functional, state-building community where the priority was to establish independence, it is perfectly clear why little attention was given to statistics-related issues. A significant level of grey economy, an incomplete legal framework, often amended even several times in the same field, high level of liberalisation and introduction of the euro in a country with a relatively low trust in banks and high rate of cash payments as well as savings under the mattress are some of the elements that affected the quality of the balance of payments statistics.

Considering all of the above, annual data from 2001 to 2012 and quarterly data from 2005 to 2012 will be analysed in this work. The focus will be on the most recent data precisely for the purpose of quality data and consistency of the methodology applied.⁷ Furthermore, it must be stressed out that forming a judgment on actual sources of net errors and omissions is very hard and it implies a rather questionable degree of truth (probability), considering a great number of factors affecting the position concerned.

Traditionally, Montenegro generates a current account deficit while the capital and financial account balance is always positive, and if considered in absolute amounts, the current account balance is almost always greater.

⁷ *Since 2005 onwards, the same methodology which, due to certain peculiarities could not be entirely used for former periods, has been applied. Therefore, quarterly data can be analysed only for this period.*

Graph No. 1 – Balance of Payments of Montenegro per year, 2011-2012, in '000 EUR



As a result, the *Net errors and omissions* position in the balance of payments of Montenegro was positive and rather significant in the period from 2001 to 2012, except for 2007. "Rather significant" refers to its share in GDP compared to other countries with similar characteristics. An exception is 2007 when the absolute amount of the capital and financial account balance exceeded the absolute current account amount by approximately 160 million euro.

Graph No. 2 – Net errors and omissions, in '000 EUR



According to annual data, if we exclude 2007, one may say, at first glance, that the reasons of balance of payments imbalance should be sought either in the current account deficit overestimate or in the capital and financial account surplus underestimate. The next step in the analysis requires a more detailed examination of both accounts, i.e. an examination of single positions of the current account as well as capital and financial account. A possible current account deficit overestimate does not necessarily mean that certain expenditures have been reported greater than they really are. Since every position is composed of the credit and the debit side, there are several combinations that may lead to a position balance overestimate. The credit side may be overestimated while the debit side is fine or the credit side may be realistically assessed while the debit side is overesti-

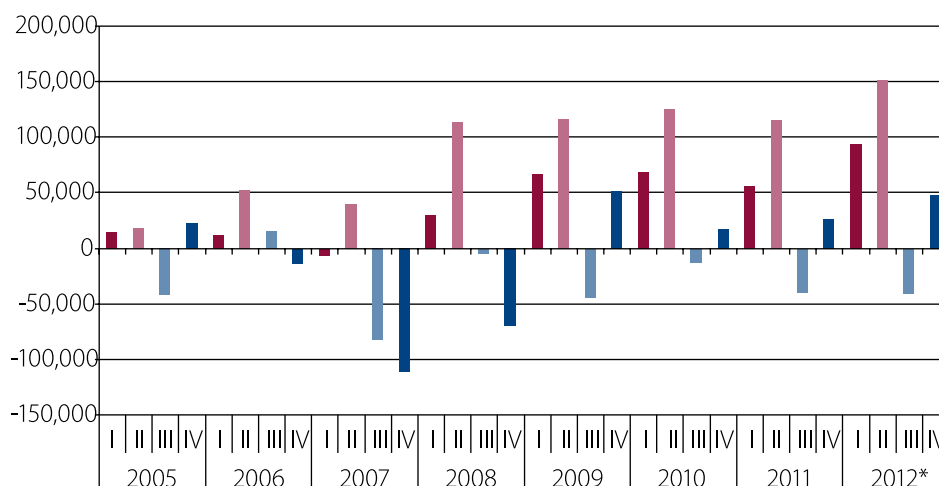
mated. There may be an error on both sides, whereby the absolute value of the overestimated position is greater than the absolute value of the underestimated position. The following step would imply a more thorough analysis of that position alone, because every position consists of a series of sub-positions, whether on the credit or on the debit side. For example, the "services" position includes tourism services, transport services etc., which are then divided into even smaller positions (transport can be air, water, road transport or other transport or transport of people, goods etc.). The capital and financial account situation is similar.

As one may see, with such a complex statistics containing a lot of data coming from many different sources, it is very difficult to give a right and accurate interpretation of the reasons of existence of the credit and debit side discordance, i.e. net errors and omissions.

Since Montenegro is a country where a good portion of development relies on the tourism sector, the payment of balance statistics reveals an obvious and strong seasonal impact of this sector both on individual positions and the movement of the *Net errors and omissions* position.

The following graph shows the movement of this position on a quarterly basis.

Graph No. 3 – Net errors and omissions, quarterly basis, 2005-2012, in '000 EUR



If we are to observe the graph above, we may conclude that the movement of Net errors and omissions in the period from 2005 to 2012 was as follows:

- They were always positive in the first quarter, except in 2007;
- They were always positive in the second quarter;
- They were always negative in the third quarter, except in 2006; and
- They were positive in the fourth quarter, except in 2007 and 2008.

The "exceptions" confirm our conclusion according to which there are several reasons of the existence or different sources of origin of the *Net errors and omissions* position.

Based on economic indicators reflecting the national economy, work experience in this field and comparison with the international practice, a general conclusion is that the deficit of Montenegro's balance of payments current account is overestimated and that in the case of financial account, the *Cash and deposits* position is the most difficult to assess.

4. ANALYSIS OF SINGLE POSITIONS OF THE BALANCE OF PAYMENT OF MONTENEGRO

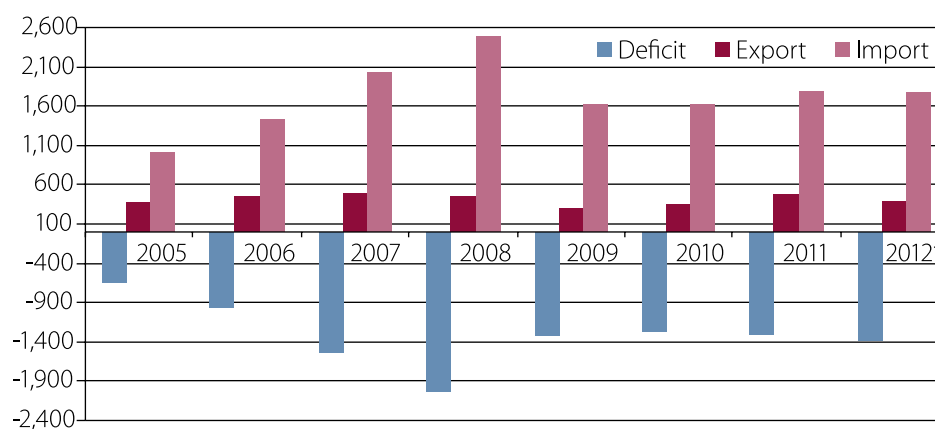
This section includes analyses of single positions of the balance of payments of Montenegro that are deemed to represent the possible primary cause of imbalance of this account, i.e. the origin of an important amount of the *Net errors and omissions* position. The analyses were based on national data used for the compilation of the balance of payments (comparison of data originating from different sources of movements of a specific balance of payments position), on the comparison of certain balance of payments positions with other macroeconomic indicators describing the Montenegrin economic conditions and finally, on the comparison of balance of payments data of other countries.

4.1. Goods

Our analysis shall begin with the first balance of payments position — Goods. However, even if the order of analysis were set from a different angle, the one indicating which positions might have the greatest impact on Montenegro's balance of payments imbalance, Goods would surely "rank high", if not for anything else, then due to the fact that high foreign trade deficit of Montenegro is the generator of high current account deficit.

The foreign trade deficit, a constant element of Montenegro's international trade, ranged from 35.4% of GDP to 65.6% of GDP in the period from 2005 to 2012, with the period average of 46.4% of GDP. At the same time, the current account deficit ranged from 16.6% of GDP to 49.8% of GDP, while its average for the same period was 27.9% of GDP. Or, if we observe the deficit of goods and export of goods ratio in that period, we shall see that the export was 3.2 times lower on average during those eight years where the minimum amount (the deficit 1.7 times higher than the value of exports) was recorded in 2005 and the maximum of 4.5 times in 2008 and 2009. The coverage of imports of goods by the exports ranged from 18% to 37%.

Graph No. 4 – Import, export of goods and deficit, 2005-2012, million EUR



Constant foreign trade deficit requires permanent sources of available funds in order to be financed. If we were to take a look on Montenegro's economy, its industry, agriculture, its orientation towards tourism as one of the key development sectors, it would be perfectly logical to expect that demand for goods cannot be fully met by domestic supply of goods. Nevertheless, it is a fact that the deficit has been high for years.

Let us consider international practice for a moment. When examining international practice, the IMF data including 190 countries (more precisely 189 countries and data for the Eurozone) in the period from 2005 to 2012 were used. The following tables show the movements in approximately forty countries which are most important for the purpose of this work, including Montenegro's neighbouring countries. The data are expressed in percentage share of GDP of the countries concerned, an indicator that gives the most realistic economic picture of such countries. The data from this base for Montenegro for 2005 have been corrected with more recent data at CBMN's disposal.

130 out of the 190 countries generated a negative average foreign trade balance in the period from 2005 to 2012. It is important to point out that the deficit was not generated every year, but in this case, total average eight-year balance will be used as the comparison criterion.

NET ERRORS AND OMISSIONS

Table No. 2 – Foreign trade deficit, % of GDP

Country	2005	2006	2007	2008	2009	2010	2011	2012	Average
Anguilla	-117.6	-176.6	-159.7	-174.2	-119.9	-127.2	-116.6	-114.2	-138.2
Montserrat	-134.5	-129.8	-115.2	-138.8	-103.7	-120.8	-126.2	-101.9	-121.3
Afghanistan	-63.4	-65.3	-63.4	-61.9	-55.7	-45.9	-43.6	-42.8	-55.2
Kiribati	-61.8	-52.8	-43.7	-46.4	-47.5	-45.7	-46.3	-45.9	-48.8
Maldives	-49.8	-45.3	-47.8	-47.0	-34.4	-48.1	-56.5	-56.4	-48.1
Tuvalu	-47.4	-40.6	-34.4	-51.0	-46.3	-53.7	-56.2	-50.4	-47.5
Montenegro	-35.4	-45.0	-57.6	-65.6	-44.3	-40.8	-40.4	-41.8	-46.4
Marshall Islands	-44.8	-44.7	-46.4	-45.7	-48.5	-61.8	-40.2	-37.7	-46.2
Lesotho	-47.7	-43.0	-43.0	-41.2	-47.6	-46.7	-43.7	-48.7	-45.2
Moldova	-39.9	-46.4	-52.2	-53.2	-35.8	-38.2	-40.9	-40.7	-43.4
Cabo Verde	-35.9	-41.7	-49.6	-48.7	-42.3	-40.9	-44.6	-42.0	-43.2
Samoa	-38.2	-42.6	-44.0	-38.5	-41.8	-41.8	-40.3	-44.8	-41.5
Kosovo	-35.9	-37.6	-40.3	-43.3	-42.8	-42.1	-45.1	-44.1	-41.4
Tajikistan	-26.9	-35.1	-45.1	-53.0	-39.8	-37.0	-47.7	-43.3	-41.0
Antigua and Barbuda	-37.4	-42.8	-45.7	-44.9	-40.8	-35.9	-33.3	-34.3	-39.4
Djibouti	-37.7	-43.8	-50.1	-51.4	-35.6	-26.1	-33.2	-34.8	-39.1
São Tomé and Príncipe	-28.2	-38.1	-40.2	-46.0	-37.9	-41.9	-42.2	-32.7	-38.4
Liberia	-29.1	-37.5	-30.6	-40.7	-36.4	-35.5	-40.8	-35.6	-35.8
Seychelles	-36.3	-31.6	-27.3	-41.9	-35.5	-34.2	-39.2	-40.2	-35.8
Tonga	-34.1	-34.1	-35.8	-38.7	-36.5	-34.3	-35.8	-36.2	-35.7
Saint Vincent and the Grenadines	-30.8	-32.2	-34.6	-39.0	-35.7	-37.1	-36.0	-35.6	-35.1
Grenada	-38.4	-37.9	-37.8	-36.1	-29.5	-32.9	-32.7	-31.8	-34.7
Saint Lucia	-36.4	-42.0	-39.1	-37.1	-22.8	-28.7	-35.0	-34.4	-34.4
Bosnia and Herzegovina	-45.1	-34.2	-36.9	-38.1	-27.6	-25.6	-27.7	-26.9	-32.7
Lebanon	-28.5	-27.7	-31.5	-37.1	-32.3	-33.0	-35.6	-36.3	-32.7
Dominica	-28.9	-26.8	-32.3	-38.4	-33.5	-33.3	-33.7	-33.2	-32.5
Jordan	-39.9	-33.6	-37.7	-32.6	-26.3	-25.7	-30.6	-33.7	-32.5
Jamaica	-22.9	-24.6	-30.6	-31.9	-27.7	-25.3	-27.5	-27.1	-27.2
Saint Kitts and Nevis	-22.7	-25.6	-26.9	-32.8	-33.1	-28.9	-25.3	-21.8	-27.1
Cyprus	-25.2	-27.2	-29.8	-32.4	-25.5	-26.8	-24.2	-22.6	-26.7
Vanuatu	-23.7	-23.8	-26.1	-35.0	-26.7	-26.8	-24.4	-25.9	-26.5
Albania	-22.4	-23.5	-27.0	-27.5	-26.0	-23.2	-24.1	-20.9	-24.3
Macedonia	-17.8	-19.1	-19.8	-26.2	-23.3	-20.8	-22.4	-23.7	-21.6
Serbia	-21.1	-21.3	-24.9	-26.2	-17.1	-16.5	-17.1	-18.7	-20.4
Croatia	-20.9	-21.1	-21.8	-22.8	-16.6	-13.5	-14.3	-13.1	-18.0
Bulgaria	-19.0	-21.0	-23.5	-24.3	-11.9	-7.7	-5.6	-9.1	-15.3
Greece	-14.3	-16.9	-18.6	-18.9	-13.3	-12.7	-13.1	-10.1	-14.7
Italy	0.0	-0.7	0.2	-0.1	0.1	-1.3	-1.1	1.3	-0.2

Source: IMF

The above table shows the countries with the highest foreign trade deficit in the period from 2005 to 2012. The criterion used is the highest average foreign trade deficit generated in the period concerned.

The prerequisite of any analysis is good data. If observed from this perspective, a logical question about quality of statistics produced by those countries arises. It is a fact that there are international standards put in place to ensure the uniformity and thereby the comparability of data, but it is also a fact that the degree of conformity of each country's statistics with international statistics is different. This is also the greatest reason of non-conformity of import and export flows when observed at a global level. It is clear that richer countries invest more in the improvement of statistics, while poorer countries do not rank good quality statistics development very high on their priority scale.

Based on data from the previous table, one may see that the foreign trade deficit champions are Anguilla and Montserrat⁸ with average foreign trade deficits of 138.2% and 121.3% of GDP respectively. Anguilla is also the champion in the highest annual foreign trade deficit generated in 2006, which amounted to 176.7% of GDP. It is followed by a continental country, Afghanistan, with the average foreign trade deficit of 55.2% of GDP. Montenegro took a very high seventh place in this list of average foreign trade deficits. Foreign trade deficit is not bad per se. It depicts the characteristics of a country economy and its orientation toward other types of production. However, what poses a dilemma is the level of deficit.

Let us take a look at some basic characteristics of the countries analysed. They are mainly small, underdeveloped island countries (green fields), an important share of which engages in fishing and some forms of tourism, or very poor continental countries (Moldova) and countries with economies in disarray, some of which were involved in war events until recently (Afghanistan, Liberia). Montenegro is not an island country but it has a coastline. Most of these countries are as little populated as Montenegro. Finding further characteristics that Montenegro and these countries may have in common would probably require a deeper, separate analysis of each country. Nonetheless, a general conclusion is that Montenegro has very little in common with most of these countries if looked at from the viewpoint of economy and economic and political stability.

Let us consider the situation in the neighbouring countries. Kosovo is the closest to Montenegro in terms of average foreign trade deficit of 41.4% of GDP (5 percentage points less than Montenegro), followed by Bosnia and Herzegovina with an average deficit of 32.7% of GDP (13.7 percentage points less than Montenegro), Albania with 20.4% of GDP (26 percentage points less) and so on. If we observe the annual deficit, Montenegro is the champion with its deficit of 65.6% of GDP generated in 2008, followed by Bosnia and Herzegovina and Kosovo with 45.1% each and Albania with 27.5% of GDP.

⁸ *Anguilla is a British overseas territory in the Lesser Antilles, the Caribbean, lying east of Puerto Rico, having the surface area of 91 km² and 61 km coastline. Its main industries are fishing and tourism. Montserrat is an island in the Caribbean, having a surface area of 102 km², located in the Leeward Islands, that is, the Lesser Antilles. Source: Wikipedia*

Let us now take a look at the situation regarding international import of goods. If we observe the average import of goods, expressed as a percentage of GDP, Montenegro takes the 23rd place with 61.7% of GDP, out of all 190 countries, Hong Kong⁹ ranked first with an average share of 179.9% of GDP. Singapore ranked third. The import of goods of Hong Kong was 201.7% of the generated GDP in 2012, which put it in the first place in the period from 2005 to 2012. In the period observed, Montenegro's import was the highest in 2008 when it reached 80.2% of GDP and, according to this criterion, it made Montenegro take the 13th place out of 190 countries.

However, countries such as Singapore and Hong Kong are not relevant for this work. The reason lies in the fact that those are countries with a significant share of import as well as export of goods in GDP, i.e. their foreign trade balance (surplus in case of Singapore or deficit in case of Hong Kong) is not as high as Montenegro's. For instance, in the period from 2005 to 2012, Singapore's average import was 143.8% of GDP while its export was 172.7% of GDP. Singapore is one of the countries whose development is based on duty-free trade and export of processed import products. A parallel with Montenegro cannot be drawn here because Montenegro does not engage in processing, i.e. finishing activities¹⁰. However, if one is to take a look at Montenegro's import and export, one may see that even though the share of the *Oil and oil derivatives* position is high in import, a significant part also refers to export. Nevertheless, considering that no processing of oil derivatives is conducted in Montenegro, this is a classic case of re-export (the situation with electrical energy is similar).

Due to above reasons, the starting point for examining the import per country will be the previous table — countries with the highest foreign trade deficit.

⁹ *Hong Kong is one of the Special Administrative Regions of China with its own self-government. It is treated as an independent country by the IMF in its statistical data, which is why it has been included here.*

¹⁰ *Parts of footwear used to be imported once, assembled in Cetinje and then exported as finished goods. That was a standalone case though and such a thing does not exist anymore.*

NET ERRORS AND OMISSIONS

Table No. 3 - Import of goods as GDP percentage, 2015-2012

Country	2005	2006	2007	2008	2009	2010	2011	2012	Average
Anguilla	-135.4	-188.3	-166.7	-183.0	-142.1	-140.0	-127.7	-125.5	-151.1
Montserrat	-144.9	-139.2	-130.9	-158.0	-118.4	-125.5	-137.7	-118.4	-134.1
Lesotho	-94.7	-94.3	-93.9	-93.0	-91.1	-87.7	-86.5	-93.0	-91.8
Seychelles	-74.5	-73.6	-65.8	-87.1	-86.5	-75.4	-84.2	-87.9	-79.4
Afghanistan	-92.0	-91.1	-84.6	-85.5	-75.8	-62.5	-58.8	-56.0	-75.8
Moldova	-76.8	-77.6	-83.4	-80.4	-60.2	-65.5	-73.3	-71.3	-73.6
Marshall Islands	-61.9	-57.2	-58.7	-58.9	-62.2	-81.6	-69.5	-66.7	-64.6
Jordan	-74.0	-68.1	-71.2	-68.8	-53.1	-52.3	-58.3	-59.0	-63.1
Maldives	-66.0	-62.6	-62.6	-64.5	-42.9	-57.4	-69.1	-68.4	-61.7
Montenegro	-55.7	-66.5	-75.7	-80.2	-54.3	-52.3	-55.1	-53.5	-61.7
Bosnia and Herzegovina	-68.5	-61.2	-64.5	-65.9	-51.3	-55.3	-60.8	-60.6	-61.0
Bulgaria	-59.7	-66.4	-67.5	-67.2	-45.4	-50.8	-58.2	-61.5	-59.6
Macedonia	-52.0	-55.7	-61.2	-66.3	-52.1	-56.1	-64.8	-64.8	-59.1
Slovenia	-54.4	-58.6	-62.0	-60.9	-47.6	-55.5	-61.7	-61.2	-57.7
Liberia	-45.9	-59.2	-52.5	-63.5	-49.7	-52.2	-65.5	-63.2	-56.5
Kiribati	-67.0	-55.9	-53.1	-53.1	-53.8	-49.5	-52.5	-52.3	-54.7
Cabo Verde	-45.1	-50.4	-55.7	-56.0	-48.1	-49.1	-55.7	-51.8	-51.5
Tajikistan	-41.9	-47.5	-55.4	-61.9	-48.0	-45.2	-56.8	-53.3	-51.3
Tuvalu	-49.0	-42.4	-35.9	-52.8	-48.0	-55.1	-58.1	-52.2	-49.2
Saint Lucia	-46.2	-51.6	-48.1	-51.9	-39.2	-48.6	-50.8	-48.4	-48.1
Kosovo	-38.2	-41.5	-45.5	-49.0	-47.3	-49.4	-52.0	-49.8	-46.6
Djibouti	-43.3	-51.0	-56.9	-58.4	-43.0	-33.3	-43.3	-43.4	-46.6
Antigua and Barbuda	-45.7	-49.3	-50.3	-49.7	-43.8	-40.0	-38.3	-39.1	-44.5
Samoa	-41.4	-45.0	-46.4	-40.7	-43.9	-44.8	-44.0	-49.6	-44.5
Serbia	-40.9	-43.2	-47.3	-49.0	-37.8	-43.0	-44.2	-49.1	-44.3
São Tomé and Príncipe	-33.8	-43.8	-45.0	-50.2	-42.6	-47.8	-46.6	-37.4	-43.4
Saint Vincent and the Grenadines	-38.6	-38.9	-42.1	-47.3	-43.6	-43.7	-42.3	-42.6	-42.4
Grenada	-43.1	-42.5	-43.2	-41.0	-34.1	-37.0	-37.2	-36.5	-39.3
Tonga	-39.6	-38.4	-38.7	-41.0	-38.7	-36.7	-38.4	-38.8	-38.8
Croatia	-40.9	-42.3	-42.9	-43.4	-33.7	-33.9	-36.4	-35.2	-38.6
Albania	-30.4	-32.3	-37.0	-37.9	-35.0	-36.3	-39.1	-36.3	-35.6
Greece	-21.6	-24.7	-26.4	-27.4	-19.9	-20.4	-22.8	-21.5	-23.1
Italy	-20.8	-23.0	-23.3	-23.6	-19.2	-23.1	-24.9	-23.6	-22.7

Source: IMF

If we now observe the average export as a GDP percentage, Montenegro qualifies 139th out of 190 included countries, with an average export of 21.5% of GDP in the course of those eight years. Singapore and Hong Kong are the champions, of course, with an average export of 172.7% of GDP

NET ERRORS AND OMISSIONS

and 166% of GDP respectively. The same applies to the highest export: Singapore – 192.9% of GDP and Hong Kong – 176% of GDP.

Montenegro's situation is a little better if the highest export in that period is observed. Montenegro generated the highest export in 2006 (21.5% of GDP) and took 134th place. For the sake of comparability with other tables, the following table contains countries and an additional column specifying the place a specific country has taken in the list of 190 countries.

Table No. 4 – Import of goods as GDP percentage, 2015-2012

Ord. No.	Country	2005	2006	2007	2008	2009	2010	2011	2012	Average
29	Slovenia	50.8	54.9	57.2	54.5	46.2	52.7	58.8	60.4	54.4
37	Lesotho	47.1	51.3	50.9	51.8	43.4	40.9	42.9	44.3	46.6
42	Bulgaria	40.7	45.4	43.9	42.9	33.5	43.2	52.6	52.4	44.3
45	Seychelles	38.2	42.0	38.5	45.2	51.0	41.1	45.0	47.8	43.6
81	Moldova	37.0	31.1	31.2	27.2	24.4	27.4	32.4	30.6	30.2
90	Bosnia and Herzegovina	23.4	27.0	27.5	27.8	23.7	29.8	33.2	33.7	28.3
104	Serbia	19.8	21.9	22.4	22.8	20.7	26.6	27.1	30.3	24.0
110	Italy	20.8	22.3	23.5	23.5	19.2	21.8	23.9	24.9	22.5
118	Liberia	16.8	21.7	21.9	22.8	13.3	16.7	24.7	27.6	20.7
119	Croatia	20.0	21.2	21.1	20.5	17.1	20.4	22.0	22.1	20.6
120	Afghanistan	28.6	25.8	21.2	23.5	20.2	16.5	15.2	13.1	20.5
126	Marshall Islands	17.1	12.5	12.2	13.2	13.7	19.8	29.3	28.9	18.3
139	Montenegro	20.3	21.5	18.0	14.6	9.9	11.5	14.7	11.8	15.3
148	Saint Lucia	9.8	9.6	9.0	14.8	16.4	19.9	15.8	14.0	13.7
149	Maldives	16.3	17.3	14.8	17.5	8.5	9.4	12.6	12.0	13.5
152	Anguilla	17.8	11.7	7.0	8.8	22.3	12.8	11.1	11.4	12.9
153	Montserrat	10.4	9.4	15.8	19.2	14.7	4.7	11.5	16.6	12.8
158	Albania	8.0	8.8	10.1	10.4	9.0	13.1	15.1	15.5	11.2
170	Greece	7.4	7.7	7.8	8.5	6.6	7.7	9.7	11.4	8.3
171	Cabo Verde	9.2	8.7	6.1	7.3	5.8	8.1	11.1	9.8	8.3
176	Saint Vincent and the Grenadines	7.7	6.7	7.5	8.2	7.9	6.6	6.3	7.0	7.3
178	Kiribati	5.2	3.2	9.3	6.7	6.3	3.9	6.2	6.4	5.9
180	Kosovo	2.3	3.9	5.2	5.6	4.5	7.2	6.9	5.7	5.2
181	Antigua and Barbuda	8.3	6.5	4.6	4.9	2.9	4.0	5.0	4.8	5.1
182	São Tomé and Príncipe	5.5	5.7	4.7	4.3	4.7	5.9	4.4	4.6	5.0
184	Grenada	4.7	4.6	5.4	4.9	4.6	4.0	4.5	4.7	4.7
187	Tonga	5.5	4.3	2.9	2.3	2.3	2.4	2.6	2.5	3.1
188	Samoa	3.1	2.4	2.3	2.2	2.1	3.0	3.6	4.8	3.0
189	Tuvalu	1.5	1.8	1.5	1.8	1.6	1.4	1.9	1.8	1.7

Source: IMF

In the previous three tables a doubt on deficit of goods data accuracy, i.e. its levels and thereby its sustainability has been expressed, although not many similarities between Montenegro and the countries having an analogous deficit level could be found. A more precise conclusion would require more data.

However, the result obtained from the comparison of official statistics data could be used as a warning sign that something may be wrong. The Mirror Statistics is what is implied here. The Mirror Statistics is used to compare good exchange data between two or more countries in a given period of time. In this way, the exchange of goods can be compared not only at total import/export level but also at customs tariff and procedures level and the causes of statistical data mismatch can be explained. The reasons of data discrepancy between two countries may be different, starting from correct filling out of the customs declarations and quality of statistical processing to various unlawful behaviours aimed at evading the payment of liabilities arising from economic activities. In the European Union, where nearly identical methodology regarding the movement of goods monitoring is applied, the data on foreign trade partners differ as well. The quantity of reasons that suffice is indicated by the data according to which the international theory defines a possible range of discrepancy¹¹ from 0% to 200% when mirror statistics is at stake. Low discrepancy is a discrepancy that ranges from 0% to 15%, medium discrepancy ranges from 15% to 50% whereas high discrepancy ranges from 50% to 200%. However, discrepancy exceeding 30% already constitutes a reason for additional data check and identification of discrepancy causes. According to Galinec¹², if the comparative analysis of good exchange between two countries shows differences higher than 10 to 15% at the level of all indicators or just an isolated higher difference between indicators at product level, this is an indication of the existence of grey economy in the sector concerned.

Not only does the discrepancy differ from country to country, but also the same discrepancy level has a different meaning for a large country with a significant volume of foreign trade transactions and a different meaning for a small country etc. Therefore, the fact itself that there is a discrepancy must be treated as a sign of certain matters needing some revision. This kind of statistics is frequently used in the world nowadays, and not solely due to the foreign trade data quality. As early as in 1987, the United States of America and Canada (more precisely U.S. Census Bureau and Statistics Canada) signed an agreement on balance of payments data exchange and their annual control. The USA have similar arrangements with other important foreign trade partners, such as China.

¹¹ A discrepancy is a difference expressed in percentage between the value of the country initiation the mirror analysis and the value of the compared country, determined according to the formula defined by EUROSTAT. Discrepancies can range between 8 and 200 %. If no discrepancy is found, then there are no differences between the two countries data, which is quite a rare phenomenon. If the discrepancy is 200 %, it means that one of the countries failed to record the foreign trade turnover.

¹² Galinec, D., „Neslužbeno gospodarstvo u vanjskoj trgovini“, *Financijska teorija i praksa* 26 (1), p.197-212, Croatia, 2002

NET ERRORS AND OMISSIONS

Table No. 5 – Reconciliation of USA and Canada data

Year	Official statistics		Reconciliation	
	USA	Canada	USA	Canada
2008	-80.4	83.0	-92.8	92.8
2009	-22.4	30.5	-33.5	33.5

Source: Reconciliation of the United States-Canadian Current Account, 2008 and 2009, www.bea.gov

Let us return to Montenegro's case. In 2011, Monstat wrote a working paper titled "Mirror analiza spoljnotrgovinske razmjene Crne Gore" (Mirror Analysis of Montenegro's Foreign Trade Exchange)¹³. Apart from the theoretical part, the working paper contains very useful practical information as well. The working paper encompasses the trade in goods between Montenegro and EU countries and Western Balkans countries, in the period from 2006 to 2009.

In this period, the value of goods exported to these countries by Montenegro ranged from 94.5% and 98.5% of Montenegro's export. At the same time, the value of goods imported by Montenegro ranged from 76.7% to 81.8% of the total imported goods value. Furthermore, the level of discrepancy of the value of Montenegro's import from EU countries ranged from 16.2% (93 million euro) and 33.6% (271 million euro), that is, the value of import of goods according to our data is higher by this percentage than the data provided by the export countries. The highest value of *Net errors and omissions* position recorded was 250 million euro in 2012. This is another example of how the same indicators applied to different countries do not necessarily have to mean the same, especially when small and highly open countries are at stake. The greatest discrepancies in Montenegro's import data have been evidenced in the trade of goods with Greece, Germany and France where they ranged from 39.8% to 145.4%.

Table No. 6 – Montenegro's import asymmetries and deviations¹⁴

Year	2007		2008		2009	
	Asymmetry in m EUR	Deviations in %	Asymmetry in m EUR	Deviations in %	Asymmetry in m EUR	Deviations in %
Greece	-29.5	48	-152.5	143.6	-71.2	111.4
Germany	-115	72.8	-74.7	39.8	-40.8	45
France	-46.4	145.4	-32.8	71.7	-19.5	110.2

Source: Working paper No. 1 „Mirror analiza spoljnotrgovinske razmjene Crne Gore“, Monstat

¹³ A year before that, CBMN wrote a working study titled: "Analiza statistike spoljne trgovine Crne Gore po opštem i specijalnom sistemu trgovine" (Analysis of Montenegro's Foreign Trade Statistics according to general and special trade system) where this topic is developed in a greater detail from different aspects. Considering that Monstat is in charge of foreign trade statistics by law and that it is at source of information, Monstat's data will be used as the most relevant.

¹⁴ The "-" sign means that the data available to Monstat are higher by that amount then, in this case, the export countries' data.

As far as Germany and France are concerned, the greatest asymmetries¹⁵ appear in Chapter 87: *Vehicles, except railway or tramway, and parts thereof*. In case of Germany, this product group asymmetry ranged from 84 million euro (118% discrepancy percentage) in 2007 to 20 million euro (83% discrepancy percentage) in 2009. The data on France show a lesser percentage; in those three years, the asymmetry ranged from 27 million euro (193% discrepancy percentage) to 9 million euro (173% discrepancy percentage). A possible reason given for this discrepancy is the "Rotterdam Effect"¹⁶ which means that due to the absence of customs declarations among EU Member States, different data indicating from which country the goods were imported are obtained. Should one assume that the vehicles were imported only from these two countries, the fact that the asymmetry ranged from approximately 30 to 110 million euro (if taken accumulatively for both countries) or the fact that the amount of asymmetry in those three years was 220 million euro, would be more important than the answer to the question of how many vehicles were imported from which country. This is just an issue to think about and it requires further analysis. As far as vehicles are concerned, other countries exporting to Montenegro should also be taken into account (e.g. Italy).

It is a fact that the import of vehicles has been an important position of import of goods in the past ten years. It is also a fact that in the previous years, the share of import of second-hand cars in the total import of vehicles was significant. So, in 2005, nearly 90% of imported cars were second-hand cars, in 2006 their share decreased to 64% while in 2007 the structure changed in favour of new cars, with a share of 55%.¹⁷ At this point, the balance of payments statistician wonders (from the aspect of source of *Net errors and omissions*, of course) if the customs declaration indeed contained the value of the second-hand car to begin with and second, if the car was paid via bank channels. Reporting an erroneous amount in order to pay, for instance, less customs duties and other obligations, the purchase of vehicles with cash as well as the payment of other obligations abroad with cash which are necessary to import the vehicle (from various papers (bureaucracy) to the petrol needed to transport the vehicle) and so on, are the reasons leading to statistical mismatch between the flow of goods and the cash flow, i.e. the reasons of existence of *Net errors and omissions*. The volume of import of second-hand cars in the past ten years does not require a separate elaboration, especially if we remind ourselves that this sector represented a profitable business, above all in the period when cars from Montenegro provided with a power-of-attorney could be driven in Serbia.

If we consider the trade with Greece, the asymmetry ranged from 26 million euro (60% discrepancy percentage) in 2007 and 147 million euro (176% discrepancy percentage) in 2008.¹⁸ The most frequent differences appear in Chapter 27: *Mineral fuels, mineral oils and products of their distillation*, and the explanation of such differences is that Greece failed to record its fuel export to Mon-

¹⁵ Taken as the greatest difference according to value in thousands of euro, not to discrepancy percentage.

¹⁶ Apart from the Monstat's paper, see the following web page for major details on the "Rotterdam Effect": http://www.dzs.hr/Hrv/intrastat/acquis/intrastat_guidelines.pdf

¹⁷ Analiza održivosti deficita tekućeg računa Crne Gore, www.cb-cg.org/radne_studije.

¹⁸ Just a reminder: 2008 was the year of the highest import and thereby the highest foreign trade deficit of Montenegro.

tenegro. According to Monstat, the accuracy of the foreign trade data is also based on the analysis of fuel import and collection of excise tax.

Regarding data on Montenegro's export to EU countries, the paper does not reveal important differences and it shows the discrepancy level ranging from 0.1% to 7.9%. The highest differences are observed in good exchange with Greece and Germany, where the discrepancy level in 2007, 2008 and 2009 ranged from 13.2% to 34.2%.

As far as the neighbouring countries are concerned, the aforementioned work provides an overview for 2008 and 2009 revealing the greatest asymmetry in Montenegro's import from Serbia (120 million euro in 2008 and 74 million euro in 2009) The most important position according to the impact on total asymmetry (140 million euro in 2008 and 44 million euro in 2009) is Chapter 27: *Mineral fuels, mineral oils and products of their distillation*. A constituent part of this Chapter is also electrical energy and the discordance is related to the Electrical Energy Exchange Agreement (H.E Piva), i.e. it is explained by the application of different methodology in these two countries.

Finally, the conclusion regarding Montenegro's export to EU countries is that "there are no important differences" and that discrepancies in terms of import range from 16.2% to 28.9%. In the case of trade with Western Balkans countries, discrepancies are more significant.

In the end, let us examine the situation after comparing the flows of goods (data source: customs declarations) with cash flows (data source: commercial banks¹⁹).

Each purchase and sale of goods, i.e. each import and export is followed by a movement of money, but in the opposite direction (we will exclude the possibility of good bartering, for its impact is minor). From the viewpoint of value, these data must differ in a short period of time due to the impossibility of purchasing goods on an instalment basis, prepayments and similar. However, if observed in a longer period of time, these flows should not differ significantly.

Let us take a look at the situation in the period from 2006 to 2012.

¹⁹ The reporting system of commercial banks to the central or national bank is called ITRS (International Transactions Reporting System)

NET ERRORS AND OMISSIONS

Table No. 7 – Overview of the flow of goods based on two different sources - customs declarations and ITRS

		2006	2007	2008	2009	2010	2011	2012
A	Export of goods with customs declaration ITRS	532.9	530.8	550.5	343.1	424.6	486.8	387.9
B	Export - Monstat	441.1	454.7	416.2	277.0	330.4	454.4	366.9
C	Import of goods with customs declaration ITRS	1,244.2	1,871.5	2,247.0	1,491.8	1,581.1	1,760.2	1,677.2
D	Import - Monstat	1,457.4	2,073.1	2,529.7	1,654.2	1,657.3	1,823.3	1,820.8
D	Import difference (B-A)	-91.8	-76.0	-134.4	-66.0	-94.3	-32.4	-21.0
F	Export difference (D-C)	213.2	201.6	282.8	162.4	76.2	63.2	143.6
G	Deficit according to ITRS	711.2	1,340.7	1,696.4	1,148.7	1,156.5	1,273.4	1,289.4
H	Deficit according to Monstat	1,016.2	1,618.4	2,113.6	1,377.2	1,327.0	1,369.0	1,454.0
I	Difference in deficits	305.0	277.6	417.2	228.4	170.5	95.6	164.6

Source: CBMN and Monstat

There are two types of data in the table; the data sourced from Monstat are provided in rows B and D while ITRS data (source: commercial banks) are provided in rows A and C. Rows A and B show the export of goods while C and D show the import of goods.

By comparing rows A and B, we may deduce that the money inflow from the export of goods is always higher than the value of export of goods received on the basis of customs data (row E). Such amount ranged from 21 million euro to 134.4 million euro in the period concerned. In contrast, as far as the import of goods and the respective payment are concerned (rows C and D), we may see that the payment for the goods imported is constantly lower than the value of imported goods, ranging from 63.2 million euro to 282.8 million euro. Finally, if we observe the deficits: the "cash deficit" is always lower and such shortfall ranges from 95.6 million euro to 417.2 million euro. In other words, in those seven years, approximately 1.7 billion euro less than the value of net import (cumulative good deficits) was paid in total.

What are possible reasons for this difference? Considering that data are involved here, it is possible that they are not delivered for the processing at the same time. For instance, the money has been sent but the goods are retained at the customs for some reason or, as in the case once related with the import of electrical energy, the electricity was imported but the customs duties were not paid at that moment so the customs declarations were not sent for processing²⁰. We had the money outflow (the payment for the import of electricity) but the customs import data did not exist. The import of electricity could not be stopped or stored due to the peculiarity of this commodity, but the import had to be paid. It would be very interesting to see how the present electricity situa-

²⁰ In the past there was a rule of submitting a customs declaration for process only after the entire customs procedure was completed, i.e. after all customs duties were paid by the importer.

NET ERRORS AND OMISSIONS

tion reflects itself onto the balance of the balance of payments (considering the situation with the plant KAP, where there is import, but no payment). In all these cases, the imbalance is "adjusted" if observed in a longer period of time. The next reason is the purchase on credit, implying either long-term financing or short-term prepayments.

For example, a machine worth 100,000 EUR was imported and the agreement stipulated that 50,000 EUR must be paid at the moment of delivery of goods and the remaining 50,000 EUR in the forthcoming period. Correct recording would be:

	<u>CREDIT</u>	<u>DEBIT</u>
Export of goods	100,000	
Other investments		
Funds/Commercial credit		50,000
Cash and bank deposits		50,000

In this case Net errors and omissions will be zero. However, if there were no data on commercial credit, the recording would be as follows:

	<u>CREDIT</u>	<u>DEBIT</u>
Export of goods	100,000	
Other investments		
Cash and bank deposits		50,000
Net errors and omissions		50,000

Also, it is not rare that a foreign partner requires from a domestic buyer (a resident of Montenegro importing the goods) to deposit a certain amount on an account abroad as a prepayment for the future purchase of goods. In ITRS this is recorded as a payment for imported goods and since this would refer to goods that had not been imported yet, a time gap affecting Net errors and omissions was created. The time gap had to be removed by time adjustment. The time gap thus created was successfully eliminated by means of a system that once existed within the Currency and Documentary Control Department (the CDC Department) and which will be discussed in detail further below. We are moving on to prepayments now.

Given that bank data also offer data on prepayments up to 90 days, let us take a look at what we would get if we added them in the previous table.

NET ERRORS AND OMISSIONS

Table No. 8 - Comparison of customs and commercial banks' data

		2006	2007	2008	2009	2010	2011	2012
A1	Export of goods with customs declaration ITRS	532.9	530.8	550.5	343.1	424.6	486.8	387.9
A	Export prepayment	4.3	4.6	14.2	5.1	4.8	12.2	10.5
A	Total A + A1	537.3	535.4	564.8	348.1	429.4	499.0	398.4
B	Export - Monstat	441.1	454.7	416.2	277.0	330.4	454.4	366.9
C1	Import of goods with customs declaration ITRS	1,244.2	1,871.5	2,247.0	1,491.8	1,581.1	1,760.2	1,677.2
C	Prepayment of imported goods	181.8	224.4	233.3	124.2	140.9	97.8	120.3
C	Total C1 + C2	1,426.0	2,095.9	2,480.2	1,616.0	1,722.1	1,858.0	1,797.5
D	Import - Monstat	1,457.4	2,073.1	2,529.7	1,654.2	1,657.3	1,823.3	1,820.8
D	Import difference (B-A)	-96.1	-80.6	-148.6	-71.1	-99.1	-44.6	-31.5
F	Export difference (D-C)	31.4	-22.8	49.5	38.1	-64.7	-34.6	23.3
G	Deficit according to ITRS	888.7	1,560.5	1,915.5	1,267.9	1,292.6	1,359.0	1,399.1
H	Deficit according to Monstat	1,016.2	1,618.4	2,113.6	1,377.2	1,327.0	1,369.0	1,454.0
I	Difference in deficits	127.5	57.9	198.1	109.2	34.3	10.0	54.8

Source: CBMN and Monstat

This table reveals a significant amount of prepayments under import of goods, while that amount is, certainly, clearly lower under export. Furthermore, it is evident that the difference between the "paid deficit" and actual deficit contracted and that in 2012 it amounted to 600 million euro.

Until ten years ago, there was an organisational unit in charge of cash and goods flow control at the Central Bank of Montenegro. The import and export of goods from three sources was monitored by that organisational unit (Currency and Documentary Control Department). One source were customs declarations, the second source were payment transactions data provided by the banks and the third one were "import-export reports of concluded foreign trade transactions". By combining these three sources, the time of physical crossing of goods at the border and the cash flow related to those goods were known. Thus, time adjustment of such data could be performed and imbalance of cash and goods flows avoided. Also, the reason of difference between the cash flow and the goods flow — whether due to advance collection, trade loans or something else — was easily identifiable. Unfortunately for the statisticians, this kind of control was abandoned. The reason of abandonment given was that such control represented a business barrier that slowed down trade flows and made them more expensive.

Serbia has a State Inspectorate that gathers information from four sources:

1. from the Customs Administration – import and export of goods data;
2. from the National Bank of Serbia – collection order, i.e. payment data and data on registered credit reports;
3. from the Serbian Business Registers Agency – data on registration of businesses; and
4. from the Ministry of Foreign Economic Relations.

Based on these data the compliance with laws applicable in foreign trade is monitored on the one hand, and on the other hand this kind of control and record keeping is a good source of data concerning goods flows, trade loans, i.e. deferred payments and collections, compensations and similar.

Consequently, it seems that greater reasons for the existence of errors should be sought in import.

4.2 Services

The next current account position that may be the source of errors and omissions is Services. Tourism represents the most important and the most demanding position within the above position in terms of assessment. It is the most important position not only for the purpose of balance of payments statistics but also due to its impact on Montenegrin economy. The following table shows the income from tourism and the value of import of goods per year. As it is evident from the table, tourism has been the most important export product of Montenegro since 2008.

Table No. 9 - Income from tourism and import of goods, in million EUR

	2006	2007	2008	2009	2010	2011	2012	Total
Assessed income	271	460	541	526	552	619	643	3,612
Export of goods	462	483	450	296	357	477	392	2,917

Source: CBMN

The data on Montenegro's annual income from tourism are obtained on the basis of an assessment. The basis of assessment is the number of overnight stays provided by Monstat to which the assessment of the number of unregistered tourists and the average daily consumption per tourist are added, as well as data on health tourism and some other positions having a minor impact on total income. In most countries that generate significant income from tourism, data on total income are provided by assessments. In this case, the data provided by commercial banks turned out to be less accurate, especially in the case of countries where cash is preferred. In Montenegro, this is more than pronounced. Let us take a look at the data in the following table.

Table No. 10 - Income from tourism, commercial banks' assessment and records, in million EUR

	2006	2007	2008	2009	2010	2011	2012	Total
Assessed income	271	460	541	526	552	619	643	3.612
ITRS	162	224	251	237	234	284	349	1.741
Difference	109	235	290	288	318	335	295	1.871

Source: CBMN

Assessed income from tourism is displayed in the first row, the commercial banks' data are displayed in the second row and the difference between these two sources is displayed in the third row. The difference actually represents the amount of funds that cannot be encompassed by the foreign payment transactions statistics. A part of these funds remains in hands of the residents and is used either for everyday consumption or deposited into giro and current accounts (excluding foreign currency accounts), and a significant part ends up in the trade sector and other sectors of local services, therefore, assessed income from tourism greatly differs from what is "caught" by the ITRS. The sum of differences in the period from 2006 to 2012 is higher than total income showed on the basis of ITRS. The banks include all the money generated as a result of services provided by various travel agencies²¹, hotels, restaurants, health services, recreational and entertaining services in tourism-related data, an important part of which refers also to all payment card transactions. In some countries, payment card data, as well as information on currency exchange transactions (currency exchange in exchange offices) were used for the assessment of a part of income from tourism. However, this proved to be wrong and it was abandoned by most of them. If this were applied to the previous table as well, the difference between assessed income and ITRS income would be significantly higher.

Some main reasons for the big differences are:

- high rate of cash payments²²
- high share of private accommodation in total accommodation capacities
- significant percentage of unregistered private accommodation
- impossibility to distinguish euros of domestic origin from euros of foreign origin.

We will illustrate how this affects the Net errors and omissions position by a simple example. Let us assume that the assessed income from tourism equals 500 million euro. By means of foreign payment transaction statistics we have recorded 350 million euro and this sum resulted in the increase of receivables from non-residents by the same amount (the *Cash and deposit* position

²¹ The assessment that can be found in a research conducted by the Visa company indicates that in terms of travel organisation, 76.5 % of visitors organised their stay on their own and that only 16 % of subjects used a travel agent's services. In the document "Istraživanje o turističkim iskustvima posjetilaca sjevernog i južnog regiona Crne Gore" (Research of tourist experiences of visitors to Montenegro's north and south regions) this percentage is 66.4 %.

²² In the research mentioned in the previous footnote, the Visa company found out that 74 % of subjects pay their accommodation in cash.

has increased). Given that this is the double-entry bookkeeping system, another 150 million are needed to close the position. These 150 million are in reality kept by the residents, whether "in their pockets or in their mattresses". A part of this sum is used for everyday consumption, while the other part is deposited on current or gyro accounts without indicating that the money was received by letting out rooms to non-residents, or from similar sources. The balance of the balance of payments accounts is, in this case, attained by increasing the *Net errors and omissions* position by those 150 million euro.

	<u>CREDIT</u>	<u>DEBIT</u>
Travel	500	
Cash and deposits		350
Net errors and omissions		150

Therefore, even if we used only the data provided by the banks, they would not correspond to actual movements and we would have a significant source of discordance, that is, Net errors and omissions. In fact, this is the reason why this income is assessed in the first place.

There are several means of income assessment used by countries where tourism represents an important economic sector. Some count the number of tourists and conduct tourist polling at border crossings and some do it in accommodation capacities. This is usually carried out by agencies specialising in this activity, whose services are used by central banks, ministries of tourism, finances and other interested parties. In the case of Montenegro, beside the four reasons mentioned above, there is a series of factors that make a good assessment more difficult. The first is the fact that most of accommodation capacities are privately owned. However, the exact number of accommodation capacities in Montenegro and the portion of private accommodation are unknown. The document of the Government of Montenegro titled "Politika i strategija razvoja turizma do 2020. godine" (The policy and strategy of tourism development until 2010) reports, based on Monstat's data, that there were 120,000 registered beds in 2005, 26.3% out of which refers to hotel accommodation and 45.9% to registered private rooms, while data on holiday and recreational apartments are unavailable. Furthermore, one must highlight the data from a study conducted by the International Tourism Institute in Ljubljana²³, according to which there are 300,000 beds in Montenegro with only 13.3% of them pertaining to hotel accommodation. The difference is more than significant. If one is to add the fact that a certain number of such beds is owned by non-residents (some from neighbouring countries, some from other countries further away who became interested in Montenegro during the real estate property purchase process²⁴), and the fact that this number is also unknown, then the income assessment task becomes more complicated. It is a fact that a part of these accommodation capacities is intended for letting out and that the money goes to their

²³ This study was ordered by the Ministry of Tourism and Environmental Protection of Montenegro.

²⁴ In the past ten years, billions of euro of foreign capital have been invested in the real estate sector.

owners outside Montenegro. The same document reveals that the estimated number of overnight stays realised²⁵ is almost three times higher than the registered one.

All this demonstrates how difficult conducting an assessment of the benefits that tourism brings to Montenegro is, and the extent to which such an assessment is realistic comes into question. In contrast, the table data show a major difference between the assessed income from tourism and what passes through bank channels. The total difference for the period from 2006 to 2012 was a little over 1.9 billion euro.

The answer to the question if the entire amount of that money was kept by the residents in cash and if and how much of it has been deposited into domestic accounts, would definitely allow for a much easier allocation of such funds to the *Cash and deposit* position of the balance of payments financial account, and thereby affect the errors and omissions level.

The solution to this problem requires time and, above all, more discipline in the real sector and tourism — registration of all accommodation capacities, keeping record of accommodation capacities owned by non-residents, etc. since the difference between official data and data given in the relevant studies is unacceptably high. Only after this has been accomplished, a model allowing for a good quality and reliable statistics of trends in this sector should be defined.

At this point, we shall conclude the section related to the account of services, although there are still some positions of this sub-account that may represent a source of discordance. Nevertheless, their impact on the balance of the balance of payments is lesser than a possible impact of the tourism sector.

4.3. Current transfers and factor income

Even though these two sub-accounts of the current account of the balance of payments are treated separately from the methodological point of view, we will examine them jointly in this paper.

The term "remittances" has become a customary term denoting a major part of current transfers and factor income. This implies all money that migrants and people on temporary work abroad send to their families in Montenegro. The largest portion of this money is sent by the migrants and sailors working on foreign ships. Unfortunately, what these two categories have in common is the lack of a basic piece of information — the number of those people. As strange as it may sound for a country as small as Montenegro, as well as for someone who sends important amounts of money

²⁵ The estimate of the International Tourism Institute given in the study: „Inventarizacija turističkih smještajnih kapaciteta i procjena turističkog prometa“ (The inventory or tourist accommodation capacities and the assessment of tourism turnover).

to their homeland, their number is unknown. While in the case of sailors²⁶, a 4,000 to 5,000 figure has been mentioned in the past ten years, no usable data can be obtained for the migrants.

Only a smaller portion of remittances is registered. The reason lies in the way they are transferred. Most remittances are transferred by informal channels, i.e. buses, plane, through relatives, etc. Therefore, if other cash flowing in through informal channels would be included, especially in summer when the migrants are visiting, that amount would be notably higher.

Let us consider the order of magnitude.

From the beginning of 2005 to the end of 2012, the registered inflow of remittances sent to Montenegro amounted to 1.99 billion euro. This represents almost two thirds of the Gross Domestic Product in 2012. This amount also included the assessment of sailor income, amounting to approximately 45 million euro a year. The exact percentage of unregistered income has never been determined, not even nearly.

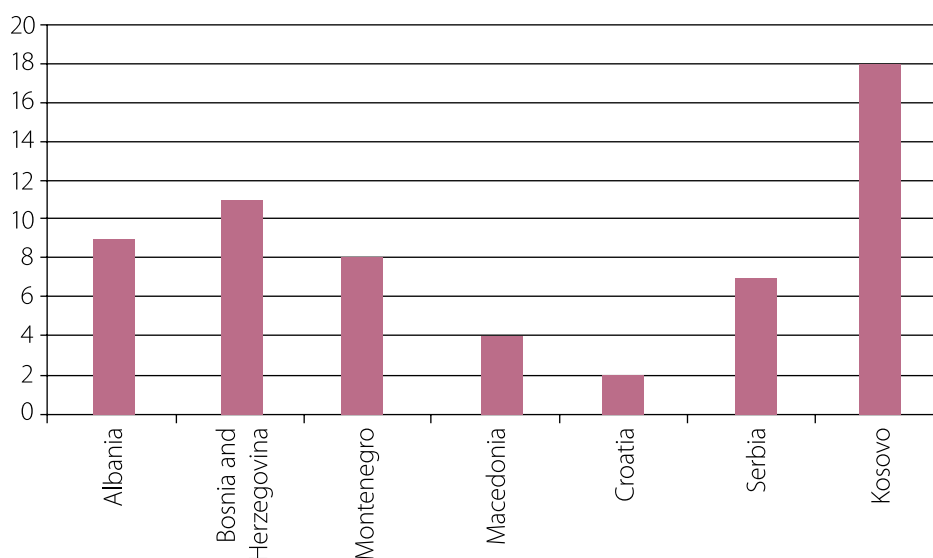
The fact that a large sum of transfers comes via informal channels is corroborated by a research on Serbia conducted in 2007 by Olivier Bove from the Swiss State Secretariat for Economic Affairs (SECO). Most countries of the former SFRY face a similar situation. The research results show that the Serbian diaspora usually sends the money through their neighbours and friends (80%), bus drivers (15%) or by mail (5%). Due to similarity among the countries of former SFRY in this aspect, it may be concluded that an analogous percentage applies to Montenegro as well. So long as the remittances are sent via these channels, whether because of lower transaction costs or other reasons, statisticians may only guess their amount. In case of Montenegro, this is even more difficult, because the euro is used as means of payment and most remittances arrive exactly in this currency. In other countries, such as Serbia for instance, statisticians may "catch" some of the remittances based on currency exchange transactions (euro is not used as the means of payment so it must be converted to dinar). Maybe the fact that in the period of conversion of the Deutsche Mark into euro the quantity of converted money greatly exceeded even the most optimistic estimates, might suggest that there is a significant amount of funds sourcing from transfers of migrants and people working abroad.

The World Bank has been closely monitoring the trends in remittance flow (earnings of workers + employees' compensations + migrants' transfers²⁷) and the inflow of remittances expressed in percentage of the Region countries GDP according to the most recent data available for 2011 is showed in the following graph.

²⁶ *This figure must have changed in the period concerned, if not for anything else, then due to the fact that there are a Faculty of Maritime Studies and a High Maritime School in Montenegro, producing at least 150 professionally qualified people in this area of expertise per year.*

²⁷ <http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTDECPROSPECTS>

Graph No. 5 – Remittances, % of GDP



Source: <http://econ.worldbank.org/>

A very interesting piece of data for Montenegro is the one recorded by chroniclers who reported that there were times during the period of the Kingdom of Montenegro when the help provided by Montenegrin emigrants equalled the sum of the Kingdom's annual budget. When the facts are taken in account that the first recorded emigrations of Montenegrins date back to 1478, that just in 1817 the international bodies approved the emigration of 20,000 people from Montenegro and that, according to passport records, about 72 000 Montenegrins emigrated to Europe, America and Africa in the period between 1879 and 1905, one may assume how many emigrants are concerned. Somebody wrote that "an additional Montenegro" lives abroad. The media have recently informed that 300,000 people of Montenegrin origins live in Turkey.

All the money arriving via informal channels directly affects the standard of the citizens, their purchasing power, consumption, money stock, import, and it serves for deficit funding and similar. A better coverage of these flows would have a direct impact on the current account deficit reduction.

On the other hand, non-residents working in different sectors in Montenegro, from tourism to construction business, also fall within this group. Some workers are registered, but a lot of them are not. The law stipulates that every foreign national must report their stay, yet the practice indicates otherwise. The border police keep the foreigners entry and exit records (without separation of residents from non-residents), but they do not have any data about their length of stay, which thus makes the entry and exit records worthless from a statistical point of view. Not even the information on the number of work permits issued tells how many days foreign nationals worked in Montenegro and how much they earned. Therefore, this information is also hardly useful for statistical purposes. It is true, though, that they take a certain amount of the money they have made out of Montenegro and bring it in their pockets to their families.

4.4. Foreign direct investment

Apart from significantly contributing to the economic growth of Montenegro and representing an important balance of payments position, Foreign direct investment (FDI) is a potential source of *Net errors and omissions* due to its various forms of appearance.

There are several categorisations of FDI. The most commonly used one consists of three categories:

1. **Equity** – investments in a legal entities' shares,
2. **Reinvested earnings** – income from affiliates not distributed as dividends, and
3. **Other capital** – short-term and long-term loans between the parent company and its affiliates.

We shall examine FDI in two of its forms — money and goods. The first form implies the inflow of money from abroad and the purchase of company shares, real estate properties etc. Most FDI in the form of money moves through the banks and is statistically well-covered so it causes no imbalance in the balance of payments. Also, when FDI is shown as a loan²⁸, for a certain reason, it does not lead to the occurrence of *Net errors and omissions*. In this case we may say that this is due to another type of error in the balance of payments statistics, that is, a data allocation error where the transaction is recorded under the *Loans* position rather than under the FDI position. This only represents a burden for the foreign deficit statistics, i.e. the international investment position²⁹, but it does not affect errors and omissions. However, cash brought into a country and directly invested (in the purchase of shares, real estate properties and similar) may cause a certain imbalance of balance of payments positions.

In August 2011, recording of the cash (above 10,000 euro) entering Montenegro began and approximately 10 million euro have been recorded up to date. It is impossible to tell how much cash had entered before August 2011, especially in the period of the investment boom (from 2005 to the end of 2011 registered inflow of FDI amounted to 4.3 billion euro). Furthermore, 10,000 euro, the amount that can be brought into and taken out of the country in cash without any certificate of origin, is no negligible amount for a country as small as Montenegro (further explained in Part 3 of the paper).

The second form of FDI affecting the *Net errors and omissions* position is FDI that enters the country in form of goods. For example, when a non-resident, i.e. a foreign investor, builds a certain facility in Montenegro, they may purchase necessary building material abroad. Purchasing material for interior works (tiles, AC, wooden floors, etc.) directly abroad rather than at building

²⁸ It has been observed in practice that a part of loans from abroad, mainly invested in tourism or the real estate sector, is not paid back. It can be safely assumed that those are not credit arrangements but FDI.

²⁹ IIP – International Investment Position.

material depots in Montenegro is not rare in case of large edifice construction (buildings, hotels and similar). The material in such cases is also mostly paid from the investor's account abroad. The reasons for operating that way are simple. Such purchase of goods is much easier and cheaper for the investor — they do not have to transfer the funds from their account abroad to the domestic account and then pay the goods imported to the foreign company from the latter. Also, it is cheaper for them to purchase the goods directly from the supplier than purchase the same goods from a domestic seller. As a result, a mismatch between the flow of goods and money is created. When the goods are imported in Montenegro, they are recorded as ordinary import both by the customs and the foreign trade statistics. In contrast, since the payment is effected abroad (the investor transfers the money from their account in their country to the account of the producer who is also located there), statisticians do not have any information thereof at their disposal. Even though a special code, clearly separating FDI in form of goods from other goods, has been introduced in the customs declaration, one may get an impression that the code is not used adequately.

The following example shows correct recording of goods clearly pertaining to a foreign investor.

When the correct type of foreign trade transaction (FDI in form of goods) is entered into field no. 24 of the customs declaration, the recording in the balance of payments will be as follows:

	<u>CREDIT</u>	<u>DEBIT</u>
Import of goods		100,000
Direct investment	100,000	

However, if the correct type of foreign trade transaction is not entered into field no. 24 (final import is entered instead of direct investment), *Net errors and omissions* will be increased by the value of imported goods. The following situation arises:

	<u>CREDIT</u>	<u>DEBIT</u>
Import of goods		100,000
Net errors and omissions	100,000	

Following events at multinational companies is particularly difficult. Let us imagine that a domestic company is a member of a multinational company and that it engages in import. It must import certain goods in order to produce an export product. Upon collecting the payment for exported goods, the money will be credited to the parent company's account, which will then pay the value of imported goods from that account. This means that the cash flow takes place outside Montenegro. In this case, beside the time difference in flows, difficulties in covering these transactions appear. In practice, it is impossible to compare each import (data from customs declaration) with its financial flow due to an enormous number of transactions.

4.5. Other investments - Cash and deposits

The *Other investments* position in the balance of payments includes the movement of loans (financial and commercial) and cash and deposits per sectors: banks, government and other sectors. The biggest source of this data is the monetary statistics, followed by ITRS data, polling on FDI and loans and other assessments (e.g. tourism) as well as Ministry of Finance data concerning country indebtedness, etc. From the perspective of errors and omissions, enough has been said earlier about cash flow recording problems, payments with cash and impossibility to distinguish the domestic euro from the euro of foreign origin. The *Cash and deposits position* includes all of this.

The problem with cash payments as well as with the need to keep the money in "mattresses" is characteristic for almost all former SFRY countries. One of them is Croatia, where a significant share of income from tourism or other transfers would end up outside bank channels, i.e. in "mattresses", in spite of Croatia using its own currency. Due to difficult coverage of these flows, after 1999, the Croatian National Bank temporarily omitted the *Cash and deposit of other sectors* position from the balance of payments, creating, thus, a strong impact on *Net errors and omissions*. In the moment of conversion of national currencies into euro by the end of 2001 and during 2002, the Croatian National Bank registered a significant rise in foreign currency retail deposits and based on that, in 2003 it made an assessment of the *Cash and deposit of other sectors* position for the first half of 2002, which explained 80% of the *Net errors and omissions* position amount in the same period³⁰. What the situation was like in Montenegro may be suggested by the fact that immediately prior to conversion of the Deutsche Mark (official means of payment at the time), it was estimated that the amount would be 500 million DM at most. After conversion, such amount equalled nearly 500 million euro. More precisely, in Montenegro, approximately 913 million DEM were converted into 466.8 million euro in the first three months of 2002³¹. Moreover, an additional 30 million euro, representing the vault reserves, were converted³² too. The citizens' conversion accounted for about 584 million DEM of the total amount in that first three-month period. That was, therefore, even more than the biggest optimists could have imagined. Just this fact indicates the amount of money kept in mattresses.

Hence, the *Cash and deposits* position is a significant source of the *Net errors and omissions* position.

The time difference created in the case of goods purchased on credit, that also leads to cash flow and good flow discordance, should be adjusted as well.

³⁰ This method of assessing the *Cash and deposits* position has proven to be effective in Croatia, although, one must bear in mind that Croatia uses its domestic currency and that payments can be made solely in that currency. The moment a person deposits euro on its account, it becomes immediately clear that the source of that euro is a foreign transaction, which allows for quite an easy monitoring of the balance of foreign currency deposits (one of the offset items of the current account debit or credit). In Montenegro is different due to the use of euro as legal tender (transactions between residents and non-residents can be carried out in euro)

³¹ The three-month period was defined as a period in which the complete conversion should have taken place. However, the possibility of conversion during the following ten years was left opened for all those who for some reason did not manage to make the conversion.

³² Source: CBMN, Annual report on the Central Bank of Montenegro operations for 2002.

4.6. Foreign exchange reserves

Foreign exchange reserves or reserve assets represent foreign assets controlled by monetary authorities who deploy them for the purpose of direct funding of the balance of payment imbalance and indirect imbalance regulation by interventions in foreign exchange market with the aim of influencing the exchange rate and for other purposes. Apart from the assets owned by monetary authorities, a broader interpretation of foreign exchange reserves also includes all foreign currencies at the disposal of commercial banks, even to the extent of encompassing all foreign assets at residents' disposal (monetary authorities, commercial banks on their accounts and individuals). The topic of this paper is the focus on the role of foreign exchange reserves in the balance of payments statistics rather than examining their importance for the economy of Montenegro. Nevertheless, in order to fully explain the role of foreign exchange reserves in the balance of payments balancing, i.e. their impact on the occurrence of imbalance, we shall touch upon their role in an economy using the euro and draw a parallel with a country using its own currency.

International reserves for Montenegro, which uses the euro as its means of payment, are lesser than those for the economy of countries using their own currency. In the case of Montenegro, international reserves have almost no impact on the stability of the currency used as the country's means of payment – the euro. Furthermore, linking foreign exchange reserves level to the import of goods level (a guideline according to which minimum amount of foreign exchange reserves should match the three-month amount of import) is not important for Montenegro either. In Montenegro, in order to import certain goods from abroad, one does not need to exchange the "national currency" for the foreign currency, which would influence the movement of foreign exchange reserves. Let us see how this works in countries that have their own currency.

In countries with their own currency, such as Serbia, companies mostly get the foreign currency amounts needed for international transactions by purchasing them from the National Bank of Serbia. The National Bank of Serbia sells the foreign currency from the foreign exchange reserves for the national currency, directly reducing the foreign exchange reserves. Therefore, there is a direct link between the foreign trade and foreign exchange reserves. Furthermore, since the payment in the foreign currency is not allowed in its country of origin, a Serbian exporter must convert the foreign currency received to dinar by selling it to the National Bank, whereby it directly influences the movement of foreign exchange reserves (or it keeps the money on its foreign currency account, which is again easy for the statisticians to keep record of). Consequently, there is trade (regardless of it being import or export) on one side and the movement of foreign exchange reserves (or foreign currency account deposits) as an offset item on the other side. Therefore, the balance has been established. What about Montenegro?

The national currency of Montenegro is the euro, which is convertible and easy to use for both domestic and international payments. The exporter does not need to turn to the Central Bank in order to convert the national currency into a convertible currency, meaning that the foreign trade is not directly linked to the foreign exchange reserves movement.

NET ERRORS AND OMISSIONS

Table No. 11 - Balance of Payments of Montenegro, 2005 - 2012, in millions of euro

	2005	2006	2007	2008	2009	2010	2011	2012
Current account	-302	-674	-1.059	-1.535	-830	-710	-573	-587
Capital and financial account	289	602	1.220	1.466	640	512	416	336
Change in CBMN reserves	-113	-137	-151	155	-85	-17	114	-45
Net errors and omissions	13	72	-162	69	190	198	157	251

Source: CBMN

The table reveals the following: The current account is constantly in deficit. The capital and financial account is in surplus but insufficient to cover the current account deficit. In addition, a rise in foreign exchange reserves has been recorded every year, except in 2008 and 2011 (a negative amount of the Change in CBMN reserves position means increase), which should not happen. Foreign exchange reserves of a country rise when there are more funds than liabilities. Therefore, either Montenegro has a surplus it does not know about (grey economy) and uses such surplus and recorded funds for covering, perhaps in excess, the current account deficit (the excess affects the increase in foreign exchange reserves) or the movements of this position do not entirely depend on Montenegro's international transactions.

The foreign exchange reserves of Montenegro (the Change in CBMN reserves position in the Table) are made of placements of securities, deposits and, in a lesser extent, the funds at IMF as well as cash in the Central Bank's Treasury. The source of these funds are the deposits of the Ministry of Finance and the Deposit Protection Fund, required reserve of the banks in Montenegro and abroad, own funds of CBMN, IMF funding liabilities and commercial accounts of the banks. The total amount of CBMN's international reserves is determined primarily on the basis of the balance of MF and DPF's deposited funds and the amount of funds committed for required reserve. Beside these external elements, the most important item of the structure of resources are financial assets of CBMN.

Does the level of foreign exchange reserves depend exclusively on Montenegro's economic relationships with foreign countries?

Once the DPF was formed, the law stipulated the amount of money the banks should place in the Fund (the initial premium) as an ordinary premium calculated on quarterly basis by applying a determined rate on the bank total deposits average on the last day of each month of the previous quarter. The Fund can also be funded through certain donations. Given that the DPF's funds are a constituent part of the foreign exchange reserves, all of the above affected their movement, but it was not connected with foreign transactions (unless the donations came from abroad). Consequently, the movements of funds in the Fund depend very little on foreign transactions of Montenegro. And what about the Ministry of Finance funds? In the years when Montenegro generated

the budget surplus, a portion of the Ministry of Finance funds was deposited on the foreign accounts, thus influencing the movement of foreign exchange reserves. However, Montenegro faced a strong budget growth and consequently generated a surplus due to considerable import, i.e. the payment of import VAT. The import VAT was paid by the residents of Montenegro so the citizens influenced the increase in funds of the Ministry of Finance. Although some may say that this case has nothing to do with foreign transactions (import of goods), it is still completely different from the situation when a resident of Montenegro imports the goods and pays them to a non-resident, i.e. a foreign supplier. Or we can take a look at an example of Eurobonds instead. In 2010 and 2011, Montenegro incurred a debt and this debt was correctly recorded, but what will happen when those funds are spent, for example, on the payment of pensions? There would be a reduction of foreign exchange reserves which is not a consequence of foreign economic relations and there would be no offset item in the balance of payments. An ideal solution for Montenegro would be provided by the possibility of monitoring the whole money stock movement. Given that Montenegro may not issue the euro, every money stock increase or reduction is a result of foreign economic relations. That would be an excellent balancing position that would monitor the *Cash and deposits* position movement caused by the movements of other balance of payments positions. However, as proved by a failed macroeconomic model of cash assessment, that is not possible for the time being. So long as cash is a preferred method of payment and significant funds are remitted via informal channels and so long as there are very liberal rules concerning financial flows, monitoring this position will be extremely difficult.

5. CONCLUSION

The balance of payments is a statistical statement that rests on the double-entry bookkeeping principle. According to this principle, every transaction is recorded twice; once on the credit and a second time on the debit side, whereby both sides must match. Since in practice this statistics covers an enormous number of transactions, as a rule these two sides hardly ever match. For that purpose, the *Net errors and omissions* position, which balances the two sides, was introduced in the balance of payments. The value, i.e. the magnitude of this position is often directly linked to the balance of payments statistics. This, however, is not always justified. The value of this position can be very low, but due to possible significant omissions while recording certain flows that should have been recorded under the opposite positions, the errors are simply cancelled. The *Net errors and omissions* position ought to be taken as an indicator that certain matters have not been recorded well or at all, so one primarily needs to investigate what they might be.

Therefore, the essence of the *Net errors and omissions* position is finding the cause of its existence and pointing the search for anomalies in the right direction rather than reducing its value to zero. By finding the cause, i.e. the origin of the existence of this position, an important prerequisite for further improvement of the quality of balance of payments statistics will be met. This paper points at a direction one should move towards in order to enhance data comprehensiveness and

quality. However, the causes of significant values of errors and omissions do not necessarily have to be linked to a correct application of the stipulated methodology. This position can also tell us something about the imperfection of the methodology itself and the need for its modernisation. Besides, the trend of *Net errors and omissions* may be a sign to the economic policy creators that a considerable part of economic flows is illegal (whether this concerns all sorts of contraband, cross-border smuggling or trafficking of goods, or just a high share of grey economy e.g. in tourism sector), which deprives the state of a certain amount of taxes due to various forms of tax evasion.

Consequently, one may say that all these reasons clearly indicate that the *Net errors and omissions* position in the balance of payments is an economic indicator of the steps we need to take in general, not only in the field of statistics.

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