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**Cost efficiency of the banking industry and unilateral euroisation: a stochastic frontier
approach in Serbia and Montenegro**

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Abstract

This paper aims at investigating the differences in cost efficiency of the banking industry in Serbia and Montenegro over the period 2005-2012. These two countries operated under a common monetary regime until 1999 and followed two different monetary regimes thereafter, unilateral euroisation for Montenegro and monetary independency for Serbia. A stochastic frontier approach incorporating bank-specific and country-related variables is used to analyze cost efficiency in the banking sectors of Serbia and Montenegro. The analysis shows that a bank operating at given conditions in terms of ownership, market and other specific characteristics presents significant higher cost efficiency if it operates in Montenegro rather than in Serbia. We argue that this result may relate to the choice of unilateral euroisation made by Montenegro. It is also shown that foreign owned banks, higher capitalized banks and banks with lower non-performing loans operate at higher cost efficiency.

Keywords: banking, cost efficiency, dollarization, euroization, Montenegro, Serbia

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