

Postgraduate Studies “Entrepreneurial Economy”
Faculty for International Economics, Finance and Business
UDG University

Entrepreneurial Economy

Podgorica, September 2011

**“Entrepreneurial economy”
Volume XVII**

Editor in Chief: Veselin Vukotic, PhD

Editorial Board:

Mladjan Sljivancanin, PhD; Danilo Sukovic, PhD; Miroslav Prokopijevic, PhD; Maja Drakic, PhD; Milica Vukotic, PhD; Igor Luksic, PhD

Board of Referees:

Mladjan Sljivancanin, PhD; Danilo Sukovic, PhD; Miroslav Prokopijevic, PhD; Stojan Dabic, PhD, Petar Ivanovic, PhD; Maja Bacovic, PhD; Zoran Djikanovic, PhD; Dusko Bjelica, PhD; Milorad Katnic, PhD; Zvezdan Vukanovic, PhD; Vlado Kavarić, PhD; Jadranka Kaludjerovic, PhD; Nina Vujosevic, PhD, Dragana Radevic PhD; Ivana Stesevic, MSci; Jelena Boljevic, MSci; Nikola Perovic, MSci

Publisher: Postgraduate Studies "*Entrepreneurial Economy*", Faculty for International Economics, Finance and Business, University Donja Gorica – UDG

Technical Editor: Dragan Knezevic

Cover design: Nebojša Klacar, studio »Arhangel«, Belgrade

Director of Postgraduate Studies: **Professor Veselin Vukotic (Podgorica)**

President of the Council of Postgraduate Studies: **professor Steve Pejovich, Texas, USA**

Address: Donja Gorica bb, Podgorica, 81000, Crna Gora
Phone: +382 (0)20 410 777
Fax: +382 (0)20 410 766
e-mail: pe@udg.edu.me
web: www.udg.edu.me

ISSN 1451-6659

Printed: 500 copies

Printed by: Montcarton, Podgorica

Introductory remarks

The first volume of economic journal „Entrepreneurial Economy“ started to be published in 2002. Sixteen volumes, some of which had several issues, has been published until now.

This is the volume XVII.

The journal is published by the Foundation „Entrepreneurial Economy“ of the Postgraduate studies „Entrepreneurial Economy“ at the Faculty for International Economics, Finance and Business, University UDG, Montenegro.

Most of the papers in this volume deal with some aspects of the Balkan integrations. Besides, this Volume contains several reviews of relevant authors and books.

All papers are written in English which is broadening the market of potential readers of this economic journal.

Editor in Chief

Professor Veselin Vukotic

Authors*

1. *Maja Bacovic, PhD*, Faculty of Economics, University of Montenegro; *holds a Doctorate from Postgraduate Studies “Entrepreneurial Economy” (fourth generation);*
2. *Branko Boskovic, MSci*, University UDG; *Teaching assistant at the Postgraduate Studies “Entrepreneurial Economy”;*
3. *Tanja Boskovic, MSci*, GIZ Open Regional Fund Foreign Trade Promotion, *holds a Master’s Degree from Postgraduate Studies “Entrepreneurial Economy” (seventh generation);*
4. *Andrej Bracanovic*, Faculty of Law, University UDG; *Teaching assistant at the Postgraduate Studies “Entrepreneurial Economy”;*
5. *Milica Dakovic Tadic, MSci*, Faculty for International Economics, Finance and Business, University UDG; *Teaching assistant at Postgraduate Studies “Entrepreneurial Economy”;*
6. *Zoran Djikanovic, PhD*, Security and Exchange Commission of Montenegro; *holds a Doctorate from Postgraduate Studies “Entrepreneurial Economy” (second generation);*
7. *Maja Drakic, PhD*, Faculty for International Economics, Finance and Business, University UDG; *holds a Doctorate from Postgraduate Studies “Entrepreneurial Economy” (sixth generation);*
8. *Nina Drakic, MSci*, Chamber of Economy of Montenegro, *holds a Master’s Degree from Postgraduate Studies “Entrepreneurial Economy”(seventh generation);*
9. *Jadranka Glomazic*, University UDG; *holds a Master’s Degree from Postgraduate Studies “Entrepreneurial Economy” (seventh generation);*
10. *Vojin Golubovic*, Institute for Strategic Studies and Prognoses; *Teaching assistant and student of Postgraduate Studies “Entrepreneurial Economy” (ninth generation);*
11. *Steve Henke, PhD*, The Johns Hopkins University; CATO Institute, Washinton DC, USA; *Professor of Postgraduate Studies “Entrepreneurial Economy”;*
12. *Petar Ivanovic, PhD*, Montenegrin Investment Promotion Agency; *holds a Doctorate from Postgraduate Studies “Entrepreneurial Economy”;*
13. *Neda Iovic, PhD*, Faculty for International Economics, Finance and Business, University UDG; *Assistant Professor at Postgraduate Studies “Entrepreneurial Economy”;*
14. *Ivan Jovetic, MSci*, Institute for Strategic Studies and Prognoses; *holds a Master’s Degree from Postgraduate Studies “Entrepreneurial Economy” (eighth generation);*

* In alphabetical order (by last name)

15. *Katnic Milorad Katnic, PhD*, Ministry of Finance, Government of Montenegro, holds a Doctorate from Postgraduate Studies "Entrepreneurial Economy" (fifth generation);
16. *Milika Mirkovic*, Institute for Strategic Studies and Prognoses; Teaching assistant and student of ninth generation of Postgraduate Studies "Entrepreneurial Economy" (ninth generation);
17. *Slavica Nikolic, MSci*, The Center for Entrepreneurship and Economic Development; Holds a Master's Degree from Postgraduate Studies "Entrepreneurial Economy" (eighth generation);
18. *Marija Orlandic*, Faculty for International Economics, Finance and Business, University UDG; Teaching assistant and student of Postgraduate Studies "Entrepreneurial Economy" (ninth generation);
19. *Dragana Radevic, PhD*, The Center for Entrepreneurship and Economic Development (CEED); holds a Doctorate from Postgraduate Studies "Entrepreneurial Economy" (fifth generation);
20. *Ivana Stesevic, MSci*, Faculty for International Economics, Finance and Business, University UDG; holds a Master's Degree from Postgraduate Studies "Entrepreneurial Economy";
21. *Sandra Tinaj, MSci*, University UDG; Holds a Master's Degree from Postgraduate Studies "Entrepreneurial Economy" (eighth generation);
22. *Ivana Vojinovic, MSci*, Ministry for Sustainable Development and Tourism, Government of Montenegro; holds a Master's Degree from Postgraduate Studies "Entrepreneurial Economy" (seventh generation);
23. *Nina Vujosevic, PhD*, Ministry of Economy, Government of Montenegro; holds a Doctorate from Postgraduate Studies "Entrepreneurial Economy" (fifth generation);
24. *Milica Vukotic, PhD*, Faculty for Information Systems and Technologies, University UDG; holds a Doctorate from Postgraduate Studies "Entrepreneurial Economy";
25. *Veselin Vukotic, PhD*, University UDG; Institute for Strategic Studies and Prognoses; Institute of Social Sciences, Belgrade; The Founder, Director and Professor of Postgraduate Studies "Entrepreneurial Economy"

Contents:

1. <i>Veselin Vukotić</i> , Risk of future	8
2. <i>Steve Henke</i> , Monetary Misjudgments and Malfeasance	24
3. <i>Milorad Katnić</i> , Debt Crisis – Challenges of the Euro zone and the Western Balkans.....	35
4. <i>Maja Baćović</i> , Economic growth in the Balkans: caused by an increase in efficiency and/or membership in the EU?	47
5. <i>Milica Vukotić</i> , Balkans and European Union: Regulation of Telecommunications market with Emphasis on Analysis of Relevant Markets in Montenegro)	61
6. <i>Maja Drakić, Ivana Stešević</i> , High education in Balkan countries in the process of European integration.....	68
7. <i>Zoran Đikanović, Associate Professor</i> , The development of investment funds' industry in Montenegro in the context of accession to EU	83
8. <i>Dragana Radević</i> , Locked Human Capital: Long-term Unemployment in Montenegro.....	95
9. <i>Neda Ivović</i> , EU as new factor in market regulation and cost and benefits of judicial intervention in the capital market in Montenegro.....	107
10. <i>Nina Vujošević</i> , Demographic Dimensions of Regional Policy	120
11. <i>Branko Bošković</i> , Balkan and European Welfare State: Opportunities and Outcomes	130
12. <i>Ivan Jovetić</i> , Balkan and European Union – The Second Journey	141
13. <i>Tanja Bošković</i> , The European Union as determinant of economic cooperation in the Balkans.....	159

14. <i>Nina Drakić</i> , The Common Agricultural Policy of the EU as Determinant of Montenegrin Agriculture	169
15. <i>Ivana Vojinović</i> , Approximation of Environmental Acquis: challenges faced by Montenegro as ecological state	180
16. <i>Slavica Nikolić</i> , Joining the EU: Ecological Potential of (Un) Limited Growth	193
17. <i>Jadranka Glomazić</i> , Harmonization of financial statements in the European Union – importance for the integration of the Balkan.....	208
18. <i>Milica Daković-Tadić</i> , The auditing profession, ethics and standards in the function of global development	218
19. <i>Sandra Tinaj</i> , Human Resource Management, Models and Processes.....	228
20. <i>Andrej Bracanović</i> , CULTURAL AND RELIGIOUS PATTERNS OF INTEGRATION TO „THE PROMISED LAND“	237
21. <i>Marija Orlandić</i> , The natural resources of the Balkans in the light of EU integration	246
22. <i>Milika Mirković</i> , The Effects of CEFTA Agreement on the Montenegrin economy	256
23. <i>Vojin Golubović</i> , The impact of age structure of population on the pension system in Montenegro.....	265

Reviews

<i>Petar Ivanović</i> . Anniversary celebrating 210 years since the birth of Frederic Bastiat	278
<i>Maja Drakić</i> , Review of the book <i>Psycho-Philosophy of Business: Our Mentality Through A Dialogue</i> by Professor Veselin Vukotic	287

Prof. dr Veselin Vukotic*

Risk of future

Abstract: *Is there a better word to concentrate us on the relation between Western Balkan and European Union then the word **risk**? While thinking about the topic of this Scientific Conference I wanted to find the word which would be able to fully express the essence of the relationship and the processes between Western Balkan and European Union. In my opinion terms which are usually used to describe this relationship, such as integration, union, accession seem too shallow, one-dimensional, non-vital, not fully in-touch with reality... The context in which these words are used is more mechanistic, and I believe it is necessary to use holistic approach here. In this search for the word which would fully express the essence of the topic we are going to discuss, I decided to use the word **risk**.*

Key words: *risk, dignified spirit, „the idea of Europe“, „courage of spirit“*

1. The Idea

Is there a better word to concentrate us on the relation between Western Balkan and European Union then the word **risk**? While thinking about the topic of this Scientific Conference I wanted to find the word which would be able to fully express the essence of the relationship and the processes between Western Balkan and European Union. In my opinion terms which are usually used to describe this relationship, such as integration, union, accession seem too shallow, one-dimensional, non-vital, not fully in-touch with reality... The context in which these words are used is more mechanistic, and I believe it is necessary to use holistic approach here. In this search for the word which would fully express the essence of the topic we are going to discuss, I decided to use the word **risk**.

2. The Context

Western Balkan within EU – that is something that will happen in close or distant future. This means that the emphasis is put on events that will take place in future. However, the real issue discussed in this paper is the relation between common understanding of the word „risk“ and future. On the other hand, is there any notion, any other concept that reveals essential features of contemporary world better than the notion of risk? I am using the word „risk“ in this paper in order to reveal the essence of changes in future.

* University of Donja Gorica – UDG; Institute for Strategic Studies and Prognoses, Podgorica;
Institute of Social Sciences, Belgrade

3. The History

The notion of risk is recent (it was first mentioned in 16th century)¹. Concept of risk didn't exist in medieval age. Giddens say that there was no something similar to the notion of risk in any other traditional society. This concept is first mentioned and used in 16th and 17th century. First people who used this concept were the people who explored the New World. First expeditions were from Spain and Portugal. The word "risk" meant sailing through unexplored seas and lands – it was used to describe dimension of "space".² As Giddens says, the meaning of the word expanded later and it was used to describe also the feature of "time", and in this context the word "risk" is use in economics, in analysis of wealth and investments.

The notion of risk is related to mathematics and statistics. In other word the notion or risk is closely related to probability concepts and uncertainty. From this point of view the essence of the term "risk" is related to the "indeterminacy" principle of famous physicist Werner Heisenberg.³ Simple explanation of this term says that somebody is taking risk only if the outcome of an action she or he is undertaking is completely uncertain.

4. Faith

The notion opposite to the concept of risk is the concept of faith – to have faith, to firmly believe that something will certainly happen. There is no doubt in faith – there is only strong belief (in every religion). Everything is clear to the person who believes. Believer is sure about everything! Everything is certain! Everything has to be just as the faith preaches. A person who has doubts is a heretic. The role of the heretic is to contribute to establishment or ranks and to strengthen the hierarchy of believers in a religion... This means that the role of "common enemy" in the history is enormous. The real issue I am raising in this paper is whether Western Balkan looks at EU with respect to the faith (more ideologically) or with respect to the risk (taking real facts into consideration)?

5. Conflict

Faith and risk are in natural, etymological conflict! How can this general pattern be applied to the relation between Balkan and European Union? Is there anybody from

¹ Hiršman, Albert (1999), „Interesi i strasti“, (translation of Hirschman, A „*The Passion and the Interest*“), Filip Višnjić, Beograd;

² Fernandes, Felipe (2010) „Tragači – globalna povijest istraživanja“ (Fernandes, F *Pathfinders: Global History of Exploratio*), Fraktura, Zagreb;

³ Heisenberg, Werner (1998) „Fizika i filozofija (translation of *Physics and Philosophy*)“, Kruzak, Zagreb;

Western Balkan who doesn't believe that joining EU will bring just benefits and only benefits? The outcome seems to be certain: when Western Balkan countries become EU member states, each resident of Western Balkan will become citizen of Europe. That is the faith into quantum jump from one system of values into another; belief in jump from poverty into European per capita income. There is no person who doubts that something else can happen.

Having in mind previously said is it appropriate to mention "risk" when we speak about "European integration of Western Balkan countries"? Is the word "risk" heretic, or does it clearly express the essence of reality **in Western Balkan countries**, in **EU countries**, as well as in the relation between EU and Western Balkan?

6. The Development

Does the notion of risk have any common point with the development? The development is understood as the change of structure of a society, but also as the change in the system of values of an individual. Our starting point here is that the structures in one society cannot fundamentally change if the social change is not the consequence of the change in system of values of an individual.⁴ With this respect, how can we describe the relation between the risk and the development? Is development the result of our walk along the well paced paths; is it the result of fact we go by inertia; does the development mean we are keeping everything we had so far? Does the development mean we are being the slaves to our habits, to what is well known to us, to our traditions?

People didn't use the term "risk" in ancient cultures and they didn't really need it. Don't we often say that traditions and traditional society is still very strong in Western Balkan countries? Can we think about the meaning of this statement with respect to our development in the future?

As Giddens said, the risk is not equal to hazard or danger. The risk is related to the hazard which is actively estimated with respect to the consequential possibilities. What possibilities Western Balkan has after it joins EU? Are these just possibilities or will it automatically become reality by itself?

The risk is the notion expressed in the societies oriented to the future – in societies where the future (time) is seen as the territory to be "conquered" while following Einstein thought "The time is the space people live in".

⁴ Nozik, Robert (2008) „Anarhija, država, utopija“ (Translation of Nozik, R. *Anarchy, State and Utopia*), CID, Podgorica, page 28;

The risk exists in the society which actively tries to break of with the past; to get free from the burden of the past.

Can we think about Western Balkan accession to EU as about the possible break of with the past? And on the other side, is the history of Europe, i.e. the past of EU, such that it can become our future? When we think about this, we must think about, at least, two issues:

- Is the thesis on European decadence true?⁵
- Isn't Europe already old?⁶

What is then our future in EU?

7. Revitalization

At the moment, prevailing thought is that EU accession of Western Balkan countries is not taking any risks. It only takes some dangers, as follows:

- a) The danger that EU countries will act superiorly, that EU residents will be arrogant and vain in relation with Western Balkan countries – they will put requirements, ultimatums, which can make citizens of Western Balkan humiliated;
- b) The danger that Western Balkan will act inferiorly, that it will look into the EU history as in the Hawking's conquest of other galaxies, in other words the danger that people from Western Balkan will underestimate themselves (and lose self-confidence as very important resource for development).

How can Western Balkan countries develop in future if their citizens feel that current EU residents are superior, if they underestimate themselves and lose self-confidence? In other words is there any risk related to future events. These feelings can disappear only if Europe revitalizes in, at least, two development directions: a) Europe needs to reanimate the spirit of inventions and discoveries; b) Europe need to bring back to city-states (region-states).

When we speak about Europe, we are not thinking only about the space and European geographic position. In this paper Europe is not understood as the space on the map, bur as the type of society, bundle of believes and behaviors which "has shaped European history and expansion".⁷ This means that Europe is not the territory, but the civilization – the way of life and the way of thinking.

⁵ Barzun, F.J. (2003) „Od osvita do dekadencije“, (Translation of Barzun, J. *From Dawn to Dekadence*), Masmedia, Zagreb;

⁶ Age structure of European population clearly proves this.

⁷ Droa, Rože-Pol (2001), „Zapad“, Geopolitika, Beograd, page 17;

If it is the case, then with respect to the risk, the relation of Western Balkan and EU can be understood at **two levels**: (1) The risks that Balkan can accept all crucial European values; (2) The risk that Europe cannot find this vital line of its integral development. Risks of Western Balkan will be discussed in chapter 8 and risks of Europe in chapter 9 of this paper.

8.1 The idea of an individual and invention of the invention

I consider these two ideas: the idea of an individual and invention of the invention had shaped the essence of Europe which brought the dominance of European civilization after 15th century.

The idea of an individual as one of the crucial ideas of liberalism meant, not to understand an individual as the person made of flesh and blood, with the exact name and surname, but to understand an individual as a human being, as the creature who naturally holds certain number of **rights**. Besides, these rights don't depend on the position of an individual in the society, which means that equal rights belong to each individual in the society. As much as we see these ideas simple and easy to understand, it is enough to stop for a moment and think about it, in order to see that it is very unusual indeed. "How can you attribute the right to an individual, if it is considered that rights regulate the relations between individuals? Remember that the idea of the right assumes the existence of some kind of community or society. The question related to this is how we can establish political legitimacy on the foundation of individual rights, if an individual in political and social life does not exist per se – it is permanently tied to other individuals in the society, in social group, profession or nation... But, in the moment when an individual votes is he or she alone and free from all other social relations? Is an individual who votes in "natural state" in the moment he/she votes?⁸... However, it is much more important for this paper to try to give an answer to the question about the origin of this idea – where did it come from, what circumstances gave birth to it and what problem was solved by this idea. We cannot fully understand the history of Europe and European civilization if we don't use this approach.

In a nutshell, this idea was born in **struggle against political power of the religion**. Christianity and the paradigm of Christian religion was the paradigm of salvation. Framework of medieval live was based on obligations and duties, not on freedom and right. The goal of humanity of that time was not in **accomplishments**, the goal was in **salvation**. In order to reach that goal (salvation) society needed to be organic unity, some kind of moral entity and ethical organism, managed by divine power.

⁸ Manent, Pjer (2001) „Intelektualna istorija liberalizma“ (Translation of Manent, Pierre *Intellectual History of Liberalism*), Stubovi kulture, Beograd, page 9;

Each individual had certain role in that entity, but individuals didn't have any rights or freedom.

The idea of individualism enabled development of a new paradigm – **paradigm of accomplishment, paradigm of achievements, paradigm of progress** – paradigm in which this world dominates over divine's world. The idea of an individual, i.e. the idea of individual rights and individual freedom took leading political role away from church. In medieval age the church had leading political role in the society. American and French revolution legally established the idea of an individual through Constitution, so this idea has become political practice.⁹

Liberating an individual contributed to the development of inventive spirit; it brought new inventions and the development of science. Steam engine, as main source of energy in capitalism, was invented very soon. Representatives of the Age of Enlightenment emphasized the need to invest in science and in the spirit of each individual in the world.

In which way contemporary EU can try to revitalize these ideas – the idea of an individual and the idea of invention – and consequently revitalize its mental and spiritual power? First of all, Europe should continue to implement policies that promote innovation through so called Green Paper.¹⁰ Instead of previously used syntagm R&D (Research & Development), now Europe is promoting R&I (Research & Innovation). This is the reason why EU is planning big investments in this area. And basic prerequisites for investments in the R&I area are individuals ready to invest in looking for innovative ideas and skills. In other words it creates environment for "the courage of spirit" of each individual.

Need for innovation is one of crucial features of contemporary world economy, and consequently European economy. However, the need to put an emphasis on the role of individual inventors is much more important – because it moves the spirit toward the position which brought European continent the dominance in 16th, 17th and 18th century. Only if this "sleeping spirit of inventions and science" wake up, Europe will have bright future.¹¹

⁹ Rifkin, Džeremi (2002) „Entropija – nov pogled na svijet“ (Translation of Rifkin, J. *Entropy – A New World View*), MIDI, Zagreb;

¹⁰ European Commission (2011), Green Paper „Towards a Common Strategic Framework for EU Research and Innovation Funding“, Brussel;

¹¹ Despite the prevailing thought that Medieval Age was the age of dark, it is the time when people in Europe made many epochal inventions such as gunpowder, mechanical clock, printing machine, eyeglasses, mill wheel (see more Lendis, Dejvid „Bogatstvo i siromaštvo nacija“ – Translation of Landes, D *The Wealth and Poverty of Nations*).

Does Western Balkan have this tradition of individualism and inventive spirit? Can we say that Western Balkan countries are oriented toward individualism and inventions today? When it comes to individualism and inventions, is there any link between Western Balkan and Europe? As much as Europe is lagging behind USA in this sense, Western Balkan is lagging behind Europe much more. Truly, Europe and Balkan have common legacy of Jewish Traditions and Classical Age and this inheritance is their common platform. However, at one moment during the course of history Europe and Balkan went along different paths: Europe along the path of individual freedom and individual rights and Balkan along the path of collectivism and dictatorship. Can we exceed this gap and if yes, when?

In my opinion, the risk of complete integration of Western Balkan with Europe lies in the weakness of this link. When I speak about complete integration, I think of spiritual integration, not only of integration of institutions or economic systems etc... We must not forget that institution express the maturity of a nation and cannot be efficient if they are "artificially transplanted by force"!

At practical level this means that Western Balkan countries should, first of all, leave the approach that education degrees are as such, per se, as diploma paper, the way to avoid difficult life (formal degrees are considered as very important). Western Balkan countries should accept the approach that education is the willingness of a society and the willingness of each individual in the society to invest in "conquering ignorance" all lifelong. From this point of view, it is of essential importance to change the essence of curricula: instead of preparing a student for a specific working place – curricula must be based on fundamental disciplines and skills, skills that develop and strengthen "the courage of spirit". Similarly, the focus of education, especially university education should move toward research, entrepreneurial and creative dimension of development; it should liberate the spirit of young individuals.

That means that I see the crucial risk of our integration, i.e. the risk that we will not recognize all opportunities provided by these integrations in inappropriate quality of our education system. Truly education system in a society sublimates many other social sub-systems. No matter for that, I am putting education system in the focus of social progress.

8.2 The idea of city-state and nation-state

The idea of city, and later the idea of city-state created specific environment for the development of Europe? What is the idea of city? That is the idea of specific organization of common life of many people. That is the idea of one public place where people, citizens discuss, agree and make decision on all "common affairs".

That is idea of “governance of human community over the circumstances of life. It is completely natural political idea!”¹² During medieval age and Crusade, this idea was implemented through city-states such as Venice, Genoa, Napoli, Firenze, etc. These city-states were economic cells. People who lived in city-states did not recognize themselves as representatives of a nation, but as citizens of a city (Venetians, Genovese...). City-states gave birth to Renaissance, but also to “double accounting principle” (rationality principles). Merchant city-states were mostly located in northern Europe (so called Hanseatic League, along the coast of Baltic and North Sea). The most famous city-states in this part of Europe were Riga, Tallinn, Danzig (in Polish: Gdansk)...

City-states followed the logics of openness and focused on the “**rest of the world**”; they didn’t follow the logic of extended hand of central power. However, the idea of nationalism spread around and central power strengthened, which consequently made national state stronger. The notion of nation-state was first introduced by French lawyer, Jean Bodin in mid-16th century. Bodin analyzed many small entities, which lived in small neighboring areas and were in permanent conflict often caused by religious differences. Establishment of the idea of nationalism weakened the idea of empire as political organization of the society... National states were born in great wars along Europe, the culmination of which were two World Wars in 20th century. In essence, two World Wars were civic wars within Europe.

The history of Europe is also the genesis of national states. Will the future of Europe bring the disappearance of nation-states? Is it possible that future Europe will be similar to Roman Empire? In Roman Empire everybody had two identities – the identity of the province of their origin and the Roman identity. Similarly, the risk of EU future depends on the path of development it will follow – **union of states** or **supra-state**. I believe the central political power in Brussels will strengthen! Stronger central political power will reduce the importance of nation-states; they will become **region-states**, as Ohmae named them. Will Europe in future consist of many region-states, similar to former city-states?

Is Europe going to return to its original idea; the idea of empire which created Europe: central political power and decentralized economy? That would replicate the model by which Italy was created – Italy was created on the foundation of its city-states, which gave birth of many invention that shaped our civilization. If all these assumptions are true, we cannot avoid the question: Is Europe ready to leave the concept of nation-state? Is Europe ready to admit that nation-state is “an intruder” that needs to be thrown out? Is it a swallowed part on Europe’s path of development?

¹² Manone, Pjer, Op.cit, page 14;

Internal organization of Europe consisting of region-states, without national borders has double foundations: (1) foundation from the past; (2) foundation from the future.

- (1) Foundation from the past comes from the experience of Europe at the time when city-states were dominant form of organization. Did this historical gene disappear? Surely, it did not! It is still alive;
- (2) Foundation from the future lies in globalization. Many people believe that traditional nation-state as form of social organization will not survive globalization wave.

Globalization ("Mondialisation") means abolishing borders. But globalization is also the product of technology. Life in contemporary globalization era means that people are using certain technologies in communication, car industry, TV, phone industry, etc. These technologies require certain working organization and specific organization of interpersonal relations. Machines people are using all around the world result in similar way of thinking. People who use these technologies understand life in similar way, no matter where they live; they have similar dress code, life style, model of education... The real question Western Balkan countries should answer is whether they can give up beloved national state. Can they give up their sovereignty; can they accept to be region-state, which means not political, but economic units, which would probably move and change current national borders?

In addition to that region-states needs to satisfy certain criteria, for example size. Although the size is not decisive criterion, if we want the region-state **to be focal point** it needs large domestic market in order to attract internal investments. With respect to size region-state should have the market of at least half a million or better million people (Ohmae). This approach is opposite from the opinion that the size of domestic market is not important at all and introduce demography as important factor of analysis (which will not be discussed in this paper). Demographic factors will be much more important in further development of Balkan and Europe then people thinks today. The truth is that demographic factors are completely neglected in process of integration.

However, the size of domestic market can be compensated by infrastructure – transport, logistic, well trained and diligent people. "It is important to have certain number of inventive universities and institutes, which will be able to attract good students and to produce well educated experts and professionals."¹³

The relation with "external" world is also very important. A region-state entity should have positive attitude toward the rest of the world; "external" world should be seen as the source of prosperity. Xenophobic attitudes must be abandoned.

¹³ Ohmae, Kenichi (2007) „Globalna pozornica“, MATE (Translation of Ohmae, K. *The Next Global Stage*), Zagreb, page 94.

Approaches which give priority to domestic over foreign and discriminating rules for foreigners must be abandoned. Are Western Balkan countries ready to implement these risky changes in organizing principles of individual and social life?

9. Risk of future

Is the idea of Europe as supra-state in conflict with globalization ("Americanization")? An answer to this question is bringing many risks to the future of „European idea“.

On one side, disappearance of national borders and birth of region-states, promoting democracy and free markets, and stronger influence of technology are the features which make "European idea" compatible to globalization. Even Kenichi Ohmae sees EU as the great step toward region-states, which he is promoting as the social organization model in modern world.

This model of development of „European idea“ is on the scene now. It is the model of EU development today and the starting point of Western Balkan integration into EU. If this model of development "works", the risks of future development of "European idea" would be reduced and focal point would move to EU states and their capabilities to use opportunities in new state with population of 500 millions people.

Nevertheless, there are warnings about the need to deeply rethink this model. People who believe that the model needs to be reconsidered are not necessarily "Euro-skeptic", but completely opposite – an attempt to deeply analyze the essence of "European idea", its history and future.

"It can happen that the future of "European idea", if there is any, does not depend on central banking and agricultural subsidies, on investments in technology and common tariffs as much as we are being assured. It can be that OECD and NATO, spreading euro-bureaucracy and rising number of parliamentary officials according to Luxemburg model are not primary promoting dynamic vision of Europe. Or, if they still are, that vision can hardly move the spirit of people."¹⁴

Is current development model of Europe result of evolutionary, traditional lifting power of „European idea“, or it is imposed externally, by globalization processes? Should we maybe look for some kind of synthesis of these two approaches?

¹⁴ Steiner, George (2009) „Ideja Evrope“ *(Translation of Steiner, G. *The Idea of Europe*), AB, Zagreb,

In lecture George Steiner has given at Institute Nexus in Tilburg 2003, he presented the idea by which each idea must be deeply anchored in reality, in the essence of things, similar to the lightning rod which is the way to ground thunders. In other words, the question that arises is whether the idea of political and economic integration of Europe is grounded in European **cultural inheritance** and how strong is it grounded. And don't forget that people who are experts for European culture say that there are no many people who know and understand these issues as George Steiner.

That's why his observations, dilemmas and practical advice are precious incentives for our thinking about these issues. Instead of simplified, almost fatalistic approach, we need intellectual-visionary approach. Don't we feel the lack of visionary approach, immanent to the "fathers of nation", through lack of strategic thought in Europe today? Steiner explains five axioms which define Europe: 1) **barroom life** (everything happens in barrooms, bars are spiritual meeting places); 2) **humanized environment** (human feet stepped on each square meter of European land, as European like to walk); 3) **streets and squares are named** by famous state leaders, scientists, artists and writers from the past and the present (not by numbers, as it is the case in USA – this put emphasis on the burden from European history); 4) Europe is "**the story about two cities**", Athens and Jerusalem, the story on the historical conflict between Greek and Jewish people;¹⁵ 5) Eschatological self-consciousness as unique feature of European consciousness – **predicting tragic finality**.

If these five axioms characterize „European idea“, George Steiner wonders **what would be next**. In thinking about this question he quotes the opinions of two great minds of Europe – Max Weber and Edmond Husserl.

Back in 1919, while Europe was in ruins, Max Weber emphasized the need to develop science, to develop free education and culture. In a word, he stressed the need for knowledge and intellectual spirit. Weber predicted "that European intellectual life will be Americanized and reduced to *managerial* bureaucracy"¹⁶

"Democracy should be put in practice when and where it is appropriate. Scientific knowledge and education (...) sometimes assumes the existence of constant type of intellectual aristocracy... And those (intellectual aristocrats) cannot be people who

¹⁵ Being an European means attempt to morally, intellectually and existentially negotiate with two competitive ideals: *praxis* of Socrates city and those from Prophet Isaiah (Steiner, G. Op.cit. page 35);

¹⁶ Christianity has never completely left the expectation that this world will end. This is the crucial feature of prevailing Christian thought. Europeans permanently look for "The Judgement Day" and this feeling of "end" was particularly emphasized in Hegel's work. (Steiner, G. Op.cit. page 68);

lack the ability to put on horse eyeglasses (...), and to convince themselves that their interpretation of a scientific article is the accurate one. They will always be strangers in science, according to Max Weber. They don't have the thing Plato used to call **mania**; they cannot be obsessed by need to discover abstract and often unusable truths and they should be engaged in other thing, not science. Weber thinks that Europe should thank scientists, researchers and artists, who were devoted to the ideal of truth, not to any kind of immediate profit, for its ingenuity and dominant position in the world in certain period of history."¹⁷

In his famous lecture "Philosophy and the Crisis of European Man", Edmond Husserl described Europe as "the unity of spiritual life and creative activity". This creative spirituality has early origins in ancient Greek Empire. Greek discovery that the world can be comprehended by human mind (Tales) brought mankind to the understanding that ideas "themselves secrete deliberate infinities in amazing new ways." Ancient Greeks, unlike other nation famous by their intellectual discoveries, were unique because they had **theory** – understood as not-interested speculative thoughts in the world of unlimited possibilities... At the same time, only in ancient Greece, and later in Europe this theory and practice was implemented as universal critics of everything that exists. This brought Europe to the source of Western civilization. Nevertheless, "Europe today" is forgetting itself, when it forgets that it was born by the idea of rationality and philosophical spirit. Husserl concludes that "great fatigue of Europe" is very dangerous for the future.

Husserl wonders is Europe really tired from the weight of its achievements, from inappropriate wealth and complicated history.

Does this fear for future come from confession that Europe "is tired"? Steiner was the one who express the fear that global uniformed life ("McDonaldization") can destroy great potential of Europe: **large differences within small areas** (differences are understood as possibility for synergy of development). This could destroy European traditions and differences. And differences are the real wealth....

„There is no such thing as small language... The death of a language cannot be fixed; it significantly reduces the opportunities of a human being. Nothing can endanger Europe more radically then exponential high tide of Anglo-American language that is coming in; there is nothing more dangerous than uniformed values and uniform picture of the world brought by this overwhelming Esperanto. Language of computer industry, popular culture and mass markets is Anglo-American. Without struggle to save its own languages, local traditions and social autonomy, Europe could really fail. If Europe forget that "dear God lives in details" disaster cannot be avoided. Europe and „European idea“ will survive if they successfully become leaders in the

¹⁷ Steiner, G. Op.cit. page 61;

world through some idea.¹⁸ It is hard to say whether it is an idea of **secular humanism**, as discussed in Steiner work. In any case, great ideas should be result of spirit and intellect. Europe can hardly confront to economic, military and technological power of USA or rising Asia. Europe has to invent the invention again, to re-confirm "the courage of its spirit", undoubtedly weakened by globalization.

The question which arises from this brief comparison of two models is **how to make the balance between political and economic unification and creative uniqueness**; how to make the balance with **the wealthy cultural roots of "European idea"**. Neither I, nor much wiser people can answer it. Focusing our attention to the search for dialectic harmony between things which are instantaneous and superficial on one side; and those which are long-term and essential on the other, could bring us an intellectual synergy and enable us to **clearly look at us today from the forthcoming future**. As much as I am not capable to see present time from the future, the history of development of ideas, the fall of civilizations, and understanding history as the museum of bygone dreams, I tend to think that **the society which neglects the importance of dignified spirit; the society which is not well tied through humanistic ideas will end in violence and self-destruction, sooner or later**. Is there better example to confirm this then ex-Yugoslavia? Dignifying spirit and, at least, promoting an idea that Europe should never again go along the path **from Sarajevo to Sarajevo** gives better chances to the success of political and economic integration..

10. Instead of conclusion

The word "risk" from the title of this paper is not understood in context of doubts or fears from European integration of Western Balkan.

Use of this term had double purpose. First, we cannot look at the processes of European integration of Western Balkan and whole Europe with ideological determinism, neither we can be sure that these processes are historically given. We cannot say that something is risky if outcomes are known in advance. This means that the paper is stressing the uncertainty of integration processes.

Second, I understand the risk as orientation to the future. In other words, risk is a part of the system of values in the society oriented to future. The purpose of this was to point out the need that processes of EU integration should be understood as the way to abandon our traditional orientation to the past (so called "rearview mirror approach"). We need to look into future... from the future. I wanted to stress out the

¹⁸ Steiner, G. Op.cit. page 71;

importance of several challenges we need to face with, if we want to preserve our spirit and our culture in this new environment and new community.

If we look at the process of European integration in context of risk – orientation to the future, then we are abandoning dead, demagogic and daily-politics approach. It is the process of much stronger and deeper intellectual movement of our spirit. Instead of improving only “administrative capacities”, we should spend much more time and energy to **spiritual capacities**.

Giddens says that risk always has to be tamed. But, active acceptance of risk is the crucial factor of dynamic economy and inventive society. The fact that we enter European integration processes along with the fact that we live in era of globalization necessarily means that we must be ready to face many risky situation. In order to support scientific inventions and other project we often need more courage, then caution. After all, etymological root of the noun risk in many world languages is in the verb: **to dare!**

11. References

1. Attali, Jacques (2008), *Kratka povijest budućnosti (Short History of Future)*, Meandar Media, Zagreb;
2. Bakunin, Mikhail (2008), *Državnost i anarhija (Statism and Anarchy)*, CID, Podgorica;
3. Barzun, Jacques (2003), *Od osvita do dekadencije Zapadne kulture (From Dawn to Dekadence)*, Masedia, Zagreb;
4. Beck, Ulrich (2008), *Kosmopolitiska Evropa (Cosmopolitan Europe)*, Školska knjiga, Zagreb;
5. Berend, Ivan T. (2006), **An Economic History of Twentieth-Century Europe: Economic Regimes from Laissez-Faire to Globalization**, Cambridge University Press, UK;
6. Dahrendorf, Ralf (2005), *U potrazi za novim poretkom (In Search for New World Order – lectures)*, Naklada Deltakont, Zagreb;
7. Dawson, Christopher (2002), *Razumijevanje Evrope (Understanding Europe)*, Verbum, Split;
8. Droa, Rože-Pol (2010), *Zapad (West)*, Geopolitika, Beograd;
9. Đurović, Momir, akademik (2010), *Svijet u kome živimo (World We Live in)*, Lecture at the meeting of Montenegrin Academy of Science and Arts, CANU, Podgorica;
10. European Commission (2011), *Green Paper Towards a Common Strategic Framework for EU Research and Innovation Funding*, Brussels;
11. Fernandez, Felipe (2010), *Tragači – globalna povijest istraživanja (Pathfinders – Global History of Exploration)*, Fraktura, Zagreb;

12. Fuše, Mišel (2000), *Evropska republika*, Stubovi kulture, Beograd;
13. Giddens, Antony (2008), *Europe in the Global Age*, Cambridge University Press, UK;
14. Gidens, Entoni (2005), *Odbjegli svijet (Runaway world)*, Stubovi kulture, Beograd;
15. Heisenberg, Werner (1998), *Fizika i filozofija (translation of Physics and Philosophy)*, Kruzak, Zagreb;
16. Hergešić, Ivo – priređivač (1944), *Razgovor o Evropi (Conversation about Europe)*, Matica Hrvatska, Zagreb;
17. Hirshman, Albert (1999), *Interesi i strasti (The Interest and The Passion)*, Filip Višnjić, Beograd;
18. Hawking, Steven (2010), *Velebni plan (The Great Design)*, Luč, Zagreb;
19. Jeremy Rifkin (2006), *Evropski san (The European Dream)*, Školska knjiga, Zagreb;
20. Klaus, Vaclav (2010), *Evropa i EU (Europe and EU)* Službeni glasnik, Beograd;
21. Lakićević, Dragan (2002), *Arhipelag Balkan (Archipelago of Balkan)*, IES, Beograd;
22. Lakićević, Dragan (2003), *Metoda i politika (Method and Politics)*, IES, Beograd;
23. Landis, David (2004), *Bogatstvo i siromaštvo nacija (Wealth and Poverty of Nation)*, Stubovi kulture, Beograd;
24. Leonar, Emil Ž. (2002), *Opšta istorija protestantizma (General History of Protestantism)*, I, II i III tom, Izdavačka knjižnica Zorana Stojanovića, Novi Sad;
25. Madžar, Ljubomir (2004), *Neoliberalizam i alternative (Neo-liberalism and Alternatives)*, Ekonomomija preduzetništva, br.5;
26. Madžar, Ljubomir (2011), *Vidljivi horizonti evropske himere (Visible Horizons of European Chimera)*, IDN, Naučni skup „Balkan i EU“;
27. Majes, Toms (2009), *Identitet Evrope (Identity of Europe)*, Službeni glasnik, Beograd;
28. Mannheim, Karl (2009), *Dijagnoza našeg vremena (Diagnosis of Our Time)*, Mediteran, Novi Sad;
29. Manent, Pierre (2001), *Intelektualna istorija liberalizma (Intellectual History of Liberalism)*, Stubovi kulture, Beograd;
30. Mencinger, Jože (2010), *Evropsko bratstvo i jedinstvo (European Brotherhood and Unity)*, nedjeljnik NIN (avgust), Beograd;
31. Morin, Edgar (1989), *Kako misliti Evropu? (Re-thinking Europe)*, Svjetlost, Sarajevo;
32. North, Douglas (2005), *Understanding the Process of Economic Changes*, Princeton University Press, USA;
33. Nozick, Robert (2008), *Anarhija, država, utopija (Anarchy, State and Utopia)*, CID, Podgorica;

34. Ohmae, Kenichi (2007), *Globalna pozornica (Next Global Stage)*, MATE, Zagreb;
35. Olson, Mancur (2006), *Moć i razvoj (Power and Prosperity)*, Stubovi kulture, Beograd;
36. Jose Ortega y Gasset (2003), *Evropa i ideja nacije (Europe and The Nation Idea)*, Artist, Beograd;
37. Ouržednik, Patrik (2001), *Europeanna*, Samizdat, B92, Beograd;
38. Paić, Žarko (2007), *Traume razlika (Trauma of Differences)*, Intermedia, Zagreb;
39. Reinert, Eric (2004), *Globalna ekonomija (Global Economy)*, Čigoja, Beograd;
40. Rifkin, Jeremy (2002), *Entropija – nov pogled na svijet (Entropy – A New Worldview)*, MIDI, Zagreb;
41. Službeni glasnik (2009), *Evropska civilizacija (European Civilization)*, (collection of works), Službeni glasnik, Beograd;
42. Sorman, Guy (1997), *Velika tranzicija (The Great Transition)*, Izdavačka knjižnica Zorana Stojanovića, Sremski Karlovci – Novi Sad;
43. Sorman, Guy (2009), *Economics Does Not Lie: A Defense of Free Markets in a Time of Crisis*, Encounter Books, New York;
44. Steiner, George (2009), *Ideja Evrope (The Idea of Europe)*, AB, Zagreb.

Steve Henke*

Monetary Misjudgments and Malfeasance**

Abstract: *The Federal Reserve has a long history of creating aggregate demand bubbles in the United States (Niskanen 2003, 2006). In the ramp up to the Lehman Brothers' bankruptcy in September 2008, the Fed not only created a classic aggregate demand bubble, but also facilitated the spawning of many market-specific bubbles. The bubbles in the housing, equity, and commodity markets could have been easily detected by observing the price behavior in those markets, relative to changes in the more broadly based consumer price index. True to form, the Fed officials have steadfastly denied any culpability for creating the bubbles that so spectacularly burst during the Panic of 2008–09.*

If all that is not enough, Fed officials, as well as other members of the money and banking establishments in the United States and elsewhere, have embraced the idea that stronger, more heavily capitalized banks are necessary to protect taxpayers from future financial storms. This embrace, which is reflected in the Bank for International Settlements' most recent capital requirement regime (Basel III) and related country-specific capital requirement mandates, represents yet another great monetary misjudgment (error). Indeed, in its stampede to make banks "safer," the establishment has paradoxically rendered the economies of the Eurozone, the United Kingdom, and the United States—among others—weaker and, therefore, less "safe" (Hanke 2011).

Key words: *The Federal Reserves, Adregate Demand Bubbles, Monetary Policy, Misjudgement*

Introduction

The Federal Reserve has a long history of creating aggregate demand bubbles in the United States (Niskanen 2003, 2006). In the ramp up to the Lehman Brothers' bankruptcy in September 2008, the Fed not only created a classic aggregate demand bubble, but also facilitated the spawning of many market-specific bubbles. The bubbles in the housing, equity, and commodity markets could have been easily detected by observing the price behavior in those markets, relative to changes in the

* Professor of Applied Economics at The Johns Hopkins University; Senio Fellow at the CATO Institute, Washinton DC, USA

** The paper was initially published in the CATO Journal, Volume 31, Number 3, Fall 2011

more broadly based consumer price index. True to form, the Fed officials have steadfastly denied any culpability for creating the bubbles that so spectacularly burst during the Panic of 2008–09.

If all that is not enough, Fed officials, as well as other members of the money and banking establishments in the United States and elsewhere, have embraced the idea that stronger, more heavily capitalized banks are necessary to protect taxpayers from future financial storms. This embrace, which is reflected in the Bank for International Settlements' most recent capital requirement regime (Basel III) and related country-specific capital requirement mandates, represents yet another great monetary misjudgment (error). Indeed, in its stampede to make banks "safer," the establishment has paradoxically rendered the economies of the Eurozone, the United Kingdom, and the United States—among others—weaker and, therefore, less "safe" (Hanke 2011).

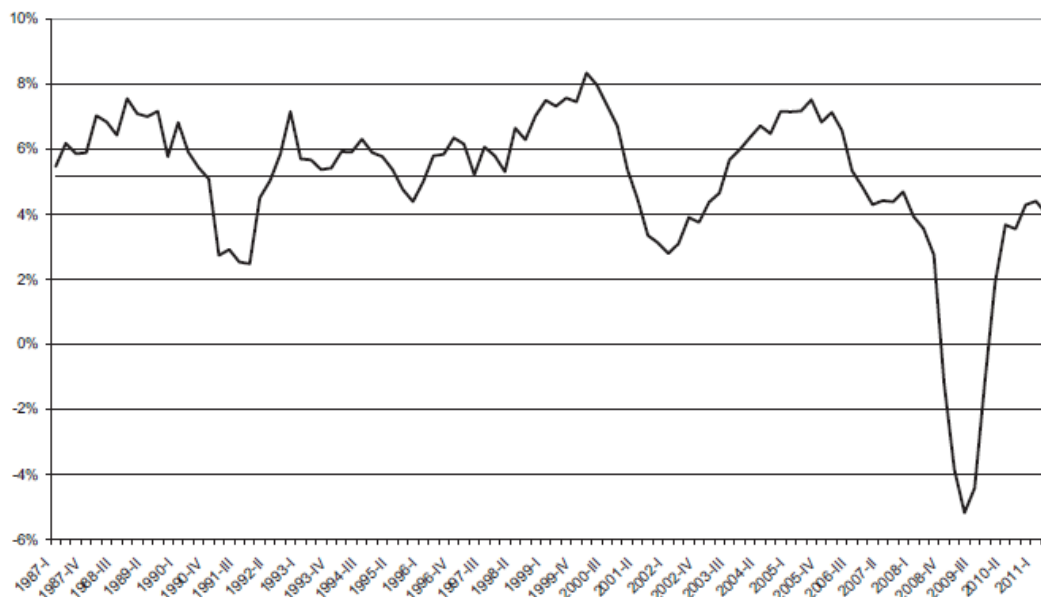
Aggregate Demand Bubbles

Just what is an aggregate demand bubble? This type of bubble is created when the Fed's laxity allows aggregate demand to grow too rapidly. Specifically, an aggregate demand bubble occurs when nominal final sales to U.S. purchasers ($GDP - \text{exports} + \text{imports} - \text{change in inventories}$) exceeds a trend rate of nominal growth consistent with "moderate" inflation by a significant amount.

During the 24 years of the Greenspan-Bernanke reign at the Fed, nominal final sales grew at a 5.2 percent annual trend rate. This reflects a combination of real sales growth of 3 percent and inflation of 2.2 percent (Figure 1). But, there were deviations from the trend.

The first deviation began shortly after Alan Greenspan became chairman of the Fed. In response to the October 1987 stock market crash, the Fed turned on its money pump and created an aggregate demand bubble: over the next year, final sales shot up at a 7.5 percent rate, well above the trend line. Having gone too far, the Fed then lurched back in the other direction. The ensuing Fed tightening produced a mild recession in 1991.

Figure 1: Final Sales to Domestic Purchasers 1987 Q1 to 2011 Q2 (annual percentage change)



Note: FSDP = GDP + Import – Export – Δinventory

Source: Bureau of Economic Analysis, U.S. Department of Commerce

During the 1992–97 period, growth in the nominal value of final sales was quite stable. But, successive collapses of certain Asian currencies, the Russian ruble, the Long-Term Capital Management hedge fund, and the Brazilian real triggered another excessive Fed liquidity injection. This monetary misjudgment resulted in a boom in nominal final sales and an aggregate demand bubble in 1999–2000. That bubble was followed by another round of Fed tightening, which coincided with the bursting of the equity bubble in 2000 and a slump in 2001.

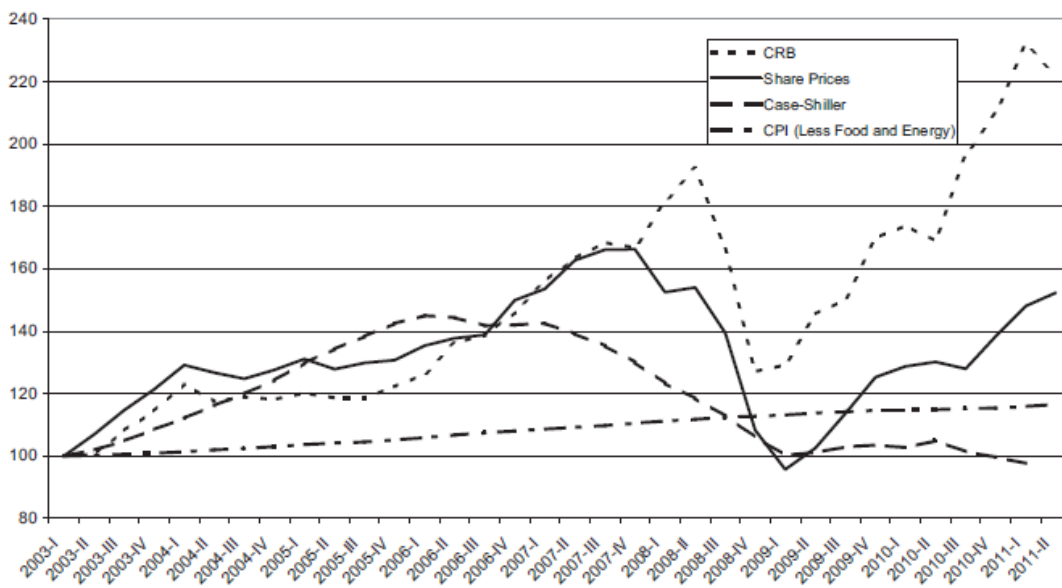
The last big jump in nominal final sales was set off by the Fed’s liquidity injection to fend off the false deflation scare in 2002 (Beckworth 2008). Fed Governor Ben S. Bernanke (now chairman) set off a warning siren that deflation was threatening the U.S. economy when he delivered a dense and noteworthy speech before the National Economists Club on November 21, 2002 (Bernanke 2002). Bernanke convinced his Fed colleagues that the deflation danger was lurking. As Greenspan put it, “We face new challenges in maintaining price stability, specifically to prevent inflation from falling too low” (Greenspan 2003). To fight the alleged deflation threat, the Fed pushed interest rates down sharply. By July 2003, the Fed funds rate was at a then-record low of 1 percent, where it stayed for a year. This easing produced the mother of all liquidity cycles and yet another massive demand bubble.

During the Greenspan-Bernanke years, and contrary to their claims, the Fed overreacted to real or perceived crises and created three demand bubbles. The last represents one bubble too many – and one that is impacting us today.

Market-Specific Bubbles

The most recent aggregate demand bubble was not the only bubble that the Fed was acilitating. As Figure 2 shows, the Fed’s favorite inflation target—the consumer price index, absent food and energy prices—was increasing at a regular, modest rate. Over the 2003–08 (Q3) period, this metric increased by 12.5 percent.

Figure 2: Price Indexes



Sources: International Monetary Fund, *International Financial Statistics*; Federal Reserve Bank of St.Louis; Standard and Poor’s; Bloomberg and Author’s Calculations

The Fed’s inflation metric signaled “no problems.” But, abrupt shifts in major relative prices were underfoot. Housing prices, measured by the Case-Shiller home price index, were surging, increasing by 45 percent from the first quarter in 2003 until their peak in the first quarter of 2006. Share prices were also on a tear, increasing by 66 percent from the first quarter of 2003 until they peaked in the first quarter of 2008.

The most dramatic price increases were in the commodities, however. Measured by the Commodity Research Bureau’s spot index, commodity prices increased by 92 percent from the first quarter of 2003 to their pre-Lehman Brothers peak in the second quarter of 2008.

The dramatic jump in commodity prices was due, in large part, to the fact that a weak dollar accompanied the mother of all liquidity cycles. Measured by the Federal Reserve's Trade Weighted Exchange Index for major currencies, the greenback fell in value by 30.5 percent from 2003 to mid-July 2008. As every commodity trader knows, all commodities, to varying degrees, trade off changes in the value of the dollar. When the value of the dollar falls, the nominal dollar prices of internationally traded commodities—like gold, rice, corn, and oil—must increase because more dollars are required to purchase the same quantity of any commodity.

Indeed, in my July 2008 testimony before the House Budget Committee on "Rising Food Prices: Budget Challenges," I estimated that the weak dollar was the major contributor to what then, only a few months before the collapse of Lehman Brothers, was viewed as the world's most urgent economic problem: world-record commodity prices. My estimates of the depreciating dollar's contribution to surging commodity prices over the 2002–July 2008 period was 51 percent for crude oil and 55.5 percent for rough rice, two commodities that set record-high prices (nominal) in July 2008 (Hanke 2008).

Before leaving the market-specific bubbles, two points merit mention. First, the relative increase in housing prices was clearly signaling a bubble in which prices were diverging from housing's fundamentals. A simple "back-of-the-envelope" calculation confirms a bubble. The so-called demographic "demand" for housing in the U.S. during the first decade of the 21st century was about 1.5 million units per year. This includes purchases of first homes by newly formed families, purchases of second homes, and the replacement of about 300,000 units per year that have been lost to fire, floods, widening of highways, and so forth (Aliber 2010). During the bubble years 2002–06, housing starts were two million per year. In consequence, an "excess supply" of about 500,000 units, or 25 percent of the annual new starts, was being created each year. These data suggest that housing prices in the 2002–06 period should have been very weak, or declining. Instead, they increased by 45 percent. The Fed, even according to the minutes of the Federal Open Market Committee of June 2005, failed to spot what was an all-too obvious housing bubble (Harding 2011).

A second point worth mentioning is that, while operating under a regime of inflation targeting and a floating U.S. dollar exchange rate, Chairman Bernanke has seen fit to ignore fluctuations in the value of the dollar. Indeed, changes in the dollar's exchange value do not appear as one of the six metrics on "Bernanke's Dashboard"—the one the chairman uses to gauge the appropriateness of monetary policy (Wessel 2009: 271). Perhaps this explains why Bernanke has been dismissive of questions suggesting that changes in the dollar's exchange value influence either

commodity prices or more broad gauges of inflation (McKinnon 2010, Reddy and Blackstone 2011).

It is remarkable that the steep decline in the dollar during the 2002–July 2008 period and associated surge in commodity prices, the subsequent surge in the dollar's value after Lehman Brothers collapsed and associated plunge in commodity prices, and the renewed decline in the dollar's exchange rate after the first quarter of 2009 and associated new surge in the CRB spot index (Figure 2) has left Fed officials in denial. Indeed, they continue to be stubbornly blind to the fact that there is a link between the dollar's exchange value and commodity prices (Reddy and Blackstone 2011).

Malfeasance

For most masters of money, it is all about an inflation target. As long as they hit a target, or come close to it, they are defended from all sides by members of the establishment (Blinder 2010, Mankiw 2011). It is as if nothing else matters. The deputy governor of the world's first central bank (Sweden's Riksbank) and a well-known pioneer of inflation targeting made clear what all the inflation-targeting central bankers have in mind:

„My view is that the crisis was largely caused by factors that had very little to do with monetary policy. And my main conclusion for money policy is that flexible inflation targeting – applied in the right way and in particular using all the information about financial conditions that is relevant for the forecast of inflation and resource utilization at any horizon – remains the best-practice monetary policy before, during, and after the financial crisis.“
[Svensson 2010: 1].

For central bankers, the “name of the game” is to blame someone else for the world's economic and financial troubles (Bernanke 2010, Greenspan 2010). How can this be, particularly when money is at the center?

To understand why the Fed's fantastic claims and denials are rarely subjected to the indignity of empirical verification, we have to look no further than the late Nobelist Milton Friedman. In a 1975 book of essays in honor of Friedman, *Capitalism and Freedom: Problems and Prospects*, Gordon Tullock (1975: 39–40) wrote:

„It should be pointed out that a very large part of the information available on most government issues originates within the government. On several occasions in my hearing (I don't know whether it is in his writing or not but I have heard him say this a number of times) Milton Friedman has pointed out

that one of the basic reasons for the good press the Federal Reserve Board has had for many years has been that the Federal Reserve Board is the source of 98 percent of all writing on the Federal Reserve Board. Most government agencies have this characteristic. "

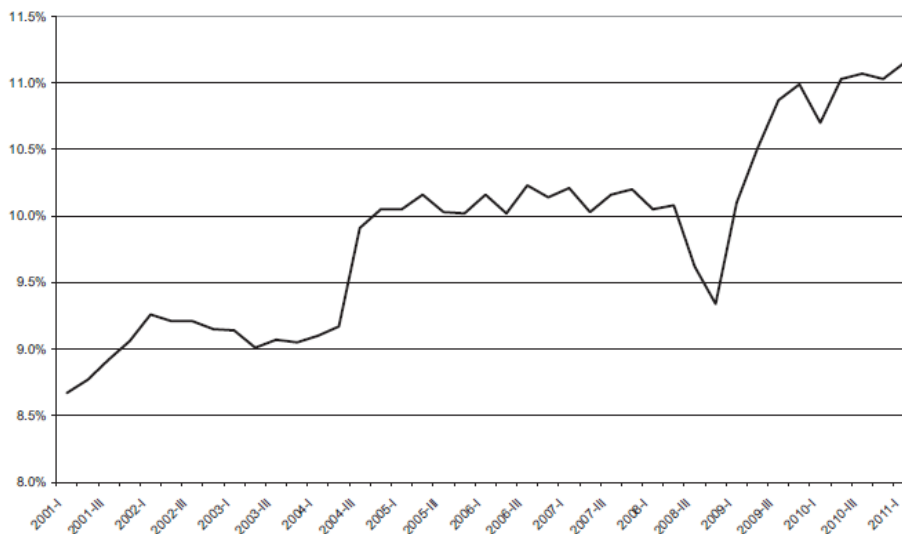
Friedman's assertion has subsequently been supported by Lawrence H. White's research. In 2002, 74 percent of the articles on monetary policy published by U.S. economists in U.S.-edited journals appeared in Fed-sponsored publications, or were authored (or co-authored) by Fed staff economists (White 2005, Grim 2009).

For powerful and uncompromising dissidents, the establishment can impose what it deems to be severe penalties. For example, after the distinguished monetarist and one of the founders of the Shadow Open Market Committee Karl Brunner was perceived as a credible threat, he was banned from entering the premises of the Federal Reserve headquarters in Washington, D.C. Security guards were instructed to never allow Brunner to enter the building. This all backfired. Indeed, the great Brunner confided to Apostolos Serletis that the ban had done wonders for his career (Serletis 2006: xiii). Alas, most money and banking professionals would, unlike Brunner, find a Fed ban to be a burden they could not bear.

Misjudgments, Again

As part of the money and banking establishment's blame game, the accusatory finger has been pointed at commercial bankers. The establishment asserts that banks are too risky and dangerous because they are "undercapitalized." It is, therefore, not surprising that the Bank for International Settlements located in Basel, Switzerland has issued new Basel III capital rules. These will bump banks' capital requirements up from 4 percent to 7 percent of their risk-weighted assets. And if that is not enough, the Basel Committee agreed in late June to add a 2.5 percent surcharge on top of the 7 percent requirement for banks that are deemed too-big-to-fail. For some, even these hurdles aren't high enough. The Swiss National Bank wants to impose an ultra-high 19 percent requirement on Switzerland's two largest banks, UBS and Credit Suisse. In June, the upper chamber of the Swiss Parliament approved that rate. In the United States, officials from the Fed and the Federal Deposit Insurance Corporation are also advocating capital surcharges for "big" banks (Braithwaite and Simonian 2011).

The oracles of money and banking have demanded higher capital-asset ratios for banks—and that is exactly what they have received. Just look at what has happened in the United States. Since the onset of the Panic of 2008–09, U.S. banks have, under political pressure and in anticipation of Basel III, increased their capital-asset ratios (Figure 3).

Figure 3: U.S. Bank's Total Equity/Total Assets

Source: Federal Reserve Bank of St. Louis.

The oracles have erupted in cheers at the increased capital-asset ratios. They assert that more capital has made the banks stronger and safer. While at first glance that might strike one as a reasonable conclusion, it is not (Dowd, Hutchinson, and Hinchliffe 2011).

For a bank, its assets (cash, loans and securities) must equal its liabilities (capital, bonds, and liabilities which the bank owes to its shareholders and customers). In most countries, the bulk of a bank's liabilities (roughly 90 percent) are deposits. Since deposits can be used to make payments, they are "money." Accordingly, most bank liabilities are money.

To increase their capital-asset ratios, banks can either boost capital or shrink assets. If banks shrink their assets, their deposit liabilities will decline. In consequence, money balances will be destroyed. So, paradoxically, the drive to deleverage banks and to shrink their balance sheets, in the name of making banks safer, destroys money balances. This, in turn, dents company liquidity and asset prices. It also reduces spending relative to where it would have been without higher capital-asset ratios.

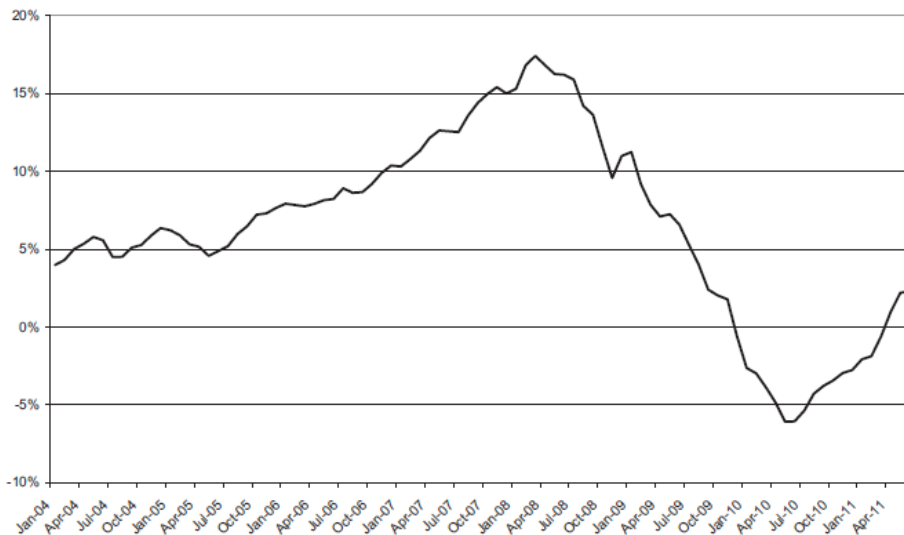
The other way to increase a bank's capital-asset ratio is by raising new capital. This, too, destroys money. When an investor purchases newly issued bank equity, the investor exchanges funds from a bank deposit for new shares. This reduces deposit liabilities in the banking system and wipes out money.

By pushing banks to increase their capital-asset ratios to allegedly make banks stronger, the oracles have made their economies (and perhaps their banks) weaker.

U.K. economist Tim Congdon convincingly demonstrates in *Central Banking in a Free Society* (2009) that the ratcheting up of banks' capital-asset ratios ratchets down the growth in broad measures of the money supply. And, since money dominates, it follows that economic growth will take a hit, if banks are forced to increase their capital-asset ratios.

The capital-raising mania in the United States and its consequences are clear. While the high-powered base money (M0) has exploded since the Panic of 2008–09, broad money (M3) has taken a different, and worrying, course (Figure 4).

Figure 4: U.S. Broad Money (M3) (Annual Growth Rate)



Source: Shadow Government Statistics.

The oracles' embrace of higher capital-asset ratios for banks in the middle of the most severe slump since the Great Depression has been a great blunder. While it might have made banks temporarily "stronger," it has contributed mightily to plunging money supply metrics and very weak economic growth. Until the oracles come to their senses and reverse course on their demands for ever-increasing capital-asset ratios, we can expect continued weak (or contracting) money growth, economic weakness, increasing debt problems, continued market volatility, and a deteriorating state of confidence.

Conclusion

Monetary misjudgments and malfeasance have characterized U.S. policy. Even though there were numerous signs that the financial systems in Europe and the

United States were enduring severe stresses and strains in 2007, the money and banking oracles failed to anticipate and prepare for the major financial and economic turmoil that visited them in 2008–09. Indeed, the oracles' ad hoc reactions turned the turmoil into a panic. Since then, members of the money and banking establishment have been busy dissembling. They have hung out "not culpable" signs and pointed their powerful accusatory fingers at others.

The Fed has a propensity to create aggregate demand bubbles. These bubbles carry with them market-specific bubbles that distort relative prices and the structure of production. Contrary to the assertions of the stabilizers who embrace inflation targeting, these relative price distortions are potentially dangerous and disruptive. If that was not enough, policymakers have latched onto a new mantra: to make banks "safe," higher capital requirements are absolutely essential. The banks have obliged and increased their capital-asset ratios. In consequence, the banks' loan books that are subject to higher capital-to-asset mandates have shrunk. With that, broad money (M3) growth rates have remained submerged and a typical post-slump economic rebound has failed to materialize.

References

1. Aliber, R. Z. (2010) Private Correspondence (19 October).
2. Beckworth, D. (2008) "Aggregate Supply-Demand Deflation and Its Implications For Macroeconomic Stability." *Cato Journal* 28 (3): 363–84.
3. Bernanke, B. S. (2002) "Deflation: Making Sure 'It' Doesn't Happen Here." Address at the National Economists Club, Washington, D.C. (21 November).
4. Bernanke, B. S. (2010) "Causes of the Recent Financial and Economic Crisis." Testimony before the Financial Crisis Inquiry Commission, Washington, D.C. (2 September).
5. Blinder, A. S. (2010) "In Defense of Ben Bernanke." *Wall Street Journal* (15 November).
6. Braithwaite, T., and Simonian, H. (2011) "Banks Make Basel Appeal to Congress." *Financial Times* (16 June).
7. Congdon, T. (2009) *Central Banking in a Free Society*. London: Institute of Economic Affairs.
8. Dowd, K.; Hutchinson, M.; Ashby, S., and Hinchliffe, J. M. (2011) "Capital Inadequacies: The Dismal Failure of the Basel Regime of Bank Capital Regulation." *Cato Policy Analysis* 681 (29 July).
9. Greenspan, A. (2003) "Federal Reserve Board's Semiannual Monetary Policy Report to Congress." Committee on Financial Services, U.S. House of Representatives. Washington, D.C. (15 July).

10. Greenspan, A. (2010) "The Crisis." *Brookings Papers on Economic Activity* (Spring): 201–46.
11. Grim, R. (2009) "Priceless: How the Federal Reserve Bought the Economics Profession." *Huffington Post* (7 September).
12. Hanke, S. H. (2008) "The Greenback and Commodity Prices." *Interest-Rate Outlook*. Boston: H.C. Wainwright & Co. Economics, Inc. (11 September).
13. Hanke, S.H (2011) "'Stronger' Banks, Weaker Economies." *Globe Asia* (August). Harding, R. (2011) "Fed Misread Dangers of Housing Crash, Minutes Show." *Financial Times* (14 January).
14. Mankiw, N. G. (2011) "What's with All the Bernanke Bashing?" *New York Times* (30 July).
15. McKinnon, R. (2010) "Rehabilitating the Unloved Dollar Standard." *Asian-Pacific Economic Literature* 24 (2): 1–18 (April).
16. Niskanen, W.A. (2003) "On the Fed's Demand Bubble." *Cato Journal* 23 (1): 135–38.
17. Niskanen, W.A. (2006) "An Unconventional Perspective on the Greenspan Record." *Cato Journal* 26 (2): 333–35.
18. Reddy, S., and Blackstone, B. (2011) "Bernanke Denies that Fed is Stoking Inflation." *Wall Street Journal* (4 February).
19. Serletis, A. (2006) *Money and the Economy*. Hackensack, N.J.: World Scientific Publishing.
20. Svensson, Lars. (2010) "Monetary Policy after the Financial Crisis." Address at the Second International Journal of Central Banking Fall Conference, Tokyo (17 September).
21. Tullock, G. (1975) "Discussion." In R. T. Selden (ed.) *Capitalism and Freedom: Problems and Prospects; Proceedings of a Conference in Honor of Milton Friedman*. Charlottesville: University Press of Virginia.
22. Wessel, D. (2009) *In Fed We Trust: Ben Bernanke's War on the Great Panic*. New York: Crown Business.
23. White, L. H. (2005) "The Federal Reserve System's Influence on Research in Monetary Economics." *Econ Journal Watch* 2 (2): 325–54.

Milorad Katnić,*

Debt Crisis – Challenges of the Euro zone and the Western Balkans

Abstract: *The consequences of government interventions created problems greater than those they were trying to solve. The state intervention in the richest countries brought high deficit and public debt that paralyzed their functioning.*

If no measures are undertaken, many countries will go bankrupt. Pumping additional money and state aid packages have only delayed and made the problem more complex. The fire cannot be put down by adding the oil to the fire. Help provided to undisciplined countries by healthier and stronger economies as well as public finances is shown to be a way towards collective disaster. Therefore, countries need radical and consistent fiscal consolidation, which is advocated in this paper and proposed as the only long-term sustainable response to the challenges of the debt crisis.

Key words: *Debt, crises, euro, fiscal consolidation*

Economic challenges in 2011

At the beginning of 2011, the features of the global economy were unpredictable shocks, ranging from political turbulences in the Middle East and North Africa to earthquakes and tsunami in Japan. The oil price is reaching its historical maximum, which is additionally firing up the growth trend in food prices and pressuring an inflation increase. The global instability is also accompanied with internal weaknesses and problems of national economies. The largest World economies, and with that the entire global economy, are facing great challenges.

Delays on the budget deal and measures that should stabilise public finances in the United States of America are deepening the uncertainties and risks. High budget deficit and growing public debt are making the largest global economy less safe. For the first time, since the data are being published, the credit rating agency *Standard&Poor's* issued a negative outlook for US bonds. China is creating increasing concern. The inflation is growing and its restraining by Yuan

* Author is a holder of PhD and Docent (Assistant Professor) at the Faculty for International Economy, Finance, and Business, University of Donja Gorica (UDG), Podgorica; employed at the Ministry of Finance of Montenegro; e-mail: katnic@t-com.me

appreciation could affect the reduction of economic growth rate and cause not only economic but also political problems. If the fastest growing economy sharply slows down that would be a new shock for fragile recovery of the global economy.

The Euro zone debt crisis is the issue causing highest concerns for economists, analysts, and decision makers. The special report of the *Economist Intelligence Unit* estimates that there is a 50% probability of imminent bankruptcy of one country of the Eurozone, while only a 10% probability is given to the recovery of public finances and overall economy of the euro zone without shocks. Largest European banks have problems with shortage of capital, while they are at the same time the biggest creditors of Greece, Ireland, Portugal, and Spain. Weakened banking system can easily slide into insolvency. Thus, increasing overall systemic risk of the Eurozone, and its future is called in question. The guesses are whether it is more likely that one of the weaker economies leaves the Eurozone first or whether Germany will be the first one to do that.

The Western Balkan countries pressured by the crisis have worsened their fiscal positions. While the most developed countries in the World can afford high debts and their regular servicing, that is not the case with small economies subject to exogenous shocks, such are the Western Balkan countries. Fiscal crisis of the Eurozone represents an additional challenge to efforts to stabilise public finances in the Western Balkan countries.

Global Debt Crisis

In the 18th century, David Hume argued, "either the nation must destroy public credit or public credit will destroy the nation". The history confirms this. High public consumption and over-indebtedness affected deterioration of the most important kingdoms, like old Egypt, Rome, and Greece. Weakness of Philip II of Spain in terms of warfare, financed from borrowing, resulted in not only bankruptcy of the state in 1557, but caused subsequent bankruptcies (four in total). During oil shocks in 1970's, oil export countries were naïve to believe that historical bankruptcy of countries is something that cannot be repeated. Today, high debts are again threatening to destroy the wealthiest countries in the World.

Public consumption grew more than four times over the course of previous hundred years. In the peak of economic crisis, many rushed to declare the end of the free market and market economy. The state is declared the supreme good, safe heaven and key to all problems. The answer to the economic crisis of developed countries was to use Keynesian recipe. There was a dramatic increase to an already excessively high public consumption. Increase in consumption and reduction of revenues led to an increase of deficit financed through borrowing.

Budget deficit and public debt in OECD countries reached unprecedented amounts during the peacetime. In spite of their reduction in 2010, thanks to the economic recovery and reduced need for the support of the financial sector, an average deficit in the most developed countries was 8% of GDP. Majority of the most developed countries has as the objective to reduce deficit in 2011 and in subsequent years. However, even with implementation of the ambitious plans, the deficit remains high. Consequently, the public debt in the most developed countries, according to present day forecasts, will grow from 75% of GDP, as it was at the beginning of 2008, to over 100% of GDP in 2011 and 115% of GDP by the end of 2014. These are the highest recorded levels after the World War II.

Some countries of the Euro zone (Greece, Ireland, and Portugal) found refugee in arrangements with the European Central Bank and the IMF, since they were not able to borrow additional funds and because of a sharply increase of borrowing costs. Since the outburst of the crisis, the standard IMF's *Stand-by* arrangement is again up to date. Most of the developed economies "used" relatively low cost for borrowing and financed themselves at the international market. However, since August 2010 the price of borrowing for majority of countries in the World was increased. Growth of interest rates coincided with the recovery of the global economy and announced further injection of money (QE2) in the United States of America.

Table 1: Fiscal Balances, 2008-2012

	2008	2009	2010	Forecasts	
				2011	2012
Total balances (as % of GDP)					
World	-2.0	-6.7	-5.6	-4.7	-3.5
Developed economies	-3.6	-8.8	-7.7	-7.1	-5.2
USA	-6.5	-12.7	-10.6	-10.8	-7.5
Eurozone	-2.1	-6.4	-6.0	-4.4	-3.6
France	-3.3	-7.5	-7.0	-5.8	-4.9
Germany	0.1	-3.0	-3.3	-2.3	-1.5
Italy	-2.7	-5.3	-4.5	-4.3	-3.5
Spain	-4.2	-11.1	-9.2	-6.2	-5.6
Japan	-4.2	-10.3	-9.5	-10.0	-8.4
Great Britain	-4.9	-10.3	-10.4	-8.6	-6.9
Canada	0.1	-5.5	-5.5	-4.6	-2.8
Other countries	2.0	-1.0	0.2	0.9	1.6

Developing economies	-0.6	-4.9	-3.8	-2.6	-2.2
Asia	-2.4	-4.7	-4.2	-3.4	-2.7
China	-0.4	-3.1	-2.6	-1.6	-0.9
India	-8.0	-10.0	-9.4	-8.3	-7.5
ASIA-5	-0.8	-3.7	-2.7	-2.8	-2.4
Europe	0.6	-6.2	-4.4	-2.3	-2.3
Russia	4.9	-6.3	-3.6	-1.6	-1.7
South America	-0.7	-3.7	-2.9	-2.2	-2.2
Brazil	-1.4	-3.1	-2.9	-2.4	-2.6
Mexico	-1.3	-4.8	-4.1	-1.8	-2.4
Middle East and North Africa	-0.1	-2.9	-2.1	-4.9	-4.2
Low income economies	-1.4	-4.2	-2.9	-2.6	-2.4
Oil producers	4.7	-4.4	-1.4	1.2	1.3
G-20 countries	-2.6	-7.5	-6.3	-5.7	-4.3
Developed countries G-20	-4.2	-9.4	-8.2	-8.0	-5.8
Developing countries G-20	-0.4	-4.8	-3.6	-2.5	-2.1

Source: *International Monetary Fund*

In order for OECD countries to set the public debt level, over the course of next five years, to the one from 2007, they must generate annual primary surplus in the range from 8 to 12% of GDP in USA, Japan, Great Britain and Ireland, or between 5 and 7% of GDP in other countries. With present deficits, expected nominal growth rates and optimistic debt expenditure up to 5%, to reach primary surplus up to 10% would mean fiscal adjustment of more than 15% of GDP for many counties.

At the same time, with existing trends and policies, trend of ageing population will lead to a drastic growth of the public debt. Over the course of next five years, the public debt of Japan would exceed 300% of GDP, Great Britain 200%, Belgium, France, Ireland, Greece, Italy and USA 150% of GDP.

The Crises of the Euro zone¹

Even though it is integrated economically and monetary, the Euro zone is being increasingly divided. On one hand, there is the periphery zone with countries that were spending above their means during the previous decade thanks to the benefits of the common currency and cheap money, and on the other hand, there is the northern zone, led by Germany, which have had mostly a good management of their public finances and economies. At the same time, economic and monetary union made economic and financial system of the euro zone intertwined and interdependent. Disruptions and bankruptcy of any, even the smallest economic country, may cause a large systemic risk. Debt crisis of the periphery countries means a banking crisis of the entire Euro zone. Some large banks in the most developed countries of the Euro zone, including also Germany, are amongst the most vulnerable ones. Their capital is below the satisfactory level, and their credit exposure to the periphery countries is high, which makes an additional solvency risk. In general, the fiscal parameters (deficit and debt) of the Euro zone are less negative if compared to the United Kingdom and the United States of America, and the private debt is considerably lower.

Table 2: Deficit and Public debt of selected Euro zone countries

		2007 ^a	2008 ^a	2009 ^a	2010 ^b	2011 ^c	2012 ^c	2013 ^c	2014 ^c	2015 ^c
Greece	Deficit	-6.4	-9.4	-15.4	-9.7	-8.1	-7.5	-3.0	-2.8	-1.2
	Public debt	105.0	110.3	126.8	143.7	155.8	165.1	96.3 ^d	92.0	88.0
Ireland	Deficit	0.0	-7.3	-14.4	-34.2	-9.9	-8.1	-7.2	-4.3	-2.2
	Public debt	25.0	44.3	65.5	93.9	110.4	125.0	97.0 ^d	91.4	85.7
Portugal	Deficit	-2.8	-3.0	-9.4	-7.3	-7.0	-6.1	-5.1	-4.3	-3.5
	Public debt	62.7	65.3	76.1	81.3	87.7	93.4	96.8	98.9	99.9
Spain	Deficit	1.9	-4.2	-11.1	-9.2	-6.7	-5.4	-4.2	-3.3	-2.9
	Public debt	36.1	39.8	53.2	60.0	69.6	71.1	72.5	72.6	72.2
Italy	Deficit	-1.5	-2.7	-5.3	-5.0	-4.6	-4.4	-4.0	-4.1	-4.5
	Public debt	103.5	106.1	115.8	119.9	121.2	121.0	120.3	119.7	119.7
Belgium	Deficit	-0.4	-1.4	-6.1	-4.5	-4.0	-3.6	-3.3	-2.9	-2.7
	Public debt	88.0	93.4	100.4	100.4	100.9	102.9	104.8	105.3	106.4
Germany	Deficit	0.3	0.1	-3.0	-2.9	-0.5	0.0	0.5	0.6	1.0
	Public debt	64.8	66.3	73.5	81.8	77.4	74.3	70.8	66.7	62.6
France	Deficit	-2.7	-3.3	-7.5	-7.5	-6.4	-5.5	-4.1	-3.3	-2.8
	Public debt	63.8	67.5	78.1	84.1	87.4	89.6	89.8	89.2	88.1

^a Actual values; ^b EIU estimate; ^c EIU forecast; ^d Decline in debt incorporates expectations of the EIU of a debt restructuring

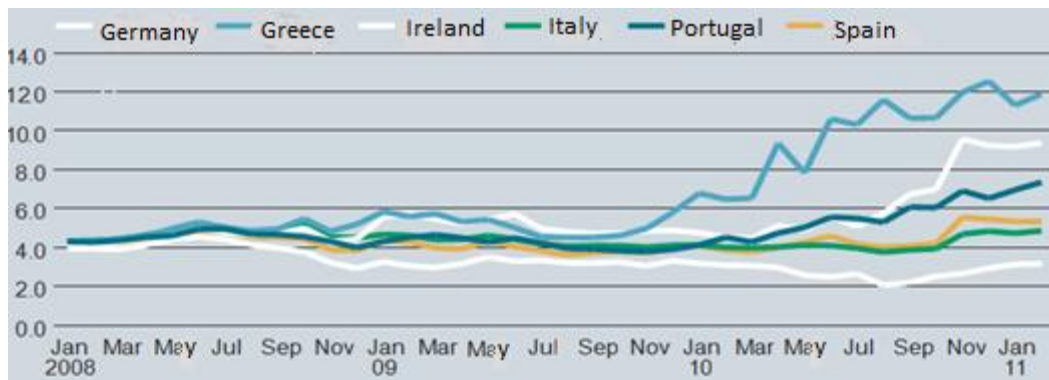
¹ Sub-chapter "the Crisis of the Euro zone" is based on the document of the „Economist Intelligence Unit (March 2011)“, EIU special report, "State of the union - Can the euro zone survive its debt crisis?"

Source: Eurostat, Economist Intelligence Unit (EIU)

Regardless of the fiscal indicators, the Euro zone is vulnerable and more risky than the United Kingdom and the United States of America. The reason for this is the fact that the Euro zone is not a country and does not have a common fiscal policy, despite the Euro as common currency. The debt of the periphery countries is burdening the banking system of the euro area. It is a consequence of the monetary union where the borrowing risk of some countries is mainly assessed in the same manner – as inexistent. Due to the increase of interest rates, which have the same “bookkeeping” value of risk (and provisions), banks find that lending to the periphery countries pays better. Since decision-makers in Germany and France prefer short-term instead of the long-term solutions, the problem of increase in capital of large banks is postponed. As the crisis deepened in the periphery countries, the problem became more pronounced and more expensive, as is usually the case with the delays.

Increase of a bankruptcy risk in the periphery countries led to an increase of the premium for new borrowings. The cost of borrowing increased dramatically for Greece, Ireland, and Portugal since the beginning of 2010. Spain and Italy have recorded a substantial increase in the borrowing costs.

Figure 1: Selected bonds yields (%; end of period; 10 years maturity)



Source: Reuters

High amount of debt makes that even a small increase in interest rates can cause significant problems. Growth of the interest rates of 100 base points for new borrowings would bring an average increase of deficit and public debt in the most developed economies of 1% of GDP by 2016. The experience shows that a deficit growth of 1% of GDP leads to growth of borrowing costs for 20 base points. The deficit and debt growth would lead to an increase of risk premiums, which would

again translate into higher borrowing costs and additional negative consequences to deficit and debt.

It is increasingly evident that Greece and Ireland, in spite of the ECB and IMF assistance, will not be able to meet their obligations. That would mean a declaration of bankruptcy and debt restructuring. The forecast of the *Economist Intelligence Unit* is that these two countries have 50% probability of bankruptcy, and it states that 2013 is the critical year (see Table 2). A bankruptcy of any of the Euro zone country would mean actually facing the problem. That would mean not only the problem of the debt restructuring, but also consequently the problem of the banking system capitalisation and sustainability of the Euro zone. This is not necessarily the worst scenario for the Euro zone, as it could be an incentive for the “big clean-up” and looking for long-term solutions for a more sustainable and competitive Europe. A scenario of sustaining the periphery countries with high debt levels with the assistance of northern Euro zone members would mean postponing a problem, increasing instability and ultimately discouraging perspective for the entire Europe. Less likely but possible scenario is gradual recovery of the euro zone. A recovery over a relatively short period would be possible with the return of investor confidence, with strong economic growth in the wealthiest countries and implementation of serious fiscal and structural reforms in the periphery economies. Medium-term stabilisation and institutional reforms that would limit decision makers from repeating similar mistakes in future could make the euro zone exit the crisis even stronger.

Fiscal position of the Western Balkans

Problems in the Euro zone are creating additional pressure for other European countries, and in particular for small and open economies subject to exogenous shocks. The Western Balkan countries are those types of countries.

Average public debt in the Euro zone is above 80% of GDP, while average public debt of the Western Balkan countries is around 40% of GDP. Average deficit in the Western Balkan countries is also lower than is the average of the Euro zone. However, we cannot claim that public finances of the Western Balkan countries are less risky or more secure due to positive fiscal indicators.

Table 3: Fiscal balances of the Western Balkan countries, 2008-2012

	2008	2009	2010	2011	2012
Total balance (% of GDP) estimate					
Montenegro	1.8	-6.5	-3.8	-3.4	-2.5

Serbia	-1.9	-3.6	-3.5	-3.3	-2.7
Bosnia and Herzegovina	-3.7	-5.8	-4.3	-3.4	-2.3
Croatia	-1.3	-4.1	-5.3	-6.3	-6.1
Macedonia	-0.9	-2.7	-2.5	-2.5	-2.2
Kosovo	-0.2	-0.7	-2.9	-3.3	-4.1
Albania	-5.1	-7.5	-3.7	-4.6	-4.6

Source: IMF

Table 4: Net Public debt, 2008-2012

	2008	2009	2010	2011	2012
Neo Public debt (% of GDP) estimate					
Montenegro	26.5	32.4	38.7	39.8	39.8
Serbia	30.0	31.5	39.2	36.2	35.9
Bosnia and Herzegovina	21.4	26.8	29.9	32.5	32.8
Croatia	29.3	35.4	40.4	48.2	49.9
Macedonia	18.6	21.2	24.0	25.5	25.9
Albania	55.2	60.2	59.7	59.9	60.4

Source: IMF

The Western Balkan countries are not integrated in the European Union and in the Euro zone system. Except for the IMF arrangements, they cannot expect support from the European Central Bank or other institutions in facing an incoming debt crisis. Except for Croatia, all the Western Balkan countries have non-investment credit rating; and by that, they are risky investment destinations even without external shocks and instabilities on the international market. Therefore, fiscal policy of these countries must be additionally cautious and responsible. Actually, they cannot afford additional deficit and public debt levels, as is the case with the rich Euro zone countries, because nobody will finance them.

Consolidation as an agreement

Over the course of last thirty years important fiscal consolidations were implemented in various groups of countries, including G-7, EU members, countries rich in natural resources, main emerging market countries and large number of developing countries.

IMF's research on fiscal consolidation covers the period from 1971 to 2001 and data were collected on 165 countries. During the observed period, 300 cases of fiscal consolidation were identified where fiscal consolidation exceeded 5% of GDP.

Moreover, 118 cases of adjustment were identified, including consolidation equal or higher than 30% of total state expenditures (whereby adjustment is compared with expenditures preceding the year of the adjustment). Out of observed cases only 38 cases of adjustment were implemented over a period equal or longer than 5 years, while in most of the countries more than two thirds of the total adjustment was focused in the first year.

This research identified 155 large fiscal adjustments (adjustment of more than 6.3% of GDP and 21.8% of state expenditures). They also include 63 cases where more than two thirds of the total consolidation is implemented in the first year and 55 cases of gradual consolidation where one third or less is implemented in the first year. On the other hand, it has identified 154 episodes of small-scale fiscal adjustment (adjustment less than 3% of GDP and 15% of state expenditures).

As a rule, large-scale fiscal consolidations were implemented under more complex macroeconomic conditions. The inflation was considerably higher, while the GDP growth, private consumption and private investments were lower. Furthermore, the share of public debt in GDP was on average two times higher, while the primary budget balance in the year preceding the adjustment was four times higher.

Out of 155 cases of large adjustment, 66 cases can be classified as sustainable. Sustainable adjustments were mainly based on reduction of expenditures. Expenditure reduction made three quarters of the total effort to sustain large-scale adjustment and was focused on the current expenditure, specifically on subsidies and wages.

Research of C. John McDermott and Robert F. Wescott is similar in terms of criteria and results, even though it has less coverage and is focused only to the OECD countries. This research covered 20 OECD countries in the period from 1970 to 1995. Out of 74 recorded cases of fiscal consolidation only 14 can be classified as successful, 48 were unsuccessful, while 12 cannot be classified due to shortage of data. Majority of successful cases of fiscal consolidation were part of a wider reform program which increased overall credibility of a government. The analysis indicates that the fiscal consolidation implemented in a discouraging economic growth rate environment and high interest rates, as it was the case in the period from 1980 to 1982 (global recession), will hardly be successful. However, the size of consolidation and its composition are dominant factors of success/failure.

Average size of a two-year fiscal consolidation in successful examples was 4% of GDP, if compared to the one of 3.2% of GDP in 48 unsuccessful examples. If comparing the composition of the fiscal consolidation, the research indicated that out of 17 cases where most of the fiscal consolidation is implemented through reduction

of expenditures, more than half were successful; while out of 37 examples where consolidation was made through tax increase, less than one sixth was successful.² Such conclusion is also supported by the fact that average structural reduction of expenditures in successful episodes was 3.7% of GDP, while in case of unsuccessful ones it was only 2.1%. It is important also to mention that number of employees in public administration, salaries in the public administration and government consumption are reduced in successful examples, while in unsuccessful ones they remained at the same level or were increased. Social allocations and transfers were controlled in successful episodes, while in unsuccessful ones they grew in terms of their share of GDP.

Most important conclusions of the IMF research could be summarised as follows: reduction of expenditures proved to be the most common successful instrument in terms of resilience of the adjustment and creation of favourable macroeconomic impacts; in order to ensure the sustainability a fiscal adjustment policy should include reduction of costs for wages of public administration and reduction of the number of employees financed from a budget; fiscal adjustment based on revenues often offers a base for a long-term and efficient stabilisation, in particular in countries having initially low share of revenues in GDP: revenue measures should be based and complemented with improvement of a tax administration efficiency. Additionally, the analysis demonstrates that these effects have the best impact on the overall economy over a long term.

Data obtained by McDermott and Wescott show that in all 14 recorded cases of "significant" fiscal consolidation there was an increase of economic growth rates, decline in unemployment and reduction of interest rates. Their analysis showed that reduction in public expenditures does not lead to recession, which is to be expected in line with traditional Keynesian school, but bursts and encourages private consumption and investments.

The European Commission report states that empirical analysis indicate that approximately half of episodes of fiscal consolidation, carried out over the last three decades in the European Union countries, are coupled with the economic growth acceleration, as well as that fiscal adjustments based on reduction of revenues have higher probably of being successful.³ One of the main reasons why fiscal consolidation based on reduction of expenditures may have a non-Keynesian effect is stated to be its connection with structural reforms, either that consumption reduction is conditioned or supported, in particular on the labour market.

² Fiscal consolidation episodes for which data exists are divided into two categories: those where the deficit is mainly reduced (at least 60%) through increase of tax revenues, and those where deficit is reduced (at least 60%) through reduction of expenditures.

³ European Commission (2003) "Public Finances in EMU - 2003", European Economy 3/2003.

Previous analyses point that most often long-term, stable, and large-scale fiscal adjustment is primarily relying on expenditures reduction. Furthermore, econometric analysis show that a balanced reduction of capital and current consumption with pronounced and permanent reduction of the wage bill gives best results in this situation. Usually fiscal consolidation is coupled with structural fiscal reforms, such as: introduction of medium-term fiscal policy and organic budget law; introduction of fiscal rules through laws, which are supporting development and implementation of the budget process; improving the expenditure management and treasury operations; tax reform, which is mainly relying on tax reduction, elimination of tax holidays, and taxation of previously untaxed revenues; strengthening of the tax administration; and similar.

At the same time, it is confirmed that high political risk is the most important negative factor in terms of long-term and permanent fiscal adjustment. Thus, political support is a key element for sustainable fiscal adjustment.

Fiscal consolidation experiences from recent past are showing the search for long-term solutions of the present fiscal crisis. With any difference, undeveloped countries, the Euro zone countries and the Western Balkan countries that wish to establish a long-term stability of their public finances must implement significant and uncompromising fiscal consolidation. The necessity of the fiscal consolidation is especially pronounced if taken into account growing costs coming along with the population ageing process.

Conclusion

The stabilisation of public finances and their recovery is possible by applying a radical fiscal consolidation, through reduction of government consumption. This includes re-examination of all programs and costs of the state their narrowing towards core functions. The United Kingdom started the process of the largest fiscal consolidation ever recorded. One thing is certain for countries that will not join them, bankruptcy and debt restructuring, or an enchanted circle of combat with high debt and economic instability.

Therefore, the largest fiscal expansion can be an introduction into a largest and possibly even a global combat with the big government. Stagnation in 1970s that preceded Thatcher and Regan era brings hope that the present-day crisis will lead to leviathans being reduced to a desirable measure.

REFERENCES:

- Economist Intelligence Unit (March 2011), EIU special report, "State of the union - Can the euro zone survive its debt crisis?"
- European Commission (2003): "Public Finances in EMU - 2003", European Economy 3/2003;
- McDermott, C.Joh; Wescott, Robert F, (1996): "*Fiscal Reforms That Work*"
- Tsibouris, George C; Horton, Mark A; Flanagan, Mark J; Maliszewski, Wojciech S, (2006): "*Experience with Large Fiscal Adjustments*", International Monetary Fund, Washington DC
- Shifting Gears (April 2011), "Tackling Challenges on the Road to Fiscal Adjustment", International Monetary Fund;

Maja Baćović⁴

Economic growth in the Balkans: caused by an increase in efficiency and/or membership in the EU?

Abstract

EU accession for the countries of the Balkans is a strategic goal, the foundation of all development debate, documents and strategy. Once done, it is expected to lead to the growth of income, better quality of life, in words, European level standard of living. Is enough to be a member? How to use the opportunity offered by the EU system and the size of the European market, and how to respond to the challenges they will inevitably wear?

The EU accession process implies a set of measures of institutional adjustment and achieving macroeconomic stability.

However, the institutional foundations for macroeconomic stability are necessary preconditions for development in the early stages. After that, it is assumed their stability and for development key determinants become those which encourage economic performance (human resources, the efficiency of goods markets and labor markets, a developed financial system, the ability to embrace new technology, etc.).

All of these determinants opting economic efficiency and productivity, which is in the Balkan countries currently at 30% of EU average (in comparison to the U.S. more or less). Such low economic efficiency directly affects the competitiveness of individual products and services, and thus on the market position and income.

In the Balkans, although not yet members of the European Union, there are companies that their economic performance successful rival European and world competitors. They are so without all the benefits of membership in the European market. Also, there are companies that instead of stable growth and profit for years have achieved negative results and eat their capital.

Balkan economies (Montenegro in particular) have been for years open to foreign investors, international companies and international know-how. Despite the positive effects of foreign investment and reform process, are still an uncompetitive (although Montenegro has the highest ranking position among Balkan states), with modest annual rates of economic growth.

⁴ University of Montenegro, Faculty of Economics

Will EU membership bring positive change for today failed companies, affect the future employment growth, generate new investment, or will these changes occur primarily as a result of domestic initiatives in the direction of investment in education, better work performance, the adoption of European standards the part of corporate and work ethics?

These are key questions that we are going to discuss in the paper.

Key words: Efficiency, Competitiveness, European Market, Investment in Education

1. Introduction

In the last 20 years, most European countries in transition were applied similar growth model, followed by the EU accession process. The model combines, from one side the implementation of institutional reforms that will bring the country closer to EU standards, while on the other, the concept of economic liberalization, primarily liberalization of flows of goods, capital and part of the labor market.

At a time when this model was conceived, Becker, Daianu and other authors argue that seemed a good solution for several reasons:

- Institutional adaptation of the EU system will reduce the cost of possible errors in the experimenting which institutions are the most appropriate;
- Free trade will provide a large enough market to allow further growth in production and strengthening competitive advantage;
- Capital inflows will solve the problem of lack of technology and know-how;
- Liberalization of work will reduce the social costs of transition.

The model is specific in relation to developmental models that are applied by countries from other continents, due to more pronounced mobility of capital, higher level of liberalization of the labor market and more intensive institutional reforms.

Although this growth model showed good results in the first decades of application, the financial crisis at the end of the last decade has made the necessary partial redefinition, particularly in Southeastern Europe, which showed a high dependence on foreign capital inflows and lack of power to solve the problem of external imbalances, primarily with high deficit in merchandise trade.

This problem is characteristic for Montenegro, which is characterized by a high foreign trade deficit, low domestic savings and still heavy dependence on capital inflows from abroad.

Not devaluing the importance of institutional reforms and market liberalization, we will analyze other factors that influence economic growth.

2. Development trends in the world

The process of globalization of economic flows has changed business conditions in all economies in the world. The global market has strengthened competition among producers, the possibility of using the benefits of economies of scale have made production costs lower and provide consumers with greater freedom of choice when making purchasing decisions.

In parallel with the networking of all markets, investments in research and development in advanced economies has been increasing steadily, resulting in technological innovations that primarily result in better, higher quality, new products, greater variety and higher productivity.

The growth of international trade is growing steadily, and the strengthening of globalization, in addition to market mechanisms (increase competition, reduce operating costs, expansion of the market), is promoted by policies of public administration (reduction or elimination of trade barriers-tariffs and quotas, joining trade blocks, privatization, etc.). .

The globalization of world economy, followed by expansion of foreign direct investment and the growth of multinational companies on the one hand, and the rapid opening and transition of former socialist economies on the other, resulted in high rates of economic growth in economies that are faced with challenges brought by way of business in a highly competitive market but the lag in those who did not.

Thanks to expanding markets and technological progress, developed economies have increased several times income per capita in the last few decades. Similar happened in the developing economies, which by attracting international multinational companies gain the new capital, new technology and know-how. On the other hand, the economic power of the economies in transition does not increase to the expected dynamics.

The following tables present data on the participation of these groups of countries in total world exports in the period 1980-2009, year, and the level of income (GDP) generated in the same period.

Table 1. Exports in the world, 1980-2009.

Export-million \$	1980	1990	2000	2006	2007	2008	2009	2009/1980
Developing countries	599,757	847,708	2,056,004	4,539,611	5,285,395	6,279,876	4,908,322	718.39%
Transition countries	85,426	118,709	154,514	455,914	550,656	740,103	478,651	460.31%
Developed countries	1,350,359	2,519,233	4,237,975	7,133,071	8,149,410	9,079,633	7,032,081	420.76%
Total	2,035,542	3,485,651	6,448,493	12,128,596	12,986,001	16,099,612	12,419,054	
Structure								
Developing countries	29.46%	24.32%	31.88%	37.43%	40.70%	39.01%	39.52%	34.14%
Transition countries	4.20%	3.41%	2.40%	3.76%	4.24%	4.60%	3.85%	-8.16%
Developed countries	66.34%	72.27%	65.72%	58.81%	62.76%	56.40%	56.62%	-14.65%
Total	100.00%	100.00%	100.00%	100.00%	107.70%	100.00%	100.00%	

Source: UNCTAD Handbook of Statistics, 2010.

In the past 30 years, export value and share of total exports of developing countries has increased significantly, from 29.4% in 1980, to 39.52% in 2009. At the same time, the share of total exports that have made the developed economies has decreased from 66.3% to 56.6%, which is largely a result of geographic relocation of production facilities from developed to developing countries, and expansion of operations of multinational companies.

Countries in transition have made a half-growth of exports in relation to developing countries and their share in total world exports fell from 4.2% to 3.85% in 2009.

Data on the growth of gross domestic product in the same period are also pointing to discrepancies in the speed of growth in these economies.

Table 2. Gross domestic product in the world, 1980-2009.

GDP-million \$	1980	1990	2000	2006	2007	2008	2009	2009/1980
Developing countries	2594703	3956806	6973156	12490922	14798839	17216823	16605809	539.99%
Transition countries	1012216	877817	395637	1394897	1821064	2339068	1771270	74.99%
Developed countries	8290702	17427502	24720544	35292331	38656047	41261546	38816629	368.19%
Total	11897621	22262124	32089338	49178150	55275950	60817437	57193708	
Structure								
Developing countries	21.81%	17.77%	21.73%	25.40%	26.77%	28.31%	29.03%	33.13%
Transition countries	8.51%	3.94%	1.23%	2.84%	3.29%	3.85%	3.10%	-63.60%
Developed countries	69.68%	78.28%	77.04%	71.76%	69.93%	67.84%	67.87%	-2.60%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	

Source: UNCTAD Handbook of Statistics, 2010.

While the participation of developing countries in total world GDP increased from 21.8% to 29.0%, the transition countries share has dropped significantly, from 8.5% to 3.1% in 2009. The share of developed countries has remained relatively unchanged, 69.6% at the beginning of the analysis period and 67.8% in 2009.

The analyzed data indicate the necessity of analysis of key factors that allowed high and long-term stable growth in the developed/developing countries, so that empirical lessons could be applied successfully in the transition countries, which also includes Montenegro.

3. Determinants of economic growth

Modern (neoclassical) growth theory explains stable long-term growth at the global level with technological progress as the result of higher levels of investment in research and production of new knowledge (P. Romer (1990), Grossman and Helpman (1991) and Aghion and Howitt (1992))⁵. At an informal level of analysis, theories show that the growth level of knowledge has a central influence on the growth of production volume and an increase in living standards over the past few decades. A number of studies have shown that the growth of labor productivity is result of residual components, which with great probability could be attributed to technological progress. In this way has been seen significant contribution of new theories of growth to explain factors and quantify the contribution of knowledge to economic growth.

However, if the world-class move to the analysis of individual countries or regions in the world, the results given by models of knowledge accumulation are less applicable and less clear. If the economic growth of developing countries is viewed through the Solow growth model postulates, D. Romer concludes that these countries have no problem in accessing new technologies, but have the problem of how to use new technologies.

In line with these conclusions, G. Becker points to the importance of investing in human capital (education, training and development of employees) to increase productivity and income.

Analyzing the economic performance of 100 countries in the world in the period from 1960-1990. year, in a study on the factors of economic growth, R. Barro suggests strongly the existence of convergence of the determinants of growth. For a given initial level of GDP per capita growth is determined by the higher educational level and higher life expectancy, lower fertility rates, lower government spending, a

⁵ Romer D.: »Advanced Macroeconomics«, McGrawHill, USA (2001)

stronger application of the legislation, low inflation and improved conditions of trade.

Current studies of growth factors which have been continuously carried out by the World Economic Forum (WEF), growth-source grouped three categories⁶:

1. Determinants important for the economy whose growth depends on usage of factors of production (institutions, infrastructure, macroeconomic stability and health and basic education);
2. Determinants that influence growth through increases in efficiency (higher education and training, goods market efficiency, labor market efficiency, financial market, technological development and market size);
3. Determinants that encourage growth through innovation (Innovation (research and development) and the sophistication of the business).

Given the importance of technological progress and education, and bearing in mind that Montenegro belongs to the countries in which the factors that enhance the effectiveness of predominantly opting growth, we will focus on these components.

4. Technological progress

Technological progress is reflected in several dimensions⁷:

1. Growth in the quantity of domestic products with a given amount of invested capital and labor, as a result of improving the production process and use of new materials and production methods;
2. The growth of the quality of existing products, which directly reflects the market position and growth in production volume;
3. Production of new products;
4. Greater diversity of existing products.

The importance of technological progress to increase production and income data suggest the rate of GDP growth and technological progress in five developed countries in the world, for the period 1950-1987.

Table 3. Average annual growth rate of GDP per capita and technological progress in five developed countries, 1950-1987.

	GDP per capita growth rate		Technological progress growth rate	
	1950-1973	1973-1987	1950-1973	1973-1987
France	1.8	2.2	2.3	2.6
Germany	4.9	2.1	5.6	1.9
Japan	8.0	3.1	6.4	1.7

⁶ World Economic Forum

⁷ Blanchard, 2005.

Great Britain	2.5	1.8	2.3	1.7
USA	2.2	1.6	2.6	0.6
Average	4.3	2.1	4.4	1.6

Source: O.Blanchard, Macroeconomics, 2005.

High rates of growth of per capita income corresponding to the high rate of technological progress, an average of 4.3% and 4.4% in the period 1950-1973. year. Slower technological progress since the 70's (Blanchard explains it with the expansion of services), corresponds to the lower growth rates of GDP per capita.

Analysis of the compliance level of ability to use technological advances and GDP per capita, based on data of the World Economic Forum confirms the strong association between these variables.

Table 4. The correlation between the components that affect growth through efficiency and level of GDP per capita in selected countries

	High education and training	Labor market	Financial markets	Technology	GDP per capita 2009, EURO
Switzerland	5.79	5.92	5.34	5.60	45,800
Sweden	5.90	4.89	5.15	6.12	31,300
USA	5.64	5.63	4.67	5.10	32,900
Germany	5.33	4.40	4.62	5.36	29,300
Japan	5.28	5.08	4.61	4.87	25,000
Finland	6.06	4.85	5.38	5.17	32,100
Netherlands	5.63	4.83	4.71	5.99	34,600
Denmark	5.84	5.47	4.94	5.62	40,300
Great Britain	5.34	5.29	4.73	5.58	25,300
Norway	5.59	4.97	5.35	5.56	56,500
France	5.36	4.47	4.96	5.28	29,600
Austria	5.38	4.75	4.74	5.09	32,800
Belgium	5.71	4.64	4.64	5.22	31,400
Luxemburg	4.68	4.71	5.35	6.11	76,500
Check republic	5.11	4.75	4.49	4.55	13,300
Poland	5.00	4.58	4.66	4.02	8,100
Spain	4.85	3.88	4.28	4.64	22,900
Slovenia	5.27	4.26	4.02	4.45	17,300
Italy	4.60	3.81	3.70	4.12	25,200
Montenegro	4.51	4.69	4.68	4.09	4,720
Correlation with GDP pc	0.247	0.315	0.613	0.757	

Source: Estimated components of competitiveness - World Economic Forum Competitiveness Report 2010-11. GDP per capita - Eurostat, correlation coefficients - estimated by author

The ability to use technological advances and the level of GDP per capita are highly correlated (correlation coefficient is 0.75), indicating the necessity to further improve this component of the economies in transition.

5. *Human capital in Montenegro*

The achieved level of education in Montenegro⁸ shows a lower stock of human capital in relation to EU countries⁹. The key difference is visible in the part of tertiary education, where, if we compare only the data for higher education, Montenegro significantly different than the EU average.

Table 5. Human capital in Montenegro, 2003.

	Montenegro - Percentage of population over 15 years (2003 census)	Montenegro - Percentage of population aged 15-64 years (2003 census)	EU27 - Percentage of population aged 15-64 years (2003) ¹⁰
No education	4.3	5.0	
1-7 years of primary education	9.64	11.34	
Primary education	22.95	27.01	36.0
Secondary education	48.44	57.02	45.9
Higher education	5.04	5.93	
Higher Education	7.51	8.84	18.1

Source: Monstat (Statistical Yearbook 2010.)

In the last few years in Montenegro are present growing trend of attending institutions of higher education. In comparison with 2002. year, when only 44% of total high school graduates continued their education¹¹, in 2008. enrollment stands at 108% of high school graduates¹².

Table 6. Number of students enrolled in undergraduate studies (all university programs)

⁸ **The achieved level of education** of the population is the best indicator of the level of human capital, although only analyze the achieved level of education and not the other socio-economic categories available to individuals. Level of education is widespread economic indicator of the level of relevant knowledge and skills. This indicator does not take into account changes in the level of skills and abilities that are acquired after completion of formal education, as well as other socio-economic categories that affect the economic use of knowledge and skills of individuals.

⁹ Data is based on the 2003 census statistics

¹⁰ In EU statistics education is divided into three categories: lower secondary education, upper secondary education and tertiary education

¹¹ The data refers only to students who are enrolled in the university in Montenegro, and does not include the number of students studying outside of Montenegro.

¹² It is assumed that they are enrolled also students who have completed secondary education in the past.

Year	Regular students who have completed secondary education (regular and special secondary schools)	Enrolled students - undergraduate studies	% Of high school students enrolled	The annual rate of growth in the number of students enrolled
2002/03	7704	3408	44.24%	
2003/04	7495	3866	51.58%	13.44%
2004/05	7508	4564	60.79%	18.05%
2005/06	7752	5478	70.67%	20.03%
2006/07	7423	6690	90.13%	22.12%
2007/08	7306	7483	102.42%	11.85%
2008/09	7318	7934	108.42%	6.03%
2009/10	n.a	7790		-1.81%

Source: Monstat

5.1. Continuous training and the concept of lifelong learning

In an era of technological progress, frequent job changes and fluctuations in the labor market, it is necessary to have a workforce that has the skills and ability to react to market changes. Traditional skills and knowledge change their value and importance and the younger staff have the advantage of having the skills that are needed in response to changes. This trend is international and is present in all economies in the world, both developed and those in development.

The solution to the lack of labor force that has the skills and capabilities in line with current technological developments can be seen in continuous education and training through a variety of forms.

The importance of specialist training and investing in human resources has been recognized in the EU, which is proved by statistics (Eurostat yearbook 2009.). On average, at the level of 27 EU member states, the number of employees aged 25-64 years participating in specialized training is 33% and 49% of companies provide specialized courses, of which 54% internally and 89% externally organized courses and training programs.

This model of investment in human capital has not yet been developed as expected in Montenegro.

Research conducted by the Employment Agency of Montenegro¹³ shows that only 9-

¹³ Employment Agency of Montenegro: "Analysis of the implementation of the National Employment Strategy and Human Resources Development 2007-2011. years, with emphasis on new employment opportunities, especially trainees in the field of education and health", Podgorica, December 2010.

10% of long-term unemployed¹⁴ participate in training programs, work practice or other measures that would increase individual human capital and therefore facilitate employment¹⁵.

The same survey shows that the concept of lifelong learning accepts and applies only 7-8% of the working population.

Survey of employers on employment¹⁶, shows that only 16.69% of employers (2009) invest resources in training employees, while employees in 83% of surveyed companies have not gone through any training program in a given period¹⁷.

5.2. Investment in education in Montenegro

Data on expenditures for education in Montenegro are available in part related to fiscal expenditures. However, it is important to note that investments in human capital were financed from private funds and companies, although there are still no precise data on their volume.

Fiscal expenditure on education¹⁸ decreased in recent years, from 5% of GDP in 2009 to 4% planned for 2011. Although this is a significant amount, they are significantly lower than investment in developed countries (OECD average is 6.1%, EU - 5.2%¹⁹).

Table 7. Fiscal expenditure on education²⁰

	2009		2010		2010/09	2011		2011/10
	Total, 000 €	% BDP	Total, 000 €	% BDP		Total, 000 €	% BDP	
The budget of the Ministry of Education and Science	129,933	4.36%	116,068	3.84%	-10.67%	115,926	3.66%	-0.12%
Pre-primary	12,016	0.40%	11,634	0.38%	-3.18%	11,305	0.36%	-2.83%
Primary	69,029	2.32%	62,486	2.07%	-9.48%	63,060	1.99%	0.92%
Secondary	33,002	1.11%	28,168	0.93%	-14.65%	27,440	0.87%	-2.58%

¹⁴ 9.2% (2007), 9.6% (2008), 10.1% (2009) and 9.6% (II quarter 2010)

¹⁵ The criteria of success is the involvement of at least 50% long-term unemployed

¹⁶ Employment Agency of Montenegro, the results for the year 2009/2010

¹⁷ The corresponding figures for 2008. year are 34.57% and 65%, respectively

¹⁸ Total expenditure (pre-primary, primary, secondary and university education).

¹⁹ Source: European Training Foundation, *Montenegro Review of Human Resources Development*, 2010.

²⁰ Source: THE BUDGET LAW 2009-2011

Other	15,886	0.53%	13,780	0.46%	-13.26%	14,121	0.45%	2.47%
University of MN	17,033	0.57%	14,783	0.49%	-13.21%	13,501	0.43%	-8.67%
GDP	2,980,967		3,025,000		1.48%	3,170,000		4.79%

Source: Budget Law for Montenegro, 2009-2011.

However, despite the fiscal sources, significant funds are invested from private source, which shows the constantly growing proportion of self-financed students, 53% in 2005. to 80% in 2009. year.

Table 8. The total number of students and financing structure²¹

Year	The total number of students	The total number of students - funding from the budget	The total number of students - self-financing	Participation of students financed from budget	Participation of self-financing students
	1	2	3=1-2		
2005/06	12903	6062	6841	46.98%	53.02%
2006/07	16173	6278	9895	38.82%	61.18%
2007/08	18009	4891	13118	27.16%	72.84%
2008/09	20490	4599	15891	22.45%	77.55%
2009/10	21799	4300	17499	19.73%	80.27%

Source: Monstat, 2010 Statistical Yearbook

In addition to the level of financial resources invested in education, an important crucial component that will determine the final result is the quality of education attained.

6. The European Union and Montenegro

Analysis of key indicators of the EU Member States and Montenegro showed the following:

- Significant variation in the level of GDP and structure. GDP per capita in Montenegro in 2009 was at the level of 20% of European average, with a productivity of 26%. The structure of value added, both in Montenegro and in the EU is dominated by services, while the rest of Montenegro's GDP has significantly more dominant share of agricultural activities as well as lower share of manufacturing. Low productivity in Montenegro is the result of many factors: low production volume (the result of lack of competitiveness of products, small market, insufficient investment, inadequate management and organization); suboptimal number of

²¹ Source: Monstat, Statistical Yearbook for 2010.

employees in a significant number of companies, non-competitive and under-developed technologies that may impact on employment growth; expertise of employees;

- The employment rate of working-age population in Montenegro is significantly lower, 49.9% compared to 64.6% in the EU.
- The level of human capital is significantly higher in the EU, where 18.1% of the population aged 15-64 has a university education (in Montenegro 8.8% population of the same age group).
- Common for EU and Montenegro is a high share of government consumption in GDP, 51% in the EU and 42% in Montenegro.
- Inflation rates are low with no significant deviations, while the long-term interest rates are significantly lower in the EU.

Table 9: EU and Montenegro, the selected indicators

2009. data	EU 27	EU (16)	Montenegro
GDP (million €)	11,805,662	8,978,677	2,981
GDP per capita	23,625	27,320	4,721
Population	499,703,311	328,649,281	631,500
Number of employees (000)	222,228.4	145,027.5	213.6
GDP/employees	53,124.0	61,910.2	13,956.0
Employment rate (15-64)	64.6	64.7	49.9
Unemployment rate	8.9	9.4	19.1
Percentage of population aged 15-64 with tertiary education (2003)	18.1		8.8
GDP structure			
Agriculture	1.7%	1.5%	8.3%
Manufacturing	18.1%	17.8%	11.3%
Construction	6.3%	6.4%	5.4%
Trade, transport and communications	20.8%	20.7%	21.5%
Financial and business services	29.1%	29.3%	12.5%
Other services	24.0%	24.2%	18.9%
Saving rate	11.0%	14.1%	
Government expenditures per capita	11,965	13,825	1,982
% GDP	51%	51%	42%
Inflation rate	1.0%	0.3%	
Long term interest rates	4.1%	3.8%	

Source: Eurostat, Monstat

Analysis of competitiveness of most developed countries of the EU and Montenegro also shows considerable variation.

The average value of the index of competitiveness for the economies listed in Table 10 is at the level of 5.08, while in Montenegro assessed value of 4.36. Larger discrepancies are visible if the total index is divided into their constituent components, where Montenegro is generating the most negative difference in the part relating to the factors which influence the efficiency (higher education and training and the ability to use advanced technology).

Table 10: Index of Competitiveness for selected developed countries and Montenegro, 2009.

	Total index	Basic requirements	Efficiency			Innovations	GDP per capita 2009, EURO
			Total	Higher education and training	Technology		
Switzerland	5.63	6.05	5.41	5.79	5.60	5.71	45,800
Sweden	5.56	5.98	5.32	5.90	6.12	5.67	31,300
USA	5.43	5.21	5.46	5.64	5.10	5.53	32,900
Germany	5.39	5.89	5.11	5.33	5.36	5.51	29,300
Japan	5.37	5.35	5.17	5.28	4.87	5.72	25,000
Finland	5.37	5.97	5.09	6.06	5.17	5.43	32,100
Netherlands	5.33	5.82	5.24	5.63	5.99	5.16	34,600
Denmark	5.32	5.86	5.20	5.84	5.62	5.15	40,300
United Kingdom	5.25	5.58	5.28	5.34	5.58	4.98	25,300
Norway	5.14	5.65	5.13	5.59	5.56	4.83	56,500
France	5.13	5.67	5.09	5.36	5.28	4.83	29,600
Austria	5.09	5.67	4.93	5.38	5.09	4.97	32,800
Belgium	5.07	5.45	5.01	5.71	5.22	4.91	31,400
Luxemburg	5.05	5.81	4.92	4.68	6.11	4.76	76,500
Check republic	4.57	4.91	4.66	5.11	4.55	4.19	13,300
Poland	4.51	4.69	4.62	5.00	4.02	3.76	8,100
Spain	4.49	5.13	4.56	4.85	4.64	3.96	22,900
Slovenia	4.42	5.18	4.33	5.27	4.45	4.08	17,300
Italy	4.37	4.84	4.33	4.60	4.12	4.11	25,200
Average	5.08	5.51	4.99	5.39	5.18	4.91	32,116
Montenegro	4.36	4.90	4.08	4.51	4.09	3.67	4,720

Source: World Economic Forum

7. Conclusion

Institutional adjustments to EU standards are a necessity in Montenegro. The liberalization of all markets will expand opportunities for production growth and financial liberalization will encourage capital inflows from abroad.

Joining the European Union offers many opportunities for the economy of Montenegro. At the same time, competition makes it demanding. Income in Montenegro will grow steady only if production and investment increase, financed by domestic or foreign capital. A production will grow only if the products are competitive in all aspects (quality, price).

Being a member of the Union greatly expands opportunities. Income growth will happen only if we are able to respond to these opportunities.

Reference:

1. Barro R.: "Determinants of Economic Growth: A cross-country empirical study", NBEW working paper 5698, 1996
2. Barro R., Becker G: "*Fertility Choice in a Model of Economic Growth*", *Econometrica*, Vol 57 (1989)
3. T.Becker, D.Daianu, Z.Darvas, V.Gligorov, M.Landesmann, P.Petrovic, J.Pisani-Ferry, D.Rosati, A.Sapir, B.Weder di Mauro: "Whither Growth in central and eastern Europe: Policy lessons for integrated Europe", Bruegel Blueprint Series, Volume XI, Bruegel, Belgium
4. Becker G, Murphy M: "*The Division of Labor, Coordination Costs and Knowledge*", *The Quarterly Journal of Economics*, Vol 107 (1992)
5. Becker S. Gary, Murphy M. Kevin, Tamura Robert: "*Human Capital, Fertility, and Economic Growth*", *The Journal of Political Economy*, Vol 98, No 5 (1990)
6. Becker S. Gary: "*Investment in Human Capital: A Theoretical Analysis*", *The Journal of Political Economy*, Vol 70, No 5 (1962)
7. Begg David, Stanley Fisher, R. Dornbusch: "*Economics*", McGraw Hill Book, England
8. "*Human Capital Investment - An International Comparison*", OECD, Centre for Educational Research and Innovation (1998)
9. Landesmann M.: »Which Growth Model for Central and Eastern Europe after the Crisis?«, FIW, Policy Brief No.4, May 2010.
10. Romer D.: »*Advanced Macroeconomics*«, McGrawHill, USA (2001)
11. Solow Robert (1970): "*A Contribution to the Theory of Economic Growth*", Penguin
12. Vukotić Veselin (2001): "*Makroekonomski računi i modeli*", CID, Podgorica

Milica Vukotic, PhD*

Balkans and European Union: Regulation of Telecommunications market with Emphasis on Analysis of Relevant Markets in Montenegro)

Abstract

A share of the telecommunication sector in GDP of Montenegro is about 10%, while Montenegrin telecommunication market represents one of the most developed in the region. In addition, a penetration of mobile phones is almost 200% with the number of mobile phone users per capita being among the highest in Europe. Regulations at the telecommunication market were in line with those in the EU even before Montenegro became a candidate member. One of the most important tasks regulators at this market face is a detailed analysis relevant markets that would determine who are the operators with the most significant market power in order to impose specific regulatory procedures. This is the topic that should be addressed when analyzing regulations at the telecommunication market and when comparing Balkans with the EU. Considering that the first analysis of telecommunication markets in Montenegro has been recently done as well as the facts mentioned above, Montenegro represents a good candidate for the analysis.

Keywords: Regulation, liberalization, relevant markets, telecommunications, price monitoring.

Introduction

Telecommunication sector is globally becoming a combined industry. Combined industry is such industry where the products are combined with products of other industries prior the arrival to the final consumers. Telecommunications are increasingly becoming the combined industry, since its basic role, transmission of electronic communication, is evermore combined with computers, media, and other products, prior its selling to final consumers.

Significant changes in telecommunication technologies have occurred. Once used microwave radio technologies, using analogue signals are more and more replaced by digital computers, optical cables, and other technology of digital transmissions. The other branches, such as computer industry, publishing and media services, started to combine products from various branches. Combination of products in all these industries consists of four main components: Consumer devices, network, network

* Faculty for Information Systems and Technologies, UDG

devices and contents. Consumer devices are telephones, computers, TV sets. Networks are sending data from one location to another. Network devices are processing and storing information for the consumers. Contents are the electronic information and software that the consumer is using (databases, music, electronic advertisements, etc.).

Creation of »new« telecommunication branches poses new challenges at telecommunication regulators, whose one of the objectives is to increase competition at the telecommunication market. However, many doubt in justification of existence of regulator in this and other markets.

1. Grounds for the regulation in telecommunication industry

The last decade of the 20th century was characterized by numerous changes in telecommunication industries. Many state owned telecommunication companies were privatized and thus the wave of pro-competition and deregulatory actions took place. As a result, novel and market oriented approaches were introduced in many countries.

Various factors contributed to the liberalization of the telecommunication markets, including: Frequent evidences that liberalized telecommunication markets provide better services for customers and grow and faster, than non-liberalized markets;

- Need for attracting private capital in order to improve telecommunication networks as well as to introduce new services;
- Internet expansion, which caused “transmittance of voice” to be substituted by the “transmittance of data”, which consequently lead to the introduction of many new services;
- Expansion of mobile and other wireless services which became the alternative for fixed telephony, and therefore introduced new participants at the telecommunication markets;
- Development of international trade in the area of telecommunication services with constantly growing supply.

Since market-oriented approaches were introduced during 90s, number of national telecommunication agencies around the world grew from 12 to over 90. Therefore, the question: *Shouldn't market oriented supply of telecommunications services lead to the decrease and not increase in intervention?* – might seem ironic. Experts around the world seem to agree that this should be the case in the long run, but not in the short run. Successful transformation of monopolized telecommunication markets into competitive ones requires significant regulation. Otherwise, it is not likely that sustainable competition will be introduced.

There are many reasons for regulatory intervention. Regulators issue licenses to the new operators. Furthermore, they have to remove barriers for the entrance of new

operators. Moreover, they have to supervise interactions between new operators and the existing ones. Finally, regulatory intervention might be required in order to ensure that services are provided also to the areas that would not be handled by the competitive markets, such as the areas with high costs and customers with small revenues.

Regulatory goals vary from country to country. In most countries governments still see telecommunications as essential public service. Even though they are not managing telecommunication networks anymore, governments most often preserve the regulatory role in order to ensure that telecommunication services are provided in accordance with public interests.

With worldwide acceptance of market-oriented approaches of telecommunication services there is a consensus that regulators should not be managing telecommunication industry. The role of the regulator is to create regulatory environment which will provide efficient supply of telecommunication services, while service providers will mainly be private operators.

The natural question that arises is what the regulatory goals are. Even though regulatory measures differ among countries, regulatory goals are very similar in all countries. The following regulatory goals are widely accepted worldwide:

- Promotion of the universal access to all basic telecommunications services;
- Stimulation of competitive markets in order to promote:
 - Efficient supply of telecommunication services;
 - Good quality of services;
 - Advanced services, and
 - Efficient prices;
- In the absence of competitive markets, discourage the use of market powers such as unjustified high prices and anti-competitive behavior of the leading companies;
- Create attractive environment for investment which are necessary for the development of telecommunication networks;
- Promote public confidence in telecommunication markets through transparent regulation process and licensing;
- Protect consumers' rights;
- Promote increase of telecommunications accesses for all consumers through efficient interconnection arrangements;
- Optimize the use of scarce resources.

Successful regulation, through the achievement of the goals mentioned above will lead to liberalization of telecommunication markets.

2. Montenegro and regulation of the telecommunication market, with the view on analysis of relevant markets

Montenegrin telecommunication market is one of the most developed telecommunication markets in the region. None of key telecommunication operators is owned by the state of Montenegro. Three major operators at the market are: Crnogorski Telekom (part of Deutsche Telekom group, established after privatization of state owned company), Telenor (part of Telenor group) and Mtel (majority owned by Telekom Srbija). Regulation in this market is made by the Agency for electronic communications and postal services (EKIP), which in ten years of its existence have shown significant results and contributed to the development of telecommunication market. Even though Montenegro is a EU candidate country as of 2009, the Agency have started with harmonization of Montenegrin legislation with EU legislative framework much earlier.

Separate aspect of regulation, which shall be reviewed in next chapter is the analysis of relevant markets in Montenegro, which fits the topic of comparing Balkan region with EU, since it shows harmonization of Montenegrin with EU regulatory framework in the field of regulations of prices at the telecommunication market, which is one of the most important issues in this area.²² The objective of analysis of relevant market is the identification of operator with significant market power and stipulating regulation measures for such operators.

2.1 Analysis of relevant markets in Montenegro

Having in mind the guidelines of European Commission on market analysis and valid revised recommendation of the European Commission on relevant service markets, Agency for electronic communication and postal services of Montenegro has initiated analysis of relevant markets in 2009, and in accordance with the referred Recommendation defined seven relevant markets. Defining relevant market is the preconditions for conducting analysis of relevant markets. The basic principles of defining relevant markets are related to the analysis of substitution level in demand, substitution level in supply and analysis of potential competition pressures. We defined following relevant markets:

- Market of access to public telephone network at fixed location for natural and legal persons
- Market of calls originating from the public telephone network provided at the fixed location - wholesale level

²² For the purpose of drafting this paper we used the report of the Agency for electronic communications and postal services on conducted procedures of market analysis.

- Market of calls ending in individual public telephone networks provided at the fixed location - wholesale level
- Market of infrastructure access at the wholesale level (including joint or fully separated access at specific location) – wholesale level
- Market of broadband access – wholesale level
- Terminal or final segments of leased lines, regardless of technology used to provide leased or allocated capacity – wholesale level
- Market of calls ending in individual mobile networks – wholesale level.

After the market is being defined, it was followed by the review of market criteria required for the assessment of the operators with significant market power at the relevant market. Identification of operators with significant market power implies defining and imposing ex-ante obligations, which should be proportional and adequate to the determined problem, i.e. to variation from the efficient competition.

2.1.1 Regulatory obligations defined for operators with significant market power at relevant markets

After the analyses of relevant markets have been conducted and operators with significant market powers identified, the Agency has defined regulatory obligations, which are proportional and adequate to the determined current and potential obstacles for development of competitiveness at the market.

Some of the measures defined for the operators with significant market power in these markets are: provision of transparency, announcing reference interconnection offer, providing equal treatment (non-discrimination), separation of bookkeeping records, enabling access to network elements and its utilization and obligation of supervision of prices and cost accounting.

In reference to the obligation of supervisions of prices and cost accounting, the Agency has imposed the prices of origination of call and termination of call in own networks for operators with significant market powers, and the prices were established using the benchmark methodology, as interim solution up to the application of prescribed model of cost accounting and separate accounting by the operator with significant market power. In cases where the valid prices of relevant services are significantly above the benchmark average, the Agency has defined the obligation of its reducing applying the two-year phase approach. At relevant market of infrastructure access at the level of wholesale and wholesale broadband internet access, whose services were not provided at the wholesale level in previous period, the Agency, in order to promote infrastructure competition in these markets has applied retail minus methodology, i.e. calculating wholesale prices on the basis of its reduction in reference to the level of appropriate retail prices, where they also used benchmark methodology in order to determine adequate level of “reduction”.

Effects of regulatory measures originating from the analysis of relevant markets shall be reflected in:

- creation of stimulating environment in terms of removing obstacles or reducing barriers for entry at the relevant market, with equal treatment of all operators for entry at the market,
- higher level of competitiveness at the market, in order to maximize benefit of final consumers in terms of possibility of wider choice of service providers and innovative services, more favourable process, greater quality of services.
- limit or disable anti-competitive activities by the operators with significant market power at the relevant market.

Conclusion

Privatization and liberalization are often interconnected. Even interconnected, they are essentially different related to specific basic rules and fundamental issues. In its basis, privatization is transformation of state owned property into private property. State owned company can be privatized as a monopole company or competitive company. Contrary to that, liberalization is the opening of monopole market to competitive providing of services and goods. It is not relevant whether the monopole operator is state owned or privately owned.

Reform of telecommunication market and opening market for competitiveness can be a game where everyone wins: consumers, existing and new operators, employees, national and international investors and state. That is exactly the goal of the regulator of the telecommunication market in Montenegro, and the analysis of relevant markets is just one of numerous activities that will facilitate accomplishing that goal.

References

1. Agency for electronic communications and postal services, Montenegro – *Annual Report for 2010*
2. Cindy van den Boogert, *The Role of National Regulatory Authority in a Liberalized Market*, European Commission, september 2005
3. Gantzoglani A. i Henten A, **AnastassiosGantzoglani and Anders Henten**, Edward Elgar Pub, 2010
4. Goodman Joseph, *Telecommunications Policy – Making in the European Union*, Edward Elgar Publishing, 2006
5. Guttler Jan, *The Competitive Environment for telecommunications in South East Europe*, 2005
6. Jamison Mark, *Industry Structure and Pricing: The New Rivalry in Infrastructure*, Kluwer Academic Publishers, 2002
7. Larouche Pierre, *Competition Law and Regulation in European Telecommunications*, Hart Publishing, 2000

8. UgarkarJayraj, *The Essentials of Telecommunications Management: A Simple Guide to Understanding a Complex Industry*, AuthorHouse, 2010
9. VukotićMilica, *Regulacijacijenametodom ROR u oblastitelemekomunikacija*, Infofest-Budva, septembar 2004
10. Walden Ian, *Telecommunications Law and Regulation*, Oxford University Press, 2009
11. http://ec.europa.eu/information_society/policy/ecomm/index_en.htm
12. www.cullen-international.com
13. www.ekip.me

Doc. dr Maja Drakić²³
Mr Ivana Stešević²⁴

High education in Balkan countries in the process of European integration

Abstract: *Education is the crucial factor of economic development. This was the goal of many strategies of education system European Union has adopted in order to become the most competitive and the most dynamic economy in world – knowledge-based economy capable to maintain sustainable development. Balkan countries see themselves as EU member countries in close future. This fact already has significant influence on the higher education systems and universities in this region, as they will enter strong competition of higher education institutions from EU countries. What practical steps should be made in order to improve the quality of higher education in countries of Balkan region? Which areas should be improved in order to make higher education systems in Balkan countries competitive and recognizable in EU? What funding mechanism should be used in financing higher education in order to achieve this goal? These are just some of the questions raised in this paper.*

Key words: *Education, knowledge-based economy, Bologna process, reforms, mechanism of financing*

1. Introduction

Education, as the basic capital of modern society has become crucial determinant of economic development. That's why it is not surprising that develop countries adopting many strategic documents whose goal is to improve education systems.

Universities all around the world, especially in Europe are facing the need to accept essential changes and adapt to new circumstances. The causes of these changes are as follows:

- a) Increasing demand for education which is necessary in order to develop knowledge-based society. This rising demand should be satisfied despite

²³ Faculty for International Economic, Finance and Business; University of Donja Gorica (UDG), Podgorica; Institute for Strategic Studies and Prognoses, Podgorica; maja.drakic@udg.edu.me

²⁴ Faculty for International Economic, Finance and Business; University of Donja Gorica (UDG), Podgorica; Institute for Strategic Studies and Prognoses, Podgorica; ivana.stesevic@udg.edu.me

- limited human capacities (with respect to number of teaching staff and researchers) and limited financial sources;
- b) Internationalization of education and research. Causes of internationalization lie in competition between different universities and different countries, as well as in use of new communication information technologies;
 - c) Development of efficient cooperation between universities and industry. Cooperation is expected with respect to transfers and dissemination of knowledge from universities into business sector and society overall. University knowledge and expertise can be directly delivered to the industry through two mechanisms: by licensing intellectual rights of universities; or by spin-off and start-up companies;
 - d) Places where knowledge is created are usually being profiled as such. The reason for this is upward trend of businesses to hire the best universities to conduct their research activities, which sharpen competition in this area;
 - e) Knowledge is being reorganized in two directions. On one side, diversification and specialization of knowledge is growing. On the other side, interdisciplinary knowledge is necessary in order to solve arising problems of society (for example sustainable development, risk management...). This reorganization of knowledge means that borders between fundamental and applied research should be erased.

Positive influence of education on economic development is indisputable. Investment in education is always the good investment which brings new working places, generates economic growth and pays off in long term. European Union follow this approach and confirms it through numerous strategies which are trying to find the right answer to the growing competitiveness of USA and Asian economies. The goal of these EU strategic documents is to make European Union the most competitive and the most dynamic economy, based on knowledge and sustainable, until 2020.

2. Development trends and importance of education in European Union

Most important documents of European Union that stress importance of education are Bologna declaration, Lisbon Agreement, Europe 2020, as well as new Green paper that represent Common Strategic Framework for European Union. Strategies that were created as the answer on the challenge of the growing societies based on knowledge, increased participation in high education, internationalization and increased competitiveness in the education sector. In the process of creation European area of high education and implementation of the reform of high education very important issue is creation of open and adjustable high education systems on the needs of economy and labor market, in the state but also within the Europe. Harmonization of supply in high education sector and needs on national and

European labor market are achieved by providing adequate quality of high education creation of proper connections among institutions that provide services of high education and economic environment and valorization of the knowledge at the labor market.

High education system in European Union is in the process of the reform of education, that was formalized by Bologna declaration adopted in 1999. That declaration was initiated by employers and their needs to have future candidates for jobs that were educated on the same way. Besides that education system has to transfer not only academic knowledge, but also practical skills and to develop their competences during the education. Today 46 countries have signed Bologna declaration. Main goals and aims of Bologna declarations are:

- Increase of transparency by adoption of the system that provides easily understandable and comparable academic position, by adoption of system that is based on three cycles of studies and implementation of European Credit Transfer System (ECTS);
- Promotion of mobility of students and teachers;
- Promotion of European cooperation in the providing of quality.

Lisbon Agenda that was valid from 2000-2010. and whose successor is Europe 2020 had goal to transform Europe in the world most competitive economy based on knowledge. Research and innovation as well as participation in education and long life learning are main tools to achieve that goal, and universities and schools are identified as main players to achieve that goal.

Europe 2020²⁵ presents European strategy for smart, sustainable and inclusive growth. Main goals of Europe 2020 are:

- raise EU employment rate of the population age 20 to 64 from 69% to at least 75%, with higher inclusion of women and older workers;
- 3% of the EU's GDP to be invested in Research and Development (R&D);
- „20/20/20“ climate-energy goal- reduce greenhouse gas emissions by 20% compared to 1990 levels (or by 30% if the conditions are right), 20% of total energy consumption to be from renewable energy and increasing energy efficiency by 20%;
- reduce school drop-out rates from 15% to less than 10%, with at least 40% of young that will have third cycle diploma;

²⁵ European Commission (2010), *Europe 2020, strategy for smart, sustainable and inclusive growth*, COM(2010)2020, European Commission, Brussels

- reduce the number of Europeans living in poverty by 25% (equivalent to 20 million people).

That smart growth means strengthening of knowledge and innovation as promoters of future growth. That goals needs as well as increase in the quality of education, but also strengthening effects of research. In table 1 given is trend of progress in the achievement of European goals in the education sector from 2000 till 2009, as well as goals that should be achieved by the 2020.

Table 1: Progress in achievement of European goals in education sector

Goal	2000	2009	Goal 2020
Participation in early childhood education	86%	92,3%	95%
Number of 15 year-olds of low achievers in reading, math and science	21,3%	20%	15%
Early school leavers (18-24 years)	17,6%	14,4%	<10%
Upper secondary attainment (20-24 years)	76,6%	78,6%	85%
Number of people with tertiary education	22,4%	32,3%	40%

Source: European Commission (2009), *Progress towards the common European objectives in education and training (2010/2011)- indicators and benchmarks*, European Commission, Brussels, page 7 and others

In the same report it is stated that current trends can be understood as the signal that member states can achieve most of goals till 2020 if they continue their efficient investments in education and if they give high priority to that sector.

3. Areas of reforms in high education sector in Balkan countries

All Western Balkan countries see their future in European Union. This fact significantly changes the environment within which these countries live. These countries are forced to think in framework of the market with 500 million consumers, GDP size of 12.000 billion EUR, with English, French and German, as dominant languages. Education sector will not stay out of influence of this change: university will enter serious competition with universities from EU. How can they withstand this competition? How can they attract students, not only "domestic" ones, but also from countries which are EU members already?

However, if we speak about high education development, we must not forget global megatrends which already significantly influence our life. Process of globalization is already our reality – something we are facing with every day, no matter whether we

like it or no; no matter whether we are globalization followers or opponents. What does globalization mean with respect to the development of high education in Balkan area? On one side, globalization brings stronger competition, but global demographic changes also bring the chance to attract students from different parts of world, especially from Asia? Some people will see this as the danger, because after graduation, at the labor market, these students will be competition to graduated students who were born and live in Balkan countries. But if you rethink the issue, can it be seen as an opportunity? Does it also mean that students who are born in Balkan countries will also be in competition at labor market in India or China with “domestic” graduated students?

How can we use this opportunity? How can we make high education sector competitive at European and global market? This raises two questions – how can we attract more students from abroad, and how can we make knowledge students are getting at our universities competitive with the one they get in foreign institutions? All of these are issues analyzed in this paper. In the paper we’ll try to identify areas within high education sector in Balkan countries which have to be reformed in order to use the opportunity that arises due to EU and global integration. If we don’t want to waste this opportunity, we must work hard in order to improve infrastructure capacities of high-education institutions in this territory (improve research equipment in laboratories, modernization). We should put efforts in improving conditions in students’ dormitories and organize study programs in different languages. All of this requires significant investments, but all of this is necessary if we want to develop high education at Balkan area and raise its competitiveness. That is the only way by which Balkan universities can attract international students and teaching staff.

The analysis in this paper starts from the premise that the development of efficient high education system is one of the crucial determinants of economic and overall social development. Economic development of modern society is founded on the capacity to innovate and to face global challenges. If we want to develop knowledge-based society it means we should develop high-education system, which promote efficiency and invention spirit. In practice, it means that the quality is the crucial assumption of high-education sustainability and development in globalized economy. All high-education institutions must put focus of its attention to the individual student – his/her needs, expectations, and preferences; to the development of his/her character and personality. Along with that, necessity to reduce public consumption imposes the need to include private investment as integral part of high-education system and to permanently increase the share of private funding. Investment into education is the most profitable investment and private investors become aware of this fact.

The state should create legal and institutional framework for all high education institutions and provide consistent implementation of legal provisions. It means that the role of state is to control whether high-education institutions respect the law, and satisfy legal conditions and standard, no matter whether these institution are private or state owned. In other words, state should treat all high-education institutions equally no matter whether they are private or state owned. It contributes to the development of unique high education system, which already operates in all Western societies. No matter whether high education institutions are private or state-owned, domestic or international, if they satisfy legal requirements and quality standards, i.e. if they satisfy certain criteria and maintain adequate level of quality of curricula, technical and organization capacities and human resources, they are being accredited and licensed by the responsible accreditation body and treated equally by the state.

After the crash of socialism, in 90's, each country from the Balkan region conducted certain reforms of complete education system and within that high-education system. These reforms aimed, at least nominally, to bring high-education system closer to European high education. Almost all countries from the region more or less accepted principles of Bologna Declaration,

High education systems of the countries from the Balkan region are similar and based on three levels of high educations: undergraduate studies – Bachelor Degree, specialist and/or master studies – Master degree and PhD studies – Doctoral degree (3+1+1+3). This model, with slight alterations, is implemented in high education system of all regional countries. Each country has introduced ECTS – European Credit Transfer System, which measures the scope of studies and enables student mobility. Student mobility and mobility of teaching stuff is promoted as one of crucial goals of European high education system, and as such, integrated in legal and institutional framework. The idea is to develop the system that can provide comparability of degrees no matter where there are obtained.

Reforms introduced principles of Bologna Declaration into high education system, and thus established the institution of diploma supplement. Diploma supplement is, as its name says, the document which is issued as an addition to the diploma, which describes details of the program a student has finished. Reforms of Law on High Education also defined accreditation procedure and criteria that a high education institution has satisfy in order to get all needed working licenses. Institutional and legal reforms promote European cooperation in the area of quality control in high education. In practice it means that legal provisions require active participation of students as equal partner in high education.

If we try to analyze results of implementation of reformed Laws on high education, we can conclude that the quality of high education programs vary, and there are

great differences between different countries, but also between different institutions in the same country or even different programs within the same institution. It is also evident that number of high-education institution is growing, as well as the number of students, however it is not easy to identify some kind of significant relationship between these trends and demand of labor market. These conclusions are mostly results of qualitative analysis, but it can also be expected that comprehensive statistical and econometric analysis would confirm them.

System of financing high education institution is not reformed yet and it doesn't follow changes in other segments of high-education system. Cooperation between high-education institutions, which should improve the quality of higher education, is still not intensive enough. All countries from the region are implementing principles of Bologna Declaration whose effects are as often praised and blamed in public. However, there was no comprehensive analysis of implementation of Bologna principles.

Similarly, it can be often heard in public that the number of students who obtain university degrees and cannot find job after graduation is alarming high. People often criticize enrolment rates at universities. As alleged too many children enroll university after high school. However, these critics don't have arguments. Opposite from this, number of students enrolled at university should increase, on one side, while on the other number of students who graduate from university should also grow. Along with this, efforts must be made in order to change attitude, which is prevailing at least in Western Balkan, that diploma itself means the guarantee that you will find good and well paid job. Today, in globalized economy, employers are interested in what you know and how much you know; they want to know what skills you had any skills, how much you know and how fast can you learn. They want to know how communicative you are and are you ready to learn and invest in yourself? Degree as the paper – diploma doesn't mean much. Diploma, by itself, is necessary but not enough condition for employment. All of these are reason to promote and implement Life-Long-Learning (LLL) concept in high education.

On the other side severe criticism of „too many“ high school students who enroll university are in conflict with the goal set by European Union, through the strategic document „Europe 2020“. If the goal of Western Balkan countries is to join EU, then much more effort should be invested in order to achieve this goal – by 2020. European Union should have no less then 40% of population in age group 30-34 with university degree. For comparison, today relevant percentage in EU is 32,3% (2009). In 2000 EU had 22.4% of 30-34 years old population with tertiary education. Comparison shows that Ireland have 49%, and Denmark 48.1% of population between 30-34 years with university degree. In order to achieve this goal the percentage of students who leave studies must be reduced, as it is on very high level

in each country of the region. Despite the fact that nominally large percentage of high school students enroll university, the share of those who graduate is not high, i.e. drop-out rate is very high. According to the data of Ministry of Education and Sport of Government of Montenegro more than 60% of enroll tertiary students abandon studies before graduation (drop-out rate is 60%).²⁶ This is very serious alarm, especially if we compare this percentage with the comparable figures – in 2009 drop-out rate in 18-24 age group is at level of 14.4% in EU; 5.3% in Poland, and 4.9% in Slovakia.²⁷ This raises the question what should be done in order to reduce the drop-out rate at universities?

At the end, one of important features of education system in Balkan countries is attractiveness and competitiveness of high education for international students, but also for international teaching staff. Although international cooperation and mobility of students and teachers is promoted as one of the goals of Bologna declaration, no Balkan country has succeeded to fully achieve it. In order to develop efficient students' and teachers' mobility, Balkan universities have to develop study programs in foreign languages (first of all, in English), but also to invest into infrastructure, equipment, buildings, organization, study rooms and dormitory facilities. New investments require financial funds which should be provided by state, but we must not forget the possibility to use accession funds from EU, aimed to support development of education system.

One university can become attractive through development of its research activities. Research and innovation are becoming the dominant factor of university competitiveness. That's why high education system in Balkan countries must be focused on the development of so called „research university“ in order to achieve one of the goals of „Europe 2020“ according to which by 2020 in EU at least 3% of GDP must be invested in research and development. Table 2 given below show the share of GDP invested in R&D area in several ex-Yugoslav countries.

Table 2. Budget spending for high education and share of investments into research activities in several ex-Yu countries – share in GDP

Country	Budget spending for high education – share of GDP	Investment into research – share of GDP
Montenegro	1,10%	0,30%
Croatia	0,72%	0,32%
Serbia	0,90%	0,32%

²⁶ Strategy of Development and Financing High Education in Montenegro 2011-2020, Ministry of Education and Sport of Government of Montenegro, www.mps.gov.me

²⁷ Source of data in this paragraph: <http://www.revicon.info/novost/11653/Obrazovanje-u-EU->

Slovenia	1,26%	n/a
----------	-------	-----

Source: Vukasović, Martina; Babin, Mihajlo and others (2009), *Financing Higher Education in South-Eastern Europe: Albania, Montenegro, Croatia, Slovenia, Serbia*, Center for Education Policies, Belgrade, Serbia, p.75²⁸

What practical steps should be undertaken in order to improve the quality of high education in regional countries? Which areas should be promoted in order to make high education system of regional countries competitive and recognized in EU? Answer to these questions should be the result of comprehensive analysis, which should also serve as the base to define policy measures aimed to advance high education. Curricula and study programs at all universities must be promoted. It is also important to establish regular independent supervision and control of all institutions and all studies programs. Independent supervisory body should also be the accreditation body which will make sure that all institutions and study programs follow certain rules. Links between study programs and labor market must strengthen in order to harmonize study programs and demand of labor. All of previously said should be primarily to goal of state, which should reform system of financing high institution. The goal of this reform of financing high education should be promotion of study programs which are of crucial importance for economic and social development of the country. In other words, the state should define program and areas with “public interest” and invest public funds in those programs.

In order to strengthen entrepreneurial and innovative component of high education programs, which is one of strategic goals of EU, it is necessary to promote introduction of courses aimed to improve entrepreneurial skills of students. These courses are enabling students to make business plans and thus realize their business ideas in practice, as business plan is necessary when an entrepreneur want to find investor. It is also very important to create cooperation between universities and businesses in different forms – cooperation agreements, establishment of entrepreneurial centers or business incubators at university. For example, University of Osijek and University of Novi Sad had established so called UNESCO Chair for Entrepreneurial Studies, which is financially supported by United Nation.

At the same time concept of Long Life Learning – LLL should be promoted in practice. European Union has promoted the goal to involve 15% of population in the age group 25-64 in LLL programs by 2020. In 2009 relevant percentage in EU was

²⁸ Note: Share of GDP is calculated based on the adopted Budget Law. Calculation include direct transfers to high-education institutions, such as wages of employees, administrative and general expenses. Calculation does not include capital investment and funds for student life and improvement of student standard, scholarship, and students activities of all kind.

on the level 9.3% (2009), while more than 50% of employees in USA attend training programs aimed to improve their professional capacities.

Having in mind strategic orientation of European Union accession funds will be allocated into development of these areas, so Balkan countries and universities should do everything in order to efficiently use them. This also implies more intensive regional cooperation between high education institutions.

4. Financing high education

Issue of financing higher education is one of the most important elements of high education policy. The goal of system of financing higher education is to provide high-quality of relevant knowledge and skills obtained at all study programs which will enable graduated students to satisfy labor market criteria and find job in business sector, state administration, research institution or to start their own business.

An issue often discussed in last few decades was the diversification of financial sources for higher education? What financial mechanism will be efficient enough to reach the goals? Financing is being put in center of attention, as high education is facing reduced budget funds, on one side, and increasing number of study programs and high-education institutions on the other. Individual investments in education are considered to be very profitable investment and we can note increase of private funding of high-education in global terms, but also in transitional countries in Balkan region.

Legal and institutional framework of high education area treat private and state owned high education institutions equally, and thus an issue which is often raised in public is whether public funds and budget money should be invested into private or state owned high education programs and institutions. Should the state allocate financial fund following the quality criteria (funds are oriented to the highest quality programs) or should the allocation be made according to ownership criteria (public funds go only on financing programs on state-owned institutions)? Consequently, it is also important to decide which areas of education are important for economic and social development of the country and whether the state should allocate its funds only to provide study programs in these areas. At the end it is very important to build the model which will be efficient in practice.

Beside public funds, that high-education institutions are getting from the state budget and tuition fees paid by students and their families, universities have the opportunity to earn certain share of their funds from alternative external or internal sources. Those can be funds obtained through research projects, organizing

specialization programs and seminar for different companies, state administration, earning from consultant services, renting the facilities or equipment, etc. This item of university budget usually doesn't make big share, but having in mind the fact research activities and science work should be promoted, it can be expected that this external budget item will grow in absolute and relative terms.

When we analyze total spending on education system, we analyze them as the percentage share of GDP. Globally, it is recommended that around 6% GDP should be spent on education. If we look at the data for the Balkan region, average spending on education system is around 4% of GDP, with exception for Slovenia where relevant figure is 6%.²⁹ However, as can be noted in the table given below, spending on high education vary from 0.72% in Croatia, to 1.26% in Slovenia. It practically means that no matter for the total amount of public spending for education, spending for high education is on very low level, which is contrary to the goal to increase the quality of education system. Low level of public funding influenced the development of many study programs at state-owned universities which are privately funded – tuition fees are paid directly by students and their families and not by state. This creates the institution of private studies at state-owned institutions. So, for example, around 60% of all students at the state-owned University of Montenegro pay tuition fees, while depending on the university, from 20% to 80% of students attend private studies at state-owned institutions in Serbia.

Second, very important element of system of financing high-education is public spending for improvement of students' life and standard. Balkan countries have never had the system of financing high education which provided students loans and scholarship for all students, as it is the case in almost all EU countries. If we analyze the situation in regional context, then Slovenia have the most comprehensive system of direct financial support for students, where in average, each fifth student use funds provided by the state (20% of student population), either in form of student loan, or in form of scholarship. In Croatia only 3% of all number of students use this support of the state, while in Montenegro 11.66% of students population are getting student loans from the state. Until this school year (2011/2012) only students of state-owned university had the opportunity to apply and get loans and scholarship from the state, as well as to use state-owned dormitories for students. This policy meant discrimination of students from private universities, so from the school year 2011/2012 all students, no matter whether they study at private or state-owned universities will have equal right to use state funds for loans and scholarship, and state owned student dormitories. This change will revoke discriminatory position of students of private universities and students who studied private programs at state-owned university (students who pay tuition fee for programs organized at state-owned university). Previous practice by which students of private and state-owned

²⁹ OECD, "Education at a Glance 2007", www.oecd.org

institutions didn't have same rights (thus some of the rights are getting the form of privilege), i.e. some students were discriminated so students considered their Constitutionally guaranteed human rights were endangered. Reforms which are implemented now will solve this situation.

To summarize, we live in the era of change of the dominant model of financing high education. There are three mechanisms of financing high education implemented in Western Europe countries:

- a) Financing according to the performance indicators, i.e. results (number of graduated students is usually determinant criteria for funding) – performance based funding;
- b) Financing of institutions – universities or faculties, and study programs – institution/program based funding;
- c) Financing students – student based funding.

Having in mind the need to treat all students equally and the necessity to improve the competitiveness of high-education institution, the most efficient financial model is student based funding, mixed with several elements of other two models. Accordingly, efficient model of financing high education would treat the student, as “the consumer” of services provided by university units. Universities and faculties are “selling” their services (study programs) and students are buying them.

The role of state in this model would be to estimate the price of that service, based on normative of expenses, comparative practice, availability of public funds and current situation in high education.

There are two fundamental points of this model of financing high education. The first one is the price i.e. the costs per student at certain program. The price per student is calculated by methodology, recommended by state, which should include all elements necessary to enable efficient education process and provide certain quality of knowledge and skills of graduated student. Price per student, i.e. the cost of student is understood as the quality standard of education process. Each high education institution is responsible to deliver such quality, measured by condition for studying, human resources, international networking, mobility of students, etc. as it is required by the Law. Other fundamental point of this model of financing high education is to estimate the demand for certain professional profiles. State should make decision on the number of students it will financially support at certain programs, depending on the area of study and give priority to study programs in areas which are priority for economic and overall development of the country. This decision is made depending on the “supply” (price per student at certain program) and “demand” for certain profiles (how many graduated students of certain profile the country needs, which is often described as area of “public interest”).

This is also the way to introduce competition on three levels: between different universities, between different university units (faculties) of the same university and between programs within the same university unit (faculty). Increasing competition raise the quality of all programs. On the other side individual financing have positive influence on the motivation od students, which have positive influence on the efficiency of studies, but also encourage innovations in high-education as the position of specific study program depend on the efficiency and the contribution of that program.

Implementation of this model of financing high education creates conditions for clear economic relations and economically efficient public funding. There is no negotiation for lower of higher budget for high education, but the focus of attention is put on the number of students state would financially support by “buying” the services of high-education institutions on their behalf, and depending on the development priorities the state have.

This is the way to get reliable parameters for enrollment policies and improving the quality of studies. Besides, this could also solve the problem of institutions which enroll too many students – many more student then their optimal capacities (technical, organizational and human resources), which significantly endanger the quality of studies and spirit of Bologna Declaration.

Implementation of this model would enable the state to shape enrollment policy of all, private and state-owned high-education institutions in efficient way and simultaneously to encourage development of high quality study programs. The role of state is to establish clear criteria for financing high education, with the goal to increase quality of knowledge of all graduated students. The state should define the model which will give priority to quality over quantity and to program over the institution.

The state decides on the number of students it will finance on each of study programs of “public interest” – state “buys” services – study programs offered by universities. Universities can also decide to enroll extra students (beside those who are funded by state) following market principles (students are paying tuition fees themselves). However, technical, organizational and human resources are limiting factor and an institution cannot enroll more student at one program then the state allows through accreditation and licensing procedure conducted by independent accreditation body. At the same time, when calculating price per student at certain study programs state should also prevent damping pricing, and thus contribute to the equal position of all high-education institutions, no matter if they are private or state owned.

5. Conclusion

Analysis in this work started with premise that the development of the efficient high-education system is one of the most crucial determinants of economic and overall development of one society. Economic development of modern society is based on innovation capacities and the possibility to face global challenges. The most efficient financial model, which could provide development of efficient high-education system is student based model of financing high education, mixed with some components of two other models (performance based model and institution based model). Such combination would provide equal treatment of all students and contribute to competitiveness of high education institutions. Accordingly, efficient model of financing high education would be the model in which student is treated as the "consumer" of services provided by university units. Universities and their units are "selling" their services (study programs) and students are buying them, or the state is buying them on behalf of students. This model of financing can develop high education system which promotes efficiency and innovation, and thus contribute to development of knowledge based society.

References:

- Cheung, B. (2003), *Higher Education Financing Policy: Mechanisms and Effects*, University of South Australia, Australia
- Đurović M. ed. (2010), *Crna Gora u XXI stoljeću – u eri kompetitivnosti (Montenegro in 21st Century – in the Competitiveness Era)*, Crnogorska akademija nauka i umjetnosti (Montenegrin Academy of Sciences and Arts), Podgorica
- European Commission (2003), *Communication from the commiccion, The role of then universities in the Europe of knowledge*, COM(2003) 58 final, European Commission, Brussels
- European Commission (2009), *Progress towards the common European objectives in education and training (2010/2011)- indicators and benchmarks*, European Commission, Brussels
- European Commission (2010), *Europe 2020*, COM(2010)2020, European Commission. Brussels
- European Commission, General Directorate foe Economic and Financial Affairs (2010), *Efficiency and effectiveness of public expenditure on tertiary education in the EU*, Country Reports
- Johnstone, D. B., A. Arora, W. Experton (1998), *The Financing and Management of Higher Education: A Status Report on Worldwide Reforms*, The World Bank, Washington DC, USA
- Jongbloed, B. (2004), *Funding higher education: options, trade-offs and dilemmas*, CHEPS, University of Twente, Netherlands.

- Kaiser, F., H. Vossensteyn, J. Koelman, ed. (2001), *Public Funding of Higher Education*, CHEPS, University of Twente, Netherlands
- Kishan N. Ramnath (2011), *Economics of education*, APH Publishing Corporation, Nju Delhi
- Ministry of Education and Sport, Government of Montenegro (2011), *Strategija razvoja i finansiranja visokog obrazovanja u Crnoj Gori 2011-2020 (Strategy of Development and Financing High Education in Montenegro 2011-2020)*, Ministry of Education and Sport, www.mps.gov.me
- Tooley, J (1999), *The Global Education Industry: Lessons from Private Education in Developing Countries*, The World Bank, Washington DC
- Vukasović, Martina; Babin, Mihajlo i dr. (2009), *Finansiranje visokog obrazovanja u Jugoistočnoj Evropi: Albanija, Crna Gora, Hrvatska, Slovenija, Srbija (Financing High Education in South-Eastern Europe: Albania, Montenegro, Croatia, Slovenia, Serbia)*, Centar za obrazovne politike, Beograd, Srbija
- Vukotić, P. ed. (2010), *Obrazovanje (Crna Gora u XXI stoljeću – u eri kompetitivnosti (Education – Montenegro in 21st Century – in the Competitiveness Era)*, Crnogorska akademija nauka i umjetnosti (Montenegrin Academy of Sciences and Arts), Podgorica
- Vukotić, V. (2003), *Psihofilozofija biznisa (Psycho-philosophy of Business)*, CID, Podgorica
- Vukotić, V. (2008, 2009, 2010), *Kolumna Eⁿ (Monthly Column Eⁿ)*, Vijesti, Podgorica
- Vukotić, V. ed. (2010), *Ekonomski razvoj (Crna Gora u XXI stoljeću – u eri kompetitivnosti (Economic Development – Montenegro in 21st Century – in the Competitiveness Era)*, Crnogorska akademija nauka i umjetnosti (Montenegrin Academy of Sciences and Arts), Podgorica

PhD Zoran Đikanović, Associate Professor³⁰

The development of investment funds' industry in Montenegro in the context of accession to EU

Abstract: *The current concept of investment funds in Montenegro has been successful and has brought positive results in the context of mass voucher privatization, as well as in the following period of consolidation of ownership. However, that concept is no more attractive. It is not competitive in attracting domestic and foreign investors and do not generate private saving. This paper discusses possible directions of changes of the concept of investment funds' operations and management companies in Montenegro.*

Key words: *investment funds, development, regulation, principal-agent problem*

The current model of investment funds and management companies (MC) in Montenegro was a good and pragmatic approach in the context of implementation of the mass voucher privatization. It had positive impacts both for the funds' owners and the managers. The achieved results during the 2002-2008 period confirm this.

However, economic circumstances have changed and this concept of development of management companies and investment funds is no more attractive. It continuously causes problems for funds' shareholders and does not generate growth in private saving. Moreover, it does not contribute to the development of companies the funds have in their portfolio.

The basic question is: How to revive the current investment funds?

This paper discusses possible directions of changes of the concept of investment funds' operations and management companies in Montenegro. In the first part of this paper, some general assumptions and suggestions are explained, as a ground for searching peculiarities that could help faster and more competitive development of capital market in Montenegro. Based on those assumptions some areas, which should be stimulated by regulations, are still initiated.

I Introduction to the problem

³⁰ Faculty for International Economics, Finance and Business, UDG; Montenegro; Securities and Exchange Commission of Montenegro

The privatization process is one of the key leverage points of transition in Central and Eastern Europe.

Mass voucher privatization had the dominant influence on the development of capital market in Montenegro. This privatization model has contributed to the creation of new capital market institutions, it has included a large number of young people with new ways of thinking and reasoning and opened the flow for new ideas. The individual has been placed in the center of events and given the opportunity to make decisions, think and be an active participant.

One of the key elements for success of mass voucher privatization was the establishment of private funds, which collected vouchers from citizens and bought shares of companies that were privatized by this method.

Considering the needs of privatization process, a privatization investment fund had a structure of a closed-end investment fund with specific investments and dispersed ownership structure, which is actively managed by a management company.

Privatization investment funds have acquired the target shares in certain companies and structured their portfolios in accordance with relatively opened investment opportunities (package of shares which provide active management in companies, real estates, debt securities, etc.). Management company's fee for the fund management was based on the fund's net asset value. Over the years it brought to relatively stable portfolio allocations, i.e. companies owned by privatization investment funds.

This concept has been successful and had positive results in the context of implementation of mass voucher privatization, as well as in the following period of consolidation of ownership. During the 2002-2008 period, a market price of all shares increased manifold. So the value of funds also grew, as well as management companies' fees. Shareholders of the funds easily achieved high earnings, so they took a little care about the efficiency of fund management and possible restructuring of companies in the fund's portfolio.

With the change of economic circumstances such a structure of investment funds and management companies is not adequate.

It does not exercise an effective management of portfolio and portfolio companies, shareholders do not pursue their interests so their interests and managers' interests are moving away. Previously management companies bought shares of funds and gained significant share in the funds' ownership. Due to the passivity of a large number of small shareholders, who do not attend shareholders meetings,

management companies have also gained a strong ownership influence and often create business policy of the fund they manage.

In this situation, investment funds are not effective, are not competitive in attracting domestic and foreign investors and do not generate private saving.

Owners of funds are around 100,000 investors, and on their behalf the funds are owners of property of around 235 million €. Asset management is inefficient, it is quite benumbed, and therefore underestimated.

The situation itself would not be worrying if the trade in fund's shares is liquid, i.e. if we could reasonably expect increase in their value.

Since the owner is unable to significantly influence the growth in the fund's shares value or the fund's portfolio, it causes a basic system disorder. On the other hand, a manager, i.e. a management company receives a fee that is not defined by the market, and is not based on the success of management. In this way, acting of agent is ever more away from the shareholders' interests.

It means that the structure of both investment funds and management companies should be adjusted, because it was made for requirements of mass voucher privatization. It is necessary to redefine the fund's structure, relationship with the management company, to arrange additional types of investment funds and the supporting infrastructure.

Current investment funds should be development-oriented, i.e. transformed, in order to adjust their shape in a manner that it can be easily determined and evaluated by the market. A clear commitment of business opportunities of investment funds would stimulate the funds, i.e. their participants, to maximize their business performance, ie. to maximize the fund's value.

Given the specificities and the need for systemic structure change of the financial system, some dilemmas for future development appear. There are several conceptual issues that require new responses, encouraging for the future development of capital market.

It is necessary to provide an answer to the questions: How to revive current investment funds? How to increase management efficiency, i.e. increase competition in the fund management? How to motivate and engage passive small shareholders to actively influence the management of their property? How to modify the structure so the disposal of property can be efficient and easy?

II Principles for development

Considering the need for the development of investment funds in Montenegro and current trends in this area, regulations of investment funds operations faces the following challenges:

a) Enhancing of competition in the management

Nowadays, management companies in Montenegro have no real competition and therefore have a little or no incentive to make special efforts that would achieve benefits for their shareholders. Management companies in Montenegro and in the region do not have strong reasons to fight for the promotion of competition, and that also applies to such companies anywhere in the world. The reason is that there is no need to place new shares in the market after it the fund has been established.

Closed-end funds in developed financial markets rarely compare their business performance with similar companies operating in other financial markets, and if such comparisons are made, it must be taken into account that investment characteristics of closed-end funds are so different, that actually there is no possibility of an adequate comparison.

The best way to encourage management companies of Montenegrin investment funds to be more efficient is to set the regulatory framework so that it is possible for management companies to lose the fund management contract if they are not efficient or if they hold high the prices of their services.

If we analyze the structure of open-end funds, competition among open-end funds is much more intense. Open-end funds have a strong incentive to be competitive in the market, since they have to sell their shares. The best funds constantly provide information about business results they achieve, because in this way they attract new investors. The growth of such funds consequently increases the amount of fees received by management companies that manage the fund.

There is a need to transform the current closed-end investment funds with a specific structure of investments, to open-end funds. This would be a radical change that might not satisfy management companies, but it would be very welcome in terms of investors. Some of current closed-end funds would have interest to become open-end funds for at least three reasons.

The first is the market price of fund shares, which is currently lower than the net asset value and sold at a considerable discount, and which will grow after the transformation to the full net value. Another reason is that the funds could actively

sell their shares on the market. The third reason is that the management company would be under pressure to improve management efficiency in order to keep shareholders in the fund, since their management fee depends on it.

b) How to give greater importance to passive shareholders?

At a time when investment funds were introduced in our practice, the prevailing opinion was that managers, i.e. management companies, should acquire ownership in the fund they manage. It was thought that this would increase their interest in increasing the value of the fund.

However, the practice has shown that if management companies or its owners have a stake in an investment fund they manage, it allows management companies to retain management of the fund even if there are better options for management. On the other hand, in case when management company has a stake in ownership of the fund it manages, it is possible that management company acts against the wishes and interests of majority of other shareholders.

The main problem arises from the logic of the management contract, i.e. principal and agent relationship. The management company has a management contract with the shareholders of the fund. Hence, the first duty of a management company is to use every opportunity in the market for the fund, not for itself, putting interests of shareholders ahead of its interests. Thus, if the fund's shares are sold at the stock exchange at affordable prices, and the management company believes that the purchase of such shares is a good investment, it is obliged to buy those shares for the fund.

Moreover, separation of ownership from management should be encouraged, i.e. a person who manages the fund should not have the fund's shares. This does not affect the acquired rights of ownership; it only affects the separation of functions of ownership and management.

Current management companies, which acquired ownership in the fund, should not have a voting right in the process of appointment of a new management company. Elimination of equity stake of management companies in investment funds they manage may generate many positive effects and influence the increase of efficiency of funds' operations.

This leads to increase in power of minority shareholders, so they become interested in their investment fund and therefore have a motive to participate at the shareholders meeting. Dissatisfied shareholders will be able to pool their votes,

which enables them to replace inefficient managers, and shareholders may dominantly affect determination of management fees.

c) Market determination of a management fee

When determining management fee the market principle should be followed, this means that the interest and the relationship between owners (principals) and managers (agents) must be balanced. The seller must not receive more than is provided to the customer.

In other words, a management fee should follow the success and benefit that the owner - a fund's shareholder enjoys.

III Recommendations to amend regulations

Given the basic orientation of harmonization and recognition of European regulations in Montenegro, I believe that the basic structure of the investment fund industry needs to rely on UCITS structure, which is now, not only the EU but also in global terms, is very attractive and competitive.

At this stage of financial system development, a literal application of so-called UCITS Directive would be inadequate. It is more realistic that the application meets the needs of Montenegrin capital market. This does not mean derogation from it or making difficult its adoption. On the contrary, such a way would enable the fastest adoption of the Directive and realistic development of Montenegrin capital market.

Certainly, such solutions point to the direction of the financial system development and expectation to enable a competitive system, which should provide even more competitive business conditions within the wider region, i.e. to create a financial environment that would be competitive and attractive foreign investment participants.

1. Transformation of a current investment funds' structure

Current investment funds are more like business and financial holding/ conglomerate with the sum of different activities, than traditional investment fund. Transformation of funds is necessary to crystallize a dominant activity of an individual fund.

In terms of selection of transformation, three main forms of transformation may be taken into account:

1.1. Open-end fund, a classic open-end fund according to UCITS structure principle.

Advantages of open-end funds are the following:

- an easy way of investment for citizens and investors. Daily cash payments to the fund are possible, which especially facilitates investment of smaller amounts of money. There is no need for issue of shares procedure as in closed-end fund (time limits for convening and holding the shareholders meeting, a required two-thirds majority needed for the decision-making of the shareholders meeting, the procedure within the Securities and Exchange Commission, CDA, Register of the Commercial Court, etc.).
- an easy repayment of the investment. The investor may, at any time, require from the fund a repayment of its units in cash.
- Easy and objective method of evaluating the investments. The value of the fund's assets is determined daily and at a market price, there is no derogation, i.e. discount as in closed-end investment funds.
- easy and objective manner of evaluating the success of fund managers. Every investor may easily conclude which amount of profit was achieved to him by fund managers and on this basis to decide whether to withdraw his investment and invest it in another fund.
- the competition among management companies. Easy "entry" into the fund and an easy "exit" from the fund mean that the most important marketing for fund managers is the data on how much profit they made by investing the capital of the fund. Management fee increases with increase of profit of the fund.

In this case it is necessary to define particularly:

- The adequacy of the fund's assets structure (most of the assets must be listed on the stock exchange) at the time of transformation.
- Limitations of "exit" in the period immediately after the transformation, to limit the excessive pressure of shareholders who wish to charge their ownership from the fund. Within the first two years after the transformation periods of withdrawal from the fund may be defined quarterly or half-yearly. Likewise, for the "exit" from the fund in that period, a higher commission may be defined.

1.2. Closed-end fund. Since the transformation of illiquid and very diversified property of the fund is a restricting factor, a rapid and uncontrolled transformation cannot be expected. This would be a transitional form towards open-end funds or it should be used as a permanent form. The condition is that the shareholders define the objective of their business strategy (dominant shares in companies within certain branches of industry, restructuring and improving companies owned).

In terms of transparency, transformation into more closed-end investment funds is also possible (real estate funds, restructuring funds, etc).

1.3. The Fund can be transformed into another type solely if the takeover of the fund was conducted under the Law on Takeover, and if the two criteria are met: that the concentration of ownership is more than 90%, and that the number of shareholders is significantly reduced - below 30.

2. Transformation of the fund's assets and liabilities

Previous types of funds would encourage greater specialization and professionalism of management: portfolio management, greater commitment in the sense of active management of companies in the portfolio, including a higher concentration of shares in companies and the number of companies in the portfolio, i.e. change of specialization towards another business activity (real estate management, etc.).

In order to introduce the principle of efficient operation of the market in the transformation, it is necessary to enable more transparent transformation of major shares both in assets and liabilities of the fund.

2.1. *The transformation of assets* is the most critical part of transformation of the fund. Management company, as an agent, limitlessly disposes with decisions regarding the purchase and sale of the fund's assets, so it is almost impossible to ensure that all its decisions are in favor of shareholders and maximization of the fund's value. Therefore, regulations should encourage, at the time of transformation, that liquid assets of the fund are transferred to open-end fund - UCITS.

2.2. *Transformation (concentration) of liabilities:* Ability to concentrate the ownership should be encouraged right from the beginning, especially in case of transformation into an open-end fund. In such a case, there is a danger that successive concentration of the property and gradual decrease in the number of shareholders may harm shareholders who remain in the fund or later come out of it. The first shareholders who express such intention (exit) are paid based on the most liquid assets, while in case of increasing pressure to exit, less liquid and low quality assets will be available for the remaining owners.

3. Enhancing competition and increasing the efficiency among management companies

For the purpose of encouraging competition and increasing the efficiency of investment funds management, it is necessary to correct a management model, first of all a manner of exercising a control and defining the commission.

The best way to influence the management company to make the most of knowledge and effort for the benefit of shareholders is to increase their uncertainty in the sense of extension of the management contract, and defining that the shareholders decide on the amount of management fee.

In this sense, it is desirable the following:

3.1. Defining the period of the management contract duration. One of manners to increase pressure on the positive performance of a management company is to limit the duration of the management contract. Shareholders may extend the contract if they are satisfied or to terminate the contract if they are not satisfied.

3.2. Management fee should be linked to the benefits enjoyed by owners of the fund. Management fee should be linked to stock market price of the fund's shares. Such treatment of management fee associates assets management interests with interests of shareholders - owners of the assets managed by managers.

4. Foreign custody

One of the most sensitive elements of investment decision-making is the safety of investments. Regarding determination of comparative advantages that can be developed, one of the most important elements is to ensure the safety and confidence of investors.

Therefore, it is necessary to enable the introduction of a "custody" institute (an institution that performs primary supervision over the management of shareholders' assets and the management policy). Development of these institutions is essential for the development of the financial system, as well as for attraction of portfolio investments in Montenegro.

Introduction, i.e. literally following of European regulations that the custody function may only be performed by a domestic custody, i.e. the custody licensed in the country in which UCITS has its registered office, is inconvenient for the development of our capital market.

This sophisticated activity needs to be developed, especially since such an institution should also cover international markets, which means that it needs to be internationally competitive. Lack of trust in relation to a young market without international recognition would block any serious foreign investors' interest. This weakness could be remedied by recognition of foreign and international famous custodies at the request of investor itself.

Indeed, a home Commission, i.e. regulator would have to be included in the process of selection and recognition of custody. In doing so, a home management company would be able to offer global management services and based on the so-called multi-management principles, with different managers, without additional risk and related costs for investors.

The development of such a structure would have resulted in:

- Gaining the domestic, and especially foreign, investors;
- Recognizability in the international system, because the international institutions themselves would be interested for cooperation;
- Development of infrastructure in Montenegro (management companies, custody, the Commission, brokers, auditors, etc.);
- Increased investment opportunities also for domestic investors.

5. Engage passive shareholders in decision-making about their property

In order to stimulate a large number of passive shareholders of funds to engage and actively participate in addressing issues of management and disposition of their property, the regulations should incorporate the principle of separation of ownership and management.

It is possible to apply the following solutions:

- Prohibit the management company the further acquisition of property in the funds they manage. This creates a conflict of objectives and interests between the owners and managers of the fund, and therefore it should be limited. Moreover, this situation motivates management company to purchases shares of the fund for itself instead of buying them for the fund itself.
- Management companies, as the owners, should not have the voting right in the process of appointment of fund managers. When this kind of conflict of objectives is eliminated, the development of positive events and tendencies for the fund should be expected. Minority shareholders will receive strength and ability to meet their interests in the fund and be active in decision-making at the shareholders meeting of the fund.
- The management companies should not exercise the voting right in case of deciding on amount of fees for fund management - the principle that the owner cannot vote on issues he is directly concerned with.

6. Profile the investment policy of the funds

The most important characteristic for all investment funds is to define themselves publicly and declare in writing their investment policy, so all shareholders, current and potential future ones, may know what type of fund they buy.

Shareholders of the fund should have a mechanism to formally agree the basic guidelines regarding the choice of strategy and operations of the fund. Following the adoption of these guidelines, management companies should be obliged to completely, clearly and truthfully report on how the guidelines are being followed. Shareholders meetings should also discuss on efficiency of investments of the fund. This would allow full shareholders knowledgeability and would significantly contribute to the development of their confidence into the management of the company.

This information should be communicated to shareholders before the annual shareholders meeting. This is particularly important in Montenegro, where minority shareholders often do not attend the annual shareholders meeting. Dissemination of this information should educate the existing shareholders of the fund and give more information to potential new shareholders.

7. New financial forms to meet international recognition

7.1. Management company. For efficiency of oversight, the Commission should have full authority over management companies and thereby control over the operations of funds and services offered in Montenegro. It is not optimal, in the first stage, to accept a subsidiary of a foreign financial institution. In order to increase competition, licensing procedure may be simplified if the majority owner or a management company itself is already licensed foreign financial institution in EU area and countries the Commission placed on a list.

In addition to management of the various types of funds it is logical that this same activity is performed for individual investors. The most important is to achieve the following:

- Segregation of clients' property by company's assets,
- Keeping efficient records (technical support - an efficient IT).

Besides management companies, this activity could also be performed by brokerage companies and banks providing investment banking services. In any case, the standards of business operations should be the same for all participants and regulated by the same regulator.

7.2. Private open-end funds. It is a simpler form of investment of wealthier and better-informed investors. Private open-end funds could serve as a possibility of so-called hedge funds, which, at present, do not yet exist in the region.

7.3. Real estate funds may follow the organizational and legal structure of closed-end funds, including the mandatory listing on the stock exchange.

Conclusion

For the future development of the financial industry in Montenegro and its market institutions, particularly in the EU accession process, it is necessary to maintain and improve the principles of market operation.

The financial system of Montenegro can only be improved based on the principles of market economy and it may be made to be attractive for foreign investments, i.e. for the presence of foreign participants in Montenegro. In this matter it is necessary to have good knowledge of international trends and their strengths and weaknesses, as well as looking for specific system solutions that can improve business operations in Montenegro.

Literature:

1. Allen, F. and Gale D., *Comparing Financial Systems*, Cambridge, The MIT Press, 2000.
2. Blundell J, Robinson C, *Regulation Without the State*, Occasional Paper 109, Institute of Economic Affairs, London, 1999.
3. Coates J., *Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis*, Virginia Journal of International Law, 2001
4. High-Level Group on Financial Supervision in the EU, *Report*, Brussels, february 2009
5. Macey J. R, *Regulatory Globalization as a Response to Regulatory Competition*, Emory Law Journal, 2003.
6. Mahoney P., *Public and Private Rule Making in Securities Markets*, Policy Analysis, Cato, No. 498, 2003
7. Mishkin F, *Policy Remedies for Conflict of Interest in the Financial System*, NBER, Columbia University, 2003
8. Montenegro SEC, *Report – Analyses of Possible Changes in the Concept of Regulation of Investment Funds in Montenegro*, Podgorica, 2010
9. Pejovich S., *Understanding the Transaction Costs of Transition: It's the Culture, Stupid*, George Mason University, Washington, 2003
10. Vukotić V., **Conceptual Bases of New Economic System in Montenegro - Genesis of Creation, ISSP, Podgorica, 2005**
11. Vukotić V., *Theoretical Bases of Montenegro Economic School*, Postgraduate School "Entrepreneurial Economy", Podgorica, 1999

Dragana Radević*

Locked Human Capital: Long-term Unemployment in Montenegro

Abstract: *The unemployment is a phenomenon with both social and economic dimensions, representing an important development indicator. It results in a loss of income of individuals, increased pressure on Government requesting more spending for social benefits, and reduced tax revenue. From an economic perspective, unemployment is seen as unused human capital. Montenegro has successfully completed the first stage of economic transition by ensuring macroeconomic stability and launching market reforms. However, its labour market still faces serious structural deficiencies, such as low employment rates, low female participation, and territorial imbalances. In addition, the incidence of long-term unemployment (LTUE) remains high - currently, 80.2% of the unemployed have been jobless for one year and longer, while among women this percentage is 84.1%³¹. LTUE and low labour market participation of women are particularly prominent in the disadvantaged Northern Region of the country, thus calling for immediate actions.*

Key words: *labour market, employment, long-term unemployment*

Introduction

Montenegro is a small, open, service-based, middle-income economy in a process of transition to a fully functioning market economy. Since the 1990s Montenegro has aimed to create a business-friendly economy with low taxes and minimal state interference. The Government embarked on an ambitious programme of economic reforms, the most critical of which were the introduction of the Euro as the official currency, price liberalisation, the opening up of the economy and privatisation.³²

The Montenegrin economy has acquired the structure of a modern service economy driven by the tertiary sector as almost 80% of the workforce was employed in the service sector in 2010, less than 20% in manufacturing and only 1.4% in agriculture mining and forestry³³. Small and medium enterprises (SMEs) comprise the backbone of Montenegrin economy, representing 99.8% of all registered businesses and approximately 60% of national GDP. Micro companies (up to 10 persons) prevail in

* Centar za preduzetništvo i ekonomski razvoj/The Center for Entrepreneurship and Economic Development (CEED), Podgorica, Montenegro

³¹ MONSTAT, Labour Force Survey (LFS), Q1 2011

³² European Training Foundation (ETF), *Human Resource Development in Montenegro – an ETF Review (draft)*, April 2010, pp. 10-11.

³³ Source: MONSTAT, www.monstat.org

number (77% of total), followed by small (9.6%) and medium-sized enterprises (2.8%).

The post-independence period was marked by a high GDP growth reaching double-digit rates in Montenegro (2006-2008), mainly driven by foreign investment (Gross FDI represented 40% of Montenegro's GDP in 2007), mostly directed in the coastal regions of the country which contributed in the growth of tourism, construction, as well as real estate, telecommunications, catering and other services. Montenegro's economy was severely affected by the global financial and economic crisis. Real GDP fell in 2009 by 5.7 per cent, with industrial production contracting by about 32 per cent, following the sharp fall in mining and manufacturing activities.³⁴ Growth in the construction and tourism sectors is also estimated to have slowed significantly. The economy is expected to recover slowly, with real GDP growth 0.5 per cent in 2010, (estimates of the Central Bank of Montenegro). Economic performance is expected to improve in 2011 with estimated 2-2.5% of GDP growth³⁵.

At the same time the Montenegrin economy faces a number of challenges, such as massive and inefficient administration, inadequate supply of infrastructure, access to financing, corruption and misbalance of the workforce supply and demand. Those are identified as the most problematic factors for doing business in the country. One of the serious aspects of economic activity in Montenegro is the size of the grey economy that remains large³⁶. Through reforms of various administrative services, as well as by completing the regulatory reform, the grey economy has been reduced. However, the recent global crisis imposes new challenges creating the incentives for flourishing of unregistered business activities. Although the real decline in the Montenegrin economy in 2009 amounted to 5.7%, the forecast of the Montenegrin Central Bank announces a slight recovery of the GDP in 2010 (0.5%).

Regional disparities remain significant with the Northern Region³⁷ lagging behind

³⁴ European Bank for Reconstruction and Development (EBRD),

<http://www.ebrd.com/pages/research/publications/flagships/transition/montenegro.shtml>

³⁵ For more information: Ministry of Finance, Economic and Fiscal Programme 2011-2013

³⁶ According to a 2005 survey, the share of the informal economy in Montenegro was about 25% - 30% of the registered GDP; some economic sectors are more prone to informal activities than others, such as retail (38.1%), agriculture (18.2%), catering (19.1%), construction (10.8%) and transport (9.6%). ETF, *Human Resource Development in Montenegro – an ETF Review (draft)*, pp. 10-11.

³⁷ Compared to other two regions, Montenegro's Northern Region is seen as having tremendous development potential due to preserved natural resources – primarily agricultural land, wood and cattle stock, good conditions for winter and eco-tourism. There are, however, some serious drawbacks too:

- The Northern municipalities of Montenegro are the least developed in terms of infrastructure that includes roads, water, electricity, and facilities that provide social services such as health care and education;
- The Northern region is the least populated of the three regions representing roughly one-

in almost all macroeconomic indicators from the rest of the country. Previous analysis are suggesting that only 18% of GDP was generated at North, with less than 9% of FDIs attracted and approximately 17% of SMEs registered there. The tourist rich coastal region has seen a boom in both foreign and domestic investment that has also extended economic benefits to the central region. At the same time, the Northern part remains largely untouched in relation to investments, economic growth, and development. Transition from a centrally planned economy to a market economy caused the collapse of large factories in that part of the country, while the emerging SME sector could not absorb the available labour force, and at the same time, it required some new skills and competences.

Employment and Unemployment, Long-term unemployment in Montenegro

The structure of the Montenegrin labour market is similar to most other Western Balkan countries, the activity rate and employment rate are low and unemployment is high. In Montenegro, 78% of the workforce is employed in SMEs (17.2% in micro-enterprises with less than 5 employees); 61.6% work in privately owned enterprises and 36.6% in state owned enterprises. Job creation has not yet compensated the job losses during the past years of transition and restructuring and it will be difficult to catch up in the current phase of reduced demand. The GDP growth during the prosperous years of 2006-2008 has not translated into employment growth and confirms the “jobless growth” phenomenon observed in many transition economies. Tourism, agriculture, construction and trade are seen as sectors with growing employment potential. SMEs, important generators of new jobs, are supported in the framework of entrepreneurial and start up schemes. SMEs account for 99% of all enterprises, 62% of GDP and approximately two thirds of the workforce.

As other countries in the region, Montenegro is coping with persistent informal economy. Informal employment plays an important role for the labour market, providing besides distortion also additional flexibility and a form of security for the people who do not find a decent job or a job at all. Informality is also a culturally “tolerated” attitude to avoid taxes and social security contributions (SSC) and to evade the relatively inflexible labour law.³⁸ The informality of Montenegrin labour market is present in three main forms: (i) employment in the informal sector, which

third of the total population while covering something more than 50% of the country territory; and

- The Northern region lags behind the rest of Montenegro in both financial capital and human capital development.

³⁸ A programme with incentives in the form of exemption from SSC for the first year of a newly registered employee and a range of sanctions for employers helped to reduce undeclared labor and formalization of jobs. ETF, *Human resource development in Montenegro – an ETF review (draft)*, pp. 18-22.

implies work arrangements in the unregistered companies, or activities of self-employed individuals that do not report their business activities to tax authorities; (ii) informal employment in formal sector, which refers to those employees who are not properly registered, usually for the reason of avoiding the costs of social security insurance; and (iii) employment in formal sector with underreported wages³⁹. According to ISSP survey from 2007, about 50,000 persons are engaged as unregistered employees in formal companies or engaged in informal business activities. Majority of persons engaged in the "grey economy" are registered with Employment Agency Montenegro (EAM) unemployment records so they can enjoy health insurance benefits.

After almost a decade of unemployment decline (i.e. number of unemployed in November 2009 is only one third of registered unemployed in 2000), the economic crisis reversed the trend and it started to increase since September 2009, reaching 21.2% at the end of the first quarter of 2011 (Q1 LFS 2011). Actions undertaken by the GoM so far⁴⁰ prevented more severe consequences at the labour market. Despite the fact that trends in employment and unemployment have not drastically worsened, the number of advertised job announcements was reduced by 26.63% in 2010 compared to 2009, employment of non-resident workers is three times less, number of unemployed youth increased, especially those with high education attained, as well as number of older unemployed persons⁴¹.

There is no significant data evidence that females suffered more from the crisis up to now. However, young and elderly population is first effected by the crises, while population between 30 and 50 years is the one that is last on the stroke of negative trends. Also, groups who are now unemployed but have been working previously up to five years as well as groups who have been working over 30 years are first under the pressure of economic downturn. The most significant rise of unemployment was recorded in Podgorica and Niksic, as two biggest administrative and economic centres, as well as in Budva as main tourism destination. Surprisingly, data shows that labour force with finished tertiary education was significantly affected by the crises, as opening of new working places did not follow their inflow to the labour market.

³⁹ Social Security Contributions are paid on the usually minimum amount of salary as determined by the labour law and collective agreement, while actual wage is higher.

⁴⁰ Including: providing guarantees for privatized companies; participating in social programs for redundant workers, increase of state capital budget compared to previous year; providing guarantees for SME loans with international development organizations; reduction of public expenditures and saving measures; further reduction of taxes and levies on wages, and reduction of the personal income tax; various active employment measures.

⁴¹ Source: Analysis of unemployment in Montenegro, Ministry of labour and social welfare, December 2009

Effects of the crises on wages have not been so significant up to now. Data shows that average gross wage increased in the first semester 2011 by 4.0%, compared to the same period 2010. Though, a delay in a payroll has been evident in both public and private sector⁴².

A salient feature of the Montenegrin labour market (and other labour market of the region) is the persistence and high share of long-term unemployment (LTUE). After Albania, the Former Yugoslav Republic of Macedonia and Kosovo (UNSCR 1244/99), Montenegro is the country with the highest incidence of LTUE in the Western Balkans. LTUE is due to a range of factors: the collapse of processing industry, unsuccessful privatization process, the booming of informal economy, limited and/or ineffective active employment measures, and the lack of new job creation. Approximately 10% of the long-term unemployed have been without a job longer than 8 years. This group includes elder persons who are entitled to indefinite unemployment insurance payment until they retire, but also discouraged jobseekers.

Long-term unemployment and low labour market participation of women are particularly prominent in the disadvantaged Northern Region of Montenegro. According to the Labour Force Survey results, the unemployment rate in the North in the first quarter of 2011 was 33.9% of in the North (compared to the country average of 21.2% or to 12.7% in the South (Q1 LFS, 2011). Similarly, according to the administrative data collected by EAM (31 March 2011), unemployment rate in Montenegro was 12.37% compared to 12.46% the same date last year. The highest unemployment rate is recorded in Bijelo Polje (19.52%), and in the northern municipalities Mojkovac, Andrijevica and Pljevlja (19.01%, 16.34% and 15.98% respectively), including Cetinje in central region with registered unemployment 18.32%.

The greatest problem is to achieve employment for long-term unemployed persons⁴³. Data is confirming a disadvantaged position of women on the Montenegrin labour market. Namely, 39.9% of women (against 54.7% of men) are economically active; 31.0% of women (against 43.5% of men) are employed; and 22.2% of women

⁴² Impact of the crisis on the labour market in Montenegro, UNDP & CEED, May 2010

⁴³ Among the factors that inhibit these are: (i) Workers who used to work in large state-owned industries, which collapsed in early 1990s (textile industry, machine industry, crystal production etc). Some of them are suitable for retraining through the policy of active employment; (ii) Recipients of money compensation from EAM; such individuals are often not interested in active labour measures, but are passive only looking for the money compensation; (iii) Disabled persons of third category which receive social assistance in the amount of minimum pensions, and have been registered at EAM for remaining working ability. For example, the person is incapable 70%, while for remaining 30% he/she has to be at EAM registry; (iv) Categorized youth or disabled persons. (persons who attended special schools for disabled persons)

(20.4% of men) are unemployed (Q1 LFS, 2011). Possible explanations for these gaps may be extensive maternity leave regulations in the labour law (e.g. one year paid maternity leave), the lack of available part time jobs (only 4.5% of all jobs are part time) and insufficient childcare facilities. However, there are no gender specific labour market measures or gender mainstreaming policies in place. Women also face obstacles when starting businesses. They have less access to loans and micro-credits because they lack the required guarantees; only 1% of real estate owners are women (EAM, 2007)⁴⁴.

In general, labour market in Montenegro is characterized by an imbalance between supply and demand of labour, increased share of more difficult-to-employ persons, increased share of young high educated graduates, lack of motivation among a number of recipients of social benefits to seek employment, presence of unregistered workers, as well as presence of immigrant workers (especially in the construction sector).

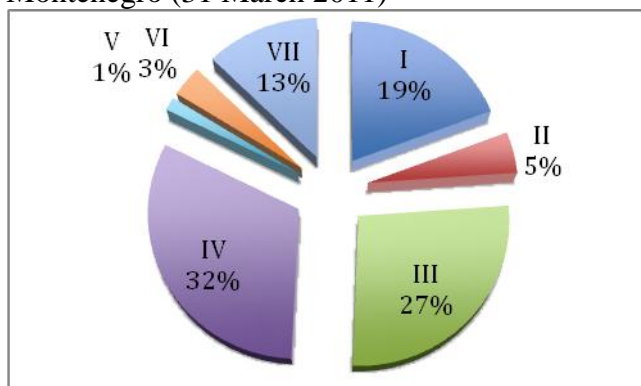
The employment of non-residents presents difficult situation for the employment of the local people. Poor wages and conditions under which foreigners accept to perform job seem unacceptable for the local population. The cheap work force from surrounding countries (Serbia, Bosnia and Herzegovina, Kosovo), the possibility of the employers to dismiss an employee and the readiness of the foreign citizens to partially or at whole work illegally are the main reasons that put the local population at unequal position. By accepting these conditions, the local population risk to lose previously gained rights such as social allowance, health protection, etc. On the other side, employers who are guided by profit, accept the whole situation. After sharp decline in 2010 compared to 2009, the total number of the working permits issued to foreign citizens in first semester 2011 amounts 9,720 which is 32.49% more compared to the same period in 2010 (7,336)⁴⁵.

Graphs 1 presents the structure of unemployed as registered by EAM on 30 June 2011. As it can be seen in the Graph, unemployed persons with lower secondary education - three years of vocational education (24.0%) and upper secondary education (23.7%) face the largest problem in getting employed. On the other hand, figures are showing that number of newly registered unemployed is lower (19,241; 3% more compared to the same period of 2010) compared to the number of advertised job vacancies (24,356, which is 25% more then in the same period 2010).

⁴⁴ ETF, HDR Country review Montenegro, March 2010.

⁴⁵ Employment Agency of Montenegro, Activity report for the first half of 2011, www.zzzcg.org

Graph 1: Unemployed qualification structure - Montenegro (31 March 2011)⁴⁶



Source: EAM Activity Report, June 30 2011

Social assistance recipients, Inactive persons

The goal of the social and child assistance is providing family support, support to individuals, children in risk, and persons facing social exclusivity. According to the Social and Child Protection Law⁴⁷, family material support⁴⁸ as the basic social protection right is provided to the family or its member when being incapable for work or is capable to work but does not obtain enough revenues and has no property (means-tested benefit). Following the adoption of amendments to the general collective agreement in 2010 minimum wage for the normal operation of 176 hours

⁴⁶ Note for the qualification structure:

I - ISCED level 0, 1, 2 - Pre-primary and Primary education

II - ISCED level 2 - Lower secondary education (two years of vocational education in a secondary school)

III - ISCED level 2 - Lower secondary education (three years of vocational education in a secondary school)

IV - ISCED level 3 - Upper secondary education (four years in a secondary school)

V - ISCED level 2 - three years of vocational education in a secondary school with additional training/education within a company for gaining the certificate to perform certain jobs

VI - ISCED level 5 - Higher education (two years at a university)

VII - ISCED level 6 - Higher education (three or four years at a university)

Note: ISCED level 4, which is post-secondary and non-tertiary education, and this is missing in the Montenegrin context

⁴⁷ Main social benefits in Montenegro are: Family material support (FMS), One-time social assistance, Child allowance, Universal birth grant, Compensation for working and non-working women, and for parents working part-time, Personal disability benefit, Other person's care allowance, Assistance for professional rehabilitation and enabling to work, Cash compensation for disabled war veterans, Survivors' benefits, Allowance for civilians disabled during wars.

⁴⁸ The amount of FMS for the family with no income in 2011 amounted monthly: for one member family - 63.50€, for two members' family - 76.20€, for three member family - 91.5€, for four member family - 108.0€, and for five and more member family - 120.7€. Children from families receiving FMS are also eligible for child allowance which amounted 19.0€ on average in 2011.

a month cannot be less than 30% of the average wage in Montenegro in the previous six months, which is approximately 150€. The amount of social assistance could be compared with the amount of minimum wage. For instance, the total income for the five-member family with two children would amount (2011):

Social assistance to the family	120,7€
Children allowance (3x19€)	57,0€
Total	177,7€

Including electricity subsidies, one-off support, costs of recreation for the children (summer and winter season), as well as free textbooks etc. it has been calculated that such five-member family can receive in total 3,208.0€, which is 267€ per month. In addition, such family enjoys health protection, 50% participation in the costs of pre-school, funeral expenses etc. Based on this, it can be concluded that under certain conditions the value of social assistance to socially vulnerable group of people can achieve monthly amount of minimum wage, or even exceed it, while opening the space for recipients to get involved in the informal activities. In other words, rather generous social assistance program is demotivating unemployed to seek for a job⁴⁹.

There has been a trend for increasing the number of the recipients of social assistance, mainly due to the rise of unemployment rate. According to MLSW, in May 2011, 13,793 families comprising from 41,991 members received on average 90.35€ of family material support per month, which is almost 30€ per month. The largest increase of social assistance recipients in 2010 is recorded in Northern Region (FMS recipients 6.6%, child allowance 5.3%, health protection 6.4%), which in the same time represented two thirds of overall number of recipients in the country⁵⁰.

Unemployment at a European and Member State level⁵¹

Recent global financial crisis impacted unemployment level in EU countries as well. However, recent figures are showing some improvements. Namely, Eurostat estimates that 22.473 million men and women in the EU-27, of whom 15.640 million were in the euro area (EA-17), were unemployed in June 2011. Compared with May 2011, the number of persons unemployed decreased by 38.000 in the EU-27 and increased by 18.000 in the euro area. Compared with June 2010, unemployment decreased by 706.000 in the EU-27 and by 346.000 in the euro area.

⁴⁹ Detailed analysis available at World Bank, Social Safety Nets in the Western Balkans: Design, Implementation and Performance - draft report, June 2010

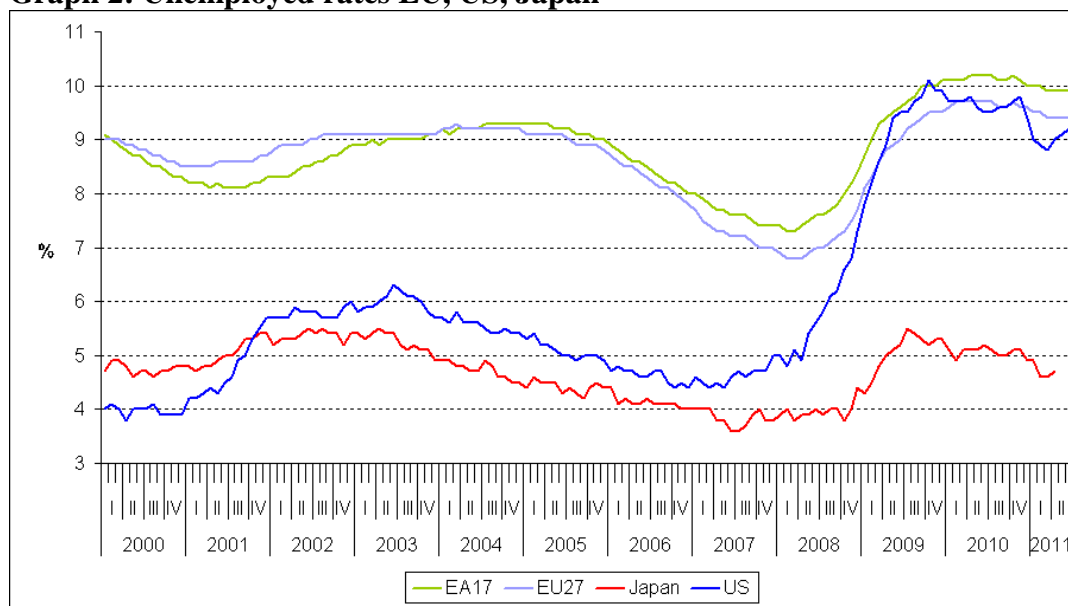
⁵⁰ In terms of population distribution, Northern region hosts one third of all citizens in Montenegro, while it covers almost half of the country.

⁵¹ Source: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Unemployment_statistics

The euro area seasonally adjusted unemployment rate was 9.9% in June 2011, unchanged compared with May 2011; it was 10.2 % in June 2010. The EU-27 unemployment rate was 9.4 % in June 2011, unchanged compared with May 2011; it was 9.7 % in June 2010.

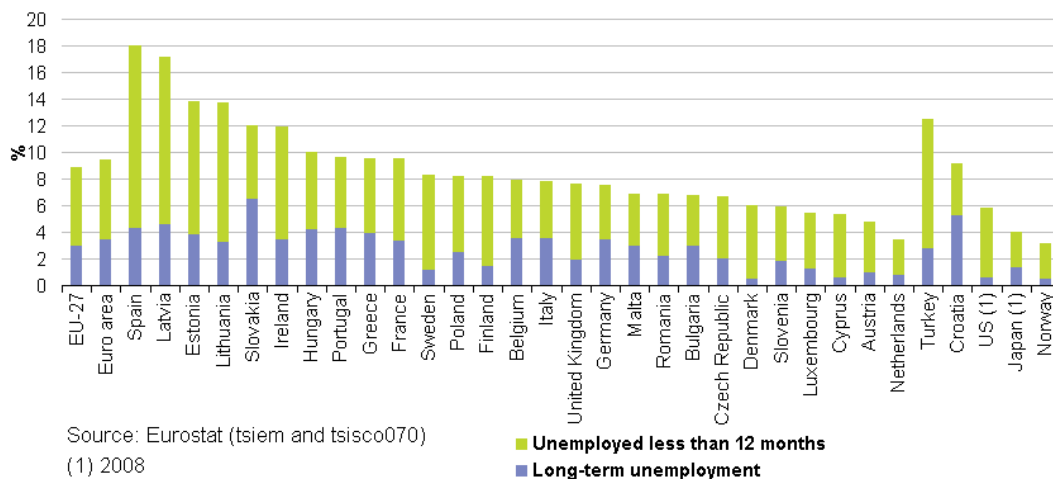
Among the Member States, the lowest unemployment rates were recorded in Austria (4.0 %), the Netherlands (4.1 %) and Luxembourg (4.5 %), and the highest rates in Spain (21.0 %), Lithuania (16.3 % in the first quarter of 2011) and Latvia (16.2 % in the first quarter of 2011). In June 2011, the unemployment rate was 9.2 % in the USA. In May 2011, it was 4.5 % in Japan. Also, level of long-term unemployment in EU countries is significantly lower compared to Western Balkan countries, including Montenegro.

Graph 2: Unemployed rates EU, US, Japan



Source: EUROSTAT

Graph 3: Unemployment rates by duration



Conclusions: how to beat the unemployment in Montenegro?

The consultations with relevant stakeholders and with representatives of the unemployed have highlighted some important conclusions regarding the problem of LTUE in Montenegro⁵². At the first place, it confirmed parallel existence of two labour markets but also in many instances of two business markets, legal and illegal and/or registered or unregistered. Also, LTUE forms part of a whole constellation of socio-economic issues and challenges, including the grey economy, informal employment, remittances, cultural attitudes and mindsets, and other. A significant number of registered LTUE and social assistance beneficiaries seem to be engaged in gainful, although not regular employment. In addition, LTUE is perceived differently by the institutions and by the unemployed in the target municipalities. While the first group accuses the other of lack of motivation and willingness to work, the latter complains that institutions at central and local level are not doing enough to help them cope with the lack of jobs and economic precariousness.

Finally, institutional stakeholders often commented that social assistance benefits act as disincentives for active job seeking. This is a common observation in nearly all countries that provide social assistance benefits and, of course, it is a very complex political question. In Montenegro, it seems any tightening of the social assistance eligibility criteria and/or increase of incentives for social assistance beneficiaries to look more actively for work, for them to be effective there have to be accompanied at the same time by initiatives that would address unregistered employment and business activity effectively. Otherwise the most likely outcome will be increased poverty and greater unregistered employment.

⁵² Organized under the ETF sponsored program “Long-Term Unemployment in the Disadvantaged Northern Region of Montenegro” in March, 2011.

The activities undertaken so far to reduce unemployment and stimulate business activity, although with limited effect, include:

- Vocational retraining and rehabilitation;
- Fiscal stimulus for Northern Montenegro⁵³;
- Public works;
- Subsidies for employers who provide working places for persons difficult to get employment;
- Simulative measures for youth employment;
- Loans for business start-ups and entrepreneurship promotion.

Still, it seems that the measures implemented hitherto for fighting LTUE have been centrally designed and applied countrywide and have had a very limited impact. The need for their complementing with tailor-made measures, fitting to the local context and making use of local strengths and opportunities, is necessary. Above all, the priority action should be to nurture and foster entrepreneurial spirit and create the environment that will support entrepreneurial endeavours and attract new investors. With such a small population, Montenegro cannot afford the luxury of unused human capital.

Literature

1. Labour force survey 1st Quarter 2011, Statistical Office of Montenegro
2. Comparative analysis of the region in Montenegro, with special reference to Northern Region, NGO Natura – Regional Advocacy Center, Kolasin 2004
3. Strategy on Regional Development of Montenegro from 2010 to 2014, Ministry of Economy, July 2010
4. World Bank, Social Safety Nets in the Western Balkans: Design, Implementation and Performance - draft report, June 2010
5. European Training Foundation (ETF), Human resource Development in Montenegro – An ETF Review (Draft), April 2010
6. European Bank for Reconstruction and Development (EBRD), <http://www.ebrd.com/pages/research/publications/flagships/transition/montenegro.shtml>
7. Analysis of unemployment in Montenegro, Ministry of Labour and Social Welfare, December 2009

⁵³ In accordance to Law on corporate profit tax, newly established legal entity in less developed municipalities, involved in production, is not obliged to pay corporate profit tax during the first three years since established, for profit gained in performing its core activities in less developed municipalities.

8. Foundation for the Development of Northern Montenegro (FORS), Socio-economic Analysis of the Northern Region of Montenegro, Podgorica, June 2008
9. European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities, Practical Handbook on Developing Local Employment Strategies in Malta, 2009, Brussels
10. The Impact of the Crisis on the Labour Market in Montenegro, UNDP and Center for Entrepreneurship and Economic Development (CEED), May 2010
11. Labour Market Reform and Workforce Development for Montenegro, Draft Interim Report, 1st August 2010 - 31st January 2011
12. EAM, Employers' Survey 2009/2010
13. EAM, Survey of the Labour Market, Qualifications and Education & Training Needs in Tourism and Hospitality, 2009
14. Long-term unemployment in the disadvantaged Northern Region of Montenegro: From analysis to action, ETF, final draft, March 2011

Neda Ivović, Ph.D*

EU as new factor in market regulation and cost and benefits of judicial intervention in the capital market in Montenegro

Abstract:

Independent regulatory agencies are established as public institutions and all of their acts and actions are subject to judicial control. They are supposed to correct market failures, provide the benefits etc. Detailed analysis of the practices and regulation in Montenegro suggests that unwise judicial doctrines deny agencies all significant policy flexibility and undoubtedly lead to regulatory stagnation. Montenegro should try to avoid regulatory stagnation that has some roots already in place. The author concludes that there is no hermetically sealed market and thus there may not be hermetically sealed system of regulatory measures.

Key words: *independent regulatory agency, judicial review, capital market*

Introduction

Economic reforms in Montenegro, based on the idea of free market and creating of competitive market conditions required adequate changes of the administrative system as well. Adoption of the numerous new legislative acts, with the aim of aligning legislation with the *acquis communautaire*, based on the idea of globalization, liberalization, deregulation and the principle of “more market, less state” necessitated formation of the regulatory agencies that, being independent, expert bodies with financial independence, should serve as a defense against state intervention in market. New approach to regulation necessitated the change of the administrative system in Montenegro, that was based at the doctrine of the state regulated market.

Reforms of public administration in Montenegro, from the aspect of the impact of free market on these changes, are mainly reflected in formation of numerous regulatory agencies such as: Securities Commission, Insurance supervision Agency, Regulatory Agency for Energetic, Agency for electronic communications and postal services, Agency for electronic media etc. The laws by which such agencies were established and that regulate their status, authority and place within the administrative system of Montenegro have been enacted in a hurry, usually inspired with the foreign models in developed market economies, without deep and detailed

* Faculty for International economics, finance and business, UDG.

analysis. Besides that, regulatory agencies are by itself specific and uncommon organizations in the administrative system in Montenegro, from the Constitutional as well as from the aspect of its status within the political system and its legal structure. That is the reason for having very developed criticism of the existence and formation of regulatory agencies mirrored in the claim that they are *sui generis* or hybrid organizations with the enormous enforcement authority what represents them as a severe threat to democracy and "fourth branch" of government.

In Montenegro, beside this issues, opened in the foreign literature, various other problems, inconsistencies and conflicts emerged, mainly due to inconsistencies of the regulation of the regulatory agencies, and a pressure from the international organizations for further development and increase in the number of regulatory agencies in Montenegro is deepening the existing problems.

In this article we leave aside the issue of the different organizational structure of the governing bodies of regulatory agencies in Montenegro. The basic issue that is enormously important from the economic aspect and that is the subject matter of this article is the issue of the costs and benefits to the market participants imposed by inadequate regulations of regulatory agencies, non-regulated relations of such agencies to the courts and competences of the courts to review the decisions of the regulatory agencies.

"Benefits" of the judicial reviewing of the regulatory decisions

In the foreign literature various benefits related to judicial reviewing of the decision of the regulatory agencies are mentioned that are summarized as follows:

a) *Legality*

The most obvious goal, or "benefit," of judicial review is to increase the incidence of legality. Under this view⁵⁴, judicial review of administrative action is necessary above all to ensure that regulatory agencies comply with congressional commands and courts "ensures administrative fidelity to public desires expressed in legislative commands"⁵⁵

If legality is the goal of judicial review, active judicial review might well be desirable. There are good reasons to believe that "courts have a comparative advantage over agencies in deciding what the law is" but it is always forgotten that "an increase in legality might not improve social welfare by any measure."⁵⁶ A statute might be foolish, it might impose costs that outweigh any benefits. A court

⁵⁴ See: P. Strauss (1989), *An Introduction to Administrative Justice in the United States*, 261; See also: F. A. Von Hayek (1960), *The Constitution of Liberty* 153-54;

⁵⁵ See: Cass R. Sunstein, (1989) *On the Costs and Benefits of Aggressive Judicial Review of Agency Action*, Duke Law Journal, pg. 522 et seq;

⁵⁶ *Ibid*;

that required literal compliance with the text of the law might increase legality but decrease net social benefits.⁵⁷

b) *Efficient Resource Allocation*

Under a second view, the goal of judicial review is to promote efficient resource allocation.⁵⁸ The principal concern here is that regulatory agencies might undertake action whose real-world benefits are exceeded or even dwarfed by their real-world costs, measured in economic terms. In these circumstances, according to the opinion of these authors, judicial review might serve as a corrective, since courts might defend against excessive intervention in the marketplace; or they might compel agencies to consider the effects of private conduct -- for example, pollution -- whose extremely high social costs are insufficiently taken into account by the marketplace.⁵⁹

If the goal of judicial review is pointed to efficient resource allocation, that goal might be promoted as a result of judicial invalidation of agency action or inaction deemed "arbitrary" or "capricious."⁶⁰ But judicial promotion of efficient resource allocation may or may not overlap with other beneficial goals, such as legality. Statutory requirements sometimes promote the goal of efficient resource allocation, but frequently they are directed toward other ends, and in such cases the promotion of legality will conflict with the goal of efficient resource allocation.⁶¹

c) *Legitimacy*

Under the traditional view the basic function of the courts might be described as the promotion of "legitimacy" in the administrative process.⁶² This concept is associated with such conventional notions as assurance of legality, protection against arbitrariness and selectivity, promotion of procedural regularity, and assurance against self-interested representation.⁶³ When regulatory agencies are subject matter there is especially expressed fear that "special interests" often have disproportionate influence over administrative processes -- a phenomenon that provides the basic insight behind the extensive literature on agency "capture."⁶⁴

This view places great emphasis on judicial independence, which serves as an important safeguard, providing both an ex ante deterrent and as an ex post check

⁵⁷ *Ibid*;

⁵⁸ See: Cramton, A (1972), *Comment on Trial-Type Hearings in Nuclear Power Plant Siting*, 58 Virginia Law Review, Tom 58, No.4, pg. 585, 591-93; cited by: Cass R. Sunstein (1989), *op. cit.*, pg. 523;

⁵⁹ *Ibid*;

⁶⁰ *Ibid*;

⁶¹ *Ibid*;

⁶² *Ibid*;

⁶³ *Ibid*;

⁶⁴ *Ibid*;

against the domination of administrative processes by irrelevant or illegitimate considerations.⁶⁵

When assessing judicial review under the above mention criteria is that the choice of each of the criteria is value-laden. Its is concluded that both courts and regulators have paid less attention to the effects of judicial review on the real world of regulation -- effects that are crucial to an evaluation of the judicial role.⁶⁶ This approach is peculiar to the developed legal systems characterized not only with the longer tradition of the market and market regulations but also with the much more dynamic and goal oriented development of administrative law. When this approach is existent for the developed market economies, than the analysis of the impact of judicial reasoning and structure of the administrative legal system of Montenegro to the development of market in Montenegro is even more needed, since market in Montenegro is in the initial phase of its development.

Comparative analysis of the judicial reviewing of regulatory agencies decisions

Whatever the relevant criteria, it surely imaginable that, in certain times and places, that aggressive judicial review will both increase illegality and decrease social welfare on any view. Under the statements of some foreign commentators, indeed, one could argue that this was precisely the pattern in the period immediately before and after the New Deal, when courts invoked a principle calling for narrow construction of regulatory power,⁶⁷ According to the views expressed in the foreign literature ignorance of the complex subject matter in issue, prolongation of the procedure and strict formality of the process as well as judging the case at *ad hoc* basis almost certainly may lead to the shortcomings in the court of judicial supervision over regulatory agencies⁶⁸

At the same time, it is stated that judicial independence may serve as a safeguard against various pressures that lead to the illegality in administrative procedures, unfairness and irrationality.⁶⁹ Even in the absence of the systemic analysis it is possible to emphasize several reasons for the statement that judicial control, judged under the any of the above criteria, will be favorable in various situations. According to the opinion of these authors "enforcement can have a strong *ex ante* deterrent

⁶⁵ Ibid;

⁶⁶ Ibid;

⁶⁷ See :FTC v. Eastman Kodak Co., 274 U.S. 619, 625 (1927); FTC v. Gratz, 253 U.S. 421, 427 (1920). See also: Fordham & Leach, *Interpretation of Statutes in Derogation of the Common Law*, 3 Vanderbilt Law Review 438 (1950); cited by: Cass R. Sunstein, (1989), Ibid;

⁶⁸ Ibid;

⁶⁹ See: Pedersen, *Formal Records and Informal Rulemaking*, 85 YALE L.J. 38, 59-60 (1975); Stewart, *The Development of Administrative and Quasi-Constitutional Law in Judicial Review of Environmental Decisionmaking: Lessons from the Clean Air Act*, 62 IOWA L. REV. 713, 762-63 (1977); Sunstein, *Constitutionalism After the New Deal*, 101 HARV. L. REV. 421, 463-78 (1987). Cited by: Cass R. Sunstein, (1989), Ibid;

effect. In some instances it improves analytical process as well as responsibility of the governing bodies of the regulator”⁷⁰

As according to the opinion of foreign legal theory of administrative law, the courts are not supposed to make rules nor are they supposed to engage in the kinds of enforcement actions that are expected of administrative agencies. Their actions in these areas lack the normative force of their interpretive activities. Thus the agency, when deciding how to read a statute in order to engage in rulemaking or implement an enforcement strategy, must employ its own interpretive approach⁷¹ Opinion of the foreign legal theory is that the whole point of granting an agency rule making authority is to enable it to enact supplementary provisions that are applicable to the “present societal, political and legal context.”⁷² The procedures established by the law are intended to provide some guarantee of reasonableness, and some court supervision, but to preserve the flexibility of the agency to act in response to changing circumstances. Critics of aggressive judicial review of agency rules point to “ossification” of the rule making process as a serious evil”. Indeed, the agency itself, as an ongoing body assigned to a specific subject area, is conceived as a mechanism for continuously monitoring that area and adjusting the body of regulations that exist within the statutory framework.⁷³ As stated in the literature: “Agencies need the authority to adjust policies in order to maintain their currency and efficacy and unwise judicial doctrines that deny agencies all significant policy flexibility would undoubtedly lead to regulatory stagnation”⁷⁴.

Analysis of the comparative judgments represents unblemished trend towards greater agency flexibility in policymaking and enforcement of the regulations. Undoubtedly this tendency will in many ways impact the improved regulatory consequences since agencies will have greater ability to "revise unwise judicial constructions of ambiguous statutes," adjust policies and programs to keep pace with the technological and economic vanguard, and generally exercise more effectively the expertise that served as the original *raison d'etre* for agency delegation.⁷⁵

⁷⁰ Ibid;

⁷¹ See: Edward Rubin, Dynamic Statutory Interpretation in the Administrative State, *Issues in Legal Scholarship*, Dynamic Statutory Interpretation (2002): Article 2. <http://www.bepress.com/ils/iss3/art2>;

⁷² See: Jonathan Masur (2007), *Judicial Deference and the Credibility of Agency Commitments*, Vanderbilt University Law Review, May, 2007, br. 60, str. 1021; John G. Osborn (1999), *Legal Philosophy and Judicial Review Of Agency Statutory Interpretation*, Harvard Journal on Legislation, Winter, 1999, br. 36, pg. 115; Thomas O. McGarity (1992), *Some Thoughts on "Deossifying" the Rulemaking Process*, Duke Law Journal, No. 41, pg.1385.

⁷³ See: Jonathan Masur, Ibid;

⁷⁴ Ibid;

⁷⁵ Ibid;

The comparative analysis points to the conclusion that flexibility - when conferred without limits - can impair, rather than further, the effective functioning of the administrative agencies. In accordance with the principles that underlie administrative law, however, it is the agencies themselves who are the best positioned to evaluate value of their foregone interpretive freedom, just as they are best positioned to decide the antecedent scientific and economic questions that motivated the initial decision to commence regulatory action and provided parties with greater numbers of options and allowing them to bargain to optimal results.⁷⁶

At this level of generalization this kind of analysis may not be sufficiently detailed. In various aspects, the analysis is framed within the context – the realm of the regulation within the competence of the specific regulatory agency, motive for regulation with the general and specific legal acts, expertise of the judges and governing bodies of the agency in the specific moment. The following is the empirical analysis of the administrative justice control system of the regulatory actions of the capital market regulator in Montenegro that represents analysis of the status of the regulatory agencies from the court's perspective.

Analysis of the judicial reviewing of the regulatory actions in Montenegro

The analysis of the opposing approaches of the Administrative court and Securities Commission of Montenegro in the interpretation of the capital market law in Montenegro may not be based on the conflicting approaches to the merits of the case. This analysis would be desirable in Montenegro but it is impossible to be composed since Administrative court, not just in the cases of the Securities Commission (SEC) but also in the legal cases of various other administrative agencies, did not used the opportunity, and even in some cases did not fulfill the obligation to decide the merits of the case.⁷⁷

In this article colorful interpretations of the Administrative court of the competences of the SEC regulated by the article 77 and 78 of the Law on Investment funds shall be analyzed. The issue of different interpretations of the SEC competences, procedural by its nature, received a specific importance for determining relationship between SEC and Administrative court, in this and future cases concerning control of the investment funds and management companies. Analysis is not a goal to itself but it intends to point to the fact that SEC as a capital market regulator, due to established and numerous repeated judgments of the Administrative court losses the competencies and authority to control and supervise capital market, these

⁷⁶ See: Jonathan Masur, *Ibid*; See also: Russell L. Weaver (1986), *Retroactive Regulatory Interpretations: An Analysis Of Judicial Responses*, Notre Dame Law Review, No. 61, pg. 167;

⁷⁷ We may take example of the procedure in front of Administrative Court repeated four times. See: U. No. 1793/2008 of 19 June 2009; U.No. 1474/09 of 24 March 2010; U.No. 1218/2010 of 03 November 2010 and U.No.88/11 of 26 May 2011;

competences being entrusted to the SEC by the Law on Investment funds. The forthcoming issue deriving from such statements: does regulatory competencies, entrusted to the regulator by the law are existing in the practice or harmonization of capital market legislation with European legislation and international standards are „law in the books“ and SEC as a regulatory institution is left without competences at the capital market?

These authorities of the SEC, in the same legal matter of various plaintiffs, and even in the repeated judicial review of the same plaintiff's case, the Administrative court analyzed at completely different ways and in numerous examples contrary to its former judgments. We will use the example of the SEC decisions imposing an order to Investment Fund Management companies to remedy deficiencies and illegalities in proposing decisions to be voted aimed to transformation of investment funds originating from privatizations in the real estate management companies, i.e. regular joint stock companies organized under Business organization law. The SEC supported the view that proposed decisions are illegal and thus forbid to be voted about at the shareholders meeting of the investment fund, basing its authority to act on those issues in the provisions of the Law on Investment Funds.

Setting aside the merits of the SEC interpretations of such decisions as illegal, we are going to analyze interpretations of the Administrative court stating (non) existence of the SEC authority to take regulatory action forbidding voting about specific item of the shareholder's meeting agenda proposed to the shareholders of the fund.

In these legal cases, the chronology of the Administrative court decisions and changes of its interpretations related to this issues is as follows:⁷⁸

Administrative Court Judgment	Date of Judgment	Interpretations
U. No. 2044/2009	02.03.2010.	SEC has authority
U. No. 2147/2009	23.04.2010.	SEC has no authority
U. No. 2035/2010	27.04.2011.	SEC has authority
U.No. 432/2011	01.07.2011.	SEC has no authority

The issue arises if the changes in the interpretations of the Administrative court related to the SEC competence to supervision in these and similar cases may be connected to some objective factors. Bearing in mind that in the meantime the Law has not been changed, nor the regulations of the SEC regulating the supervision authority of the SEC, these frequent changes of interpretations of the Administrative courts may not be induced by some objective factors.

⁷⁸ Judgments of the Administrative Court are available at web address of the Administrative Court: www.upravnisud.org.

Moreover, the Administrative court itself did not find it useful to elaborate over the change of its interpretations. Thus, in the judgment No. 2044/2009, while analyzing this issue, the Administrative court declared SEC resolution as legal⁷⁹, while deciding second time over the same issue, the various aspects „ are not clear “. So, in the judgment No. 2147/2009 the Court states: *„It is not clear how defendant in the elaboration of the contested resolution recalls the provision of the article 77 of the Law on Investment Fund prescribing remedying of the deficiencies in supervision, when defendant was not performing the supervision over the plaintiff's business but ordered remedying of the deficiencies based on the decision of the Shareholders Meeting that was not even organized and on the decisions supposed to be adopted. Besides stated, it is not clear how Defendant established measures to be taken and ordered remedying the deficiency when the article 78 Law on Investment funds does not prescribe such measures nor authorizes SEC to such actions, but the Defendant adopts contested resolutions on the basis of alleged decisions of the shareholders meeting“*⁸⁰

Thus, the Administrative court as over the issue of the authority decides second time completely contrary to its former interpretations, and grounds its decision on the fact that the proposal of the decision to the shareholders meeting of the investment fund is “alleged decision” and that SEC may not take other measures in the supervision except the measures enumerated precisely in the Law. It is especially interesting the part of the elaboration of the judgments in which the Court does not deem its former interpretations in its previous judgment as obligatory to the Court, although the cases in front of the court has been legally and actually identical. Although, the judgments of the Court are not formally obligatory as a source of the law, the issue of inequality of the court judgments from the point of legal safety arises. But, the Court did not deemed it useful to elaborate in detailed manner on this point.⁸¹

⁷⁹ See judgment: U.No. 2044/2009 available at: www.upravnisud.org: *„Statement of the claim that defendant exceeded its competences by the contested regulatory action, is not legally grounded, since the provision of the Article 77 par. 1 of the Law on Investment Funds, as also stated in the action, prescribes that, if SEC during its supervision establish irregularities and illegalities in the business of investment fund management companies, it shall order for the established irregularities and illegalities to be remedied within prescribed deadline, what is ordered by the contested resolution in the article 4, 5 and 7 of the resolution”*.

⁸⁰ See judgment U.No. 2147/2009 available at www.upravnisud.org.

⁸¹ *„The Court assessed the statements of the defendant stated at the discussion that in the judgment U. No. 20044/09 the merits of the case are identical as well as legal actions of the defendant toward plaintiffs in which the complaint was overruled, but the Court deems that these claims may not have lead to the different decision, since Defendant violated procedural rules in adoption of the contested resolutions in this case, stated in the judgment”*. See judgment U.No. 2147/2009 available at www.upravnisud.org.

Transferred to the practical level stated legal opinion explains that Administrative Court is entitled to change its interpretations of the same legal provisions on *ad hoc basis*, despite the fact that first judgment confirming the legality of the SEC resolution was confirmed by the Supreme Court.⁸² That such conclusions of the Administrative Court are not incidence is clearly depicted with the judgments on the same subject matter in various other cases.⁸³ For the present analysis, the judgments denying authority of the SEC do not elaborate in details on the issue. It is, however, interesting to note that, judgment No. 138/2011 denying authority of SEC is adopted solely ten days after judgment confirming such SEC competencies. The judgment No. 138/20011 is especially interesting for this analysis since it contains attempt of the Court to explain its statements. The legal opinion stated in this judgment is adopted at the general sessions of the Administrative Court judges and is grounded on the idea that neither the Law nor the bylaws of the SEC authorizes SEC to implement stated measures and that SEC may not decide on its own discretion, arbitrarily.⁸⁴

Analysis of the possible legal effect of the Opinion of the General Session of the Court

After so many judgments characterized solely with the consistency in variations of the Court opinions the intention of the Court to adopt general opinion on its session of June 8th, 2011 is welcomed. In its opinion the Court does not deny competence of the SEC to take measures, but limits its competences solely to the measures explicitly stated in the Law.

The opinion of the Court is generally acceptable in the part in which it states that competences of the SEC as a regulatory body may not be arbitrarily adopted and implemented, and to avoid this, should be stated in the law. Only authority regulated in that manner may achieve legal certainty and as such ensure better predictability of the proposed regulatory measures. The real issue here is if the present legal provision stating that SEC may take, besides those measures numbered in the law, all other measures required for removing illegality and irregularity at the market.⁸⁵ The Court deems this provision as nonexistent and requires all measures to be precisely numbered in the legal text. The requirement for all measures to be stated in the law explicitly has the opposite effect of legal uncertainty since the number of possible market situations invoking regulatory actions is much wider than any possible

⁸² Judgment of the Superior Court Uvr.No. 70/10 of 29 April 2010 confirmed decision of the Administrative Court U.No. 2044/2009 of 02 March 2010.

⁸³ See judgments of the Administrative Court of Montenegro: No. 1870/2010; No. 2184/2010; No. 266/2011; No. 138/2011 available at: www.upravnisud.org.

⁸⁴ See judgment No. 138/2011.

⁸⁵ See Article 78 par. 1 item 6) Law on Investment Funds;

catalogue of regulatory measures required by the Court. The system of so precise and encircled measures is contrary to the market principles and as such nonexistent in the legislation worldwide. Numbering of the enclosed circle of regulatory measures may have a practical effect of tying the hands of the regulator and lead to impossibility of timely regulatory actions with the aim of protecting investors. There is no hermetically sealed market and thus there may not be hermetically sealed system of regulatory measures. Rigid requirement of the Court has as direct consequence legal insecurity and uncertainty at the capital market that is more vivid than a legislator, and more prone to variations. This requirement of the Court is identical to the requirement for the law to be in constant change, what is impracticable, never proposed and unthinkable. On the other side it is much easier to control if the regulatory actions of the regulator are arbitrary and discretionary in the process of regular judicial control of administrative actions under the traditional well established principles of administrative law than to predict all possible market situations needing some regulatory action. There should be checks against regulatory arbitrariness but that check is to be balanced with the competences of the Parliament and the Court over SEC.

The need for widely defined authority of capital market regulator is represented in the Objectives and Principles of Securities regulations adopted by *International Organization of the Securities Commissions* (IOSCO) stating as a principle of regulation that: "The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers. It includes powers of licensing, supervision, inspection, investigation and enforcement."⁸⁶ The capital market regulation of Montenegro has been positively assessed by IOSCO and SEC was accepted as a 50th signatory of IOSCO MMoU in the world, what enables regulatory cooperation and cross border enforcement of capital market regulation. Contrary to the established assessment of the international legal standard setters the statement of the Court does not give any authority to SEC to act at the market except in precisely pre defined situations. This conclusion makes our capital market regulation obsolete and as such completely opposed to the all EU and international standards required for capital market regulations and regulators. One of the basic dangers of capital marker regulators is their obsolence.⁸⁷

After this requirement and interpretation of the Administrative Court we approach further question: may the principles of the capital market regulation be deemed as satisfactory at a practical every-day field?

⁸⁶ Document: „Objectives and Principles of Securities regulations“ available at web address: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>;

⁸⁷ See: Macey, Jonathan R, *Administrative Agency Obsolence and Interest Group Formation: A Case Study of the SEC at Sixty*, Cordozo Law Review, januar 1994, str.913

For example, if we start from the assumption that SEC implemented the substantive law correctly (correctly established that decision proposed for adoption at the shareholders meeting is illegal) because the Court did not tackle that issue, we should ask in which possible way that SEC may react after establishing such irregularities. If we accept interpretations of the Administrative Court that SEC is not authorized to forbid discussion and voting about these decisions at the shareholders meeting since, according to the Court, these decisions are “assumed decisions”, “future decisions” and “not related to the control of the business” we come to the following legal situation: investment fund shareholders meeting adopts decision, register it at the Central register of the Commercial Court. What are the regulatory actions that SEC may adopt, acting within its competences after establishing illegalities and irregularities in order to remedy it within certain deadlines? The sole measure for removing illegal decisions of the commercial company, as well as investment funds from the legal system is annulment of such decision. At this point, we are stepping aside from the Law on Investment funds and transfer to the field of shareholders actions regulated by the Business Organization Law stating that right to action, if some decision of the company is illegal or out of the competences of the company is entrusted to shareholder of the company or its successors.⁸⁸ From the stated legal provision is more than evident that SEC is not actively entitled for initiating court procedure for annulment of such decisions. If the SEC is neither authorized under the Law on Investment funds, as under the interpretation of the Court, we come to the situation that illegal decision may not be removed from the legal system nor the irregularities and illegalities of such decisions prevented *a limine* by a SEC, before such decision has some effect in the legal system.

The rigidity of Administrative Court interpretation leads to the conclusion that SEC, established with the legislative intention, clearly and explicitly stated in the Law on Securities, to take actions and perform control and examination to prevent any frauds on the securities market, to promote and encourage high standards of investor protection and integrity among licensees and to take all steps to safeguard the interests of persons who invest in securities and to suppress illegal, dishonourable and improper practices in relation to dealings in securities, has no action or regulatory measures in its hands to satisfy basic regulatory objectives aimed by the establishment of the SEC.⁸⁹

Here we approach another absurd represented in the conclusion that SEC is entitled to react, take regulatory measures and remove irregularities established in the business of lower bodies of the investment funds (for example: adopted calculation

⁸⁸ See Article 30 of the Business Organization law ("Official Gazette of Montenegro", br. 06/02, 17/07, 80/08, 40/10);

⁸⁹ See Article 8 of the Law on Securities ("Official Gazette of Montenegro", br. 59/00, 10/01, 43/05, 28/06, 53/09);

of the net asset value by the Supervisory Board) since that decisions are implemented by the SEC itself, in the administrative procedure of approving such decision. On the other hand, SEC is not entitled to react in the most serious irregularities to be decided upon by the shareholders meeting of the investment funds in case when such decisions are not to be implemented by SEC. It is indeed surprising to come to the conclusion: As the illegality becomes more serious and possible decisions aggravate the position of the shareholders more deeply, the competences of the SEC become lesser.

This conclusion clearly makes evident that harmonization with the EU legislation must not be end in itself. The above problem also makes obvious that regulatory agencies, although required to be established by the EU legislation must not be established with the sole aim to satisfy EU requirement. Regulatory agencies should mark the end of state dominated market and transfer to less regulated or lightly regulated market. This transfer must be accompanied not solely with legislative proclamations establishing regulatory agencies with the aim of free regulation of market participants, faster and more efficient market regulation and improving of high standards of investor protection. The legislative goal should be to clearly regulate competences of the regulators, position regulatory agencies within the administrative system in a way to precisely define its relation to the courts and scope of judicial reviewing of regulatory agency's administrative actions. The interpretations of the Court are not easily changeable and, as comparatively assessed, the judiciary is not prone to change with the market principles. Neither the court nor the regulatory agencies are to pick winners and losers at the market. The judiciary and regulatory agencies should have common goal aimed to ensure rule of law at the market. As stated in comparative literature unwise judicial doctrines that deny agencies all significant policy flexibility would undoubtedly lead to regulatory stagnation and Montenegro should try to avoid regulatory stagnation that has some roots already in place.

LITERATURE:

- Cass R. Sunstein, (1989) *On the Costs and Benefits of Aggressive Judicial Review of Agency Action*, Duke Law Journal, pg. 522 et seq;
- Edward Rubin, *Dynamic Statutory Interpretation in the Administrative State, Issues in Legal Scholarship*, Dynamic Statutory Interpretation (2002): Article 2, available at: <http://www.bepress.com/ils/iss3/art2>;
- John G. Osborn (1999), *Legal Philosophy and Judicial Review Of Agency Statutory Interpretation*, Harvard Journal on Legislation, Winter, 1999, No. 36;
- Jonathan Masur (2007), *Judicial Deference and the Credibility of Agency Commitments*, Vanderbilt University Law Review, May, 2007, No. 60;

- Macey, Jonathan R, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, *Cordozo Law Review*, January 1994;
- Objectives and Principles of Securities Regulations, available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>;
- P. Strauss (1989), *An Introduction to Administrative Justice in the United States*, 261;
- Russell L. Weaver (1986), *Retroactive Regulatory Interpretations: An Analysis Of Judicial Responses*, *Notre Dame Law Review*, No. 61;
- Thomas O. McGarity (1992), *Some Thoughts on "Deossifying" the Rulemaking Process*, *Duke Law Journal*, No. 41;

*dr Nina Vujošević**

Demographic Dimensions of Regional Policy

Abstract

Nowadays, there is a great diversity of demographic dynamics in Europe across the world. Population growth in Europe according to Eurostat will slow down considerably relative to the United States, China and India and Europe is the second most rapidly ageing world region, after Japan.

Demographic ageing and migration represent two key challenges for the Europe in coming years and each has a significant regional dimension. Nowadays, almost entire Europe displays a combination of high and growing life expectancy, falling mortality rates and low fertility rates as factors which strongly influence demographic ageing, especially in several regions inside the EU member states. Migration flows, both internal and external as another significant demographic challenge, displays moving of people to Western and partially to Southern Europe. Similar trends are happening in Western Balkan where most of countries face with demographic ageing, as well as internal migration. Montenegro, as on of Western Balkan countries displays existing of the same two demographic challenges like in the EU. These challenges are demographic ageing and migration of population, especially from the Northern region, as the least developed region, to the Central and Coastal region of the country, as well as for Northern region to other countries.

Current demographic changes in the EU as well as in Montenegro have a negative impact on labor market, employment, public finance, productivity, investments, competitiveness and economic growth. Actually, demographic ageing in certain regions and municipalities and outflow of young people as a key development factor, to other regions is an issue which among other should be a part of the regional policy. Nowadays, there are 271 NUTS regions in the EU, and each for out of them is under 75% of the EU average development. In order to achieve economic, social and territorial cohesion, the share of the budget for regional policy accounts for around 35% of the total EU budget. Above mentioned regional policy is supposed to contribute to the development of the less developed regions and make them more close to the EU-27 development average. In order to achieve this it is important to discontinue negative demographic trends and increase the share of young population (age 0-14) and working population (age 15-64) in total population.

* Ministarstvo ekonomije i Fakultet za međunarodnu ekonomiju, finansije i biznis

Generally, regional policy in the EU as well as in Montenegro is, among other, supposed to be related to the more even spatial distribution of inhabitants.

Key words: Regional policy, NUTS, Region, Demography, Fertility rate, Life expectancy, Immigration, Emigration, Level of Development

Introduction

Contemporary economy and development policy is characterized by existing of the new context for regional policy formulation, usually named "the new economy". Nowadays, an instruments of the economic policy (monetary, fiscal, foreign trade policy) which are conducted on national level, have limited possibilities of influence on regional and local development. The new economy is more and more focused on knowledge and human resources. Key attributes of the new economy are: (a) globalization; (b) growth; (c) migration flows and the ageing structure of population; (d) knowledge; (e) development of networks (formal and informal).

Having in mind that demographic changes are one of the most important attributes of the network and global economy, and one of the most important attributes of regional development, this Paper is pointing out importance of demographic changes on regional development in Europe as well as in Montenegro.

There are more territorial dimensions of demographic changes and they are in Europe mostly related to migration flows from Eastern and Southern Europe to Western Europe, mainly Germany, France and Great Britain as the most developed Europe's countries. Furthermore, "the capital city factor" is one of characteristics of demographic changes. This means that the largest number of capital cities in the EU and in other countries of Europe including Montenegro, is characterized by positive demographic changes and inflow of young working age population from rural areas and peripheries. In addition, an urban-rural dimension is very specific here, which means that an inflow of population exists not only from rural area to capital cities then also to urban regions, as well as inflow of people from other countries of Europe and the World to urban regions of the EU.

From the point of view of regional policy, both growth and decline of population can represent treats to a territory or open up new development opportunities. In order to respond to challenges of regional policy and demographic changes for the purpose of more balanced regional development, governments of different countries use different models of development policy.

Generally, complexity of the process of demographic changes requires leading of coordinated policy by the government, from social and economic policy to interventions in the area of infrastructure. Thus, an interdisciplinary character of

demographic changes, and their domination in certain regions and areas, requires that the issue of demographic changes shall be one of priorities of the regional policy. The growing importance of demographic themes in regional policy is reflecting in their increasing prominence on the EU's cohesion policy agenda. Also, a part of Lisbon Strategy aims to increase competitiveness in the EU, and this should be achieved by raising the employment rate of older population and hence responding to an ageing society. In addition, Directorate General for Regional Policy in the EU (DG Regio) has published a series of studies under the title "Regions 2020", whose findings are related to the issue of the future cohesion policy. Demographic changes in above mentioned reports has been identified as one of four main future challenges, together with globalization, climate change and energy supply (Ferry M., Vironen H. 2010).

Population and the EU Regional Policy

Based on data from 2008, there are 497.4 million inhabitants in EU-27⁹⁰ or 23.5% more than in 1960. Despite the fact that in last 50 years an increase of total population has been achieved in the EU, demographic ageing and migration flows among the countries and inside countries are key demographic trends which characterize the EU and its regions currently and in coming decades⁹¹. Growing life expectancy and low fertility rates as well as falling mortality rates produce a strong trend of demographic ageing. Based on projection⁹², a half of European population will be 48 year old and above in 2060. Also, based on the same projection, the life expectancy in the EU will grow from 76 years in 2008 to 84.5 years in 2060 for men and from 82.1 in 2008 to 89 in 2060 for women.

There are currently huge differences in the ageing pattern in different regions of the EU. The highest share of elderly population is in Eastern Germany, Italy, some parts of Finland and northwest of Spain. On the other hand, in Central and Eastern Europe, the impacts of ageing are delayed due to their relatively young population base. According to the projection of the DG Regio⁹³, by 2050, there will be 48 million fewer 15-64 year old people and 58 million more above 65. This could cause a shrinking of labor force which could potentially reduce an overall employment in the EU that could have a negative effect on economic growth and development.

As far as migration flows are concerned, several countries of the EU became destinations for immigrants, especially Germany, France, United Kingdom, and in

⁹⁰ Eurostat Yearbook 2010

⁹¹ Based on projections

⁹² CEC (2009): „2009 Ageing Report: Economic and budgetary projections for the EU-27 Member States (1998-2060)“, European Economy 2/2009.

⁹³ DG Regio (2008): "Demographic Challenges for European Regions", Brussels 2008

last years Italy, Spain and Ireland. By 2060, it is projected increase rise of number of immigrants to the EU-27 for 59 million and 46 million of them are projected to be immigrants into the Euro zone. Besides immigration, many countries of the EU also experienced uneven inter-regional migration. Some less developed regions and rural areas have significant outmigration of young and educated people to capital cities and regional centers due to the studies and employment opportunities these offer. In contrast, elderly people stay to live in isolated sub-urban and rural areas. However, this is not typical for elderly people in all of Europe, because some touristic regions in Southern France, Spain and Italy are expected to experience a large influx of elderly people in preparation for retirement.

In general, having in mind that within the current financial perspective of the EU until 2013, around 35% of the EU budget is used for regional policy, achieving of objectives of the regional policy contributes to the "more even spatial distribution of population"⁹⁴ and closing of less developed countries and regions to the EU-27 average. Main three objectives of the EU regional policy are: Convergence, Regional Competitiveness and Employment and European Territorial Cooperation.

Population and Regional Policy in Montenegro

General Overview of Regional Development Policy in Montenegro

Similar to the EU members and other Balkan countries, Montenegro also faces with uneven regional development. Migration flows and demographic ageing are reasons of uneven regional development in Montenegro among other reasons.

Pursuant to the NUTS classification⁹⁵ Montenegro is defined as one statistical region (NUTS 1=NUTS 2=NUTS3) and its development level represents 43.2% of the average development level of EU-27. Pursuant to Spatial Plan of Montenegro until 2020, the Regional Development Strategy and the Law on Regional Development, Montenegro is geographically divided in three regions: Northern, Central and Coastal⁹⁶. Montenegro has 13,812 square kilometers, with population density of 44.9 inhabitants per square kilometer⁹⁷, what is a little bit under the world's average (48 inhabitants per square kilometer). Northern region comprises 52.8% of Montenegrin territory and has 177,837 inhabitant or 28.7% of total Montenegrin population in 2011. Population density is the lowest in this Region (24.4 inhabitants per square kilometer), and municipalities with the lowest population density or 10 and less inhabitants per square kilometer are Savnik, Pluzine and Zabljak. Above mentioned

⁹⁴ Vukotic, 2011

⁹⁵ NUTS – Nomenclature of territorial units for statistics (see the EU Directive No. 1059-2003)

⁹⁶ These are only geographic regions in Montenegro, pursuant to the Law on Regional Development

⁹⁷ Data from Census 2011

facts show that Montenegro, especially its Northern Region dispose with space as a very significant resource which is not adequately valued. Valuation of space and the spatial content shall be one of the most important priorities due to the danger which is related not only to degradation, than also to "suboptimal utilization of this resource". The space within the Northern Region comprises hydro, wood, touristic, agricultural, mining and other resources. However, despite the fact that the Northern Region is the richest with above mentioned resources, it is economically less developed compared to other two regions in the country. Key reasons for such a situation are negative population growth, outflow of young and educated people and increase of the old population in total population structure of the Northern Region.

One of the objectives of Regional Development Strategy of Montenegro is accelerated growth of less developed regions and municipalities, and the Law on Regional Development defines incentives for less developed municipalities, which mostly belong to the Northern Region. Montenegrin Regional Development Strategy objectives related to the Northern Region as less developed region are: human resources development; competitiveness improvement trough development of business infrastructure and environment; development of communal, public and road infrastructure; competitiveness improvement trough sustainable development of economic, rural and cultural resources; improvement of natural resources management system and environment protection. Achievement of these objectives should contribute to gradual retaining of young and educated population in Northern Region of the country and realization of positive demographic trends. However, besides the Regional Development Strategy, there are other strategic document relevant for even spatial distribution of population, like Strategy for Development of Agriculture, Strategy of Transport Development, Strategy for Sustainable Development, Strategy for Development of Small and Medium Enterprises, etc.

Regional development policy comprises activities of all its stakeholders in different sectors and such policy should be adequately coordinated. However, even in circumstances of strong economic growth, high investments inflow and creation of better opportunities for employment, elimination of negative demographic trends in the Northern Region and achieving of population growth, is the process, which, under adequate measures of regional policy, needs a period of several decades.

Demographic trends in Montenegro and its Regions since 1921 and Projection by 2050

According to Census 2011, there are 620,029 people living in Montenegro. One hundred years before, at the beginning of the 20th century, total population in the country was 344,000 or almost a half of the current number of inhabitants (Breznik, 1991). Bearing in mind situation form census to census in 20th and 21st century, total

number of inhabitants in Montenegro have increased. Migration flows in the second half of the 20th century and at the beginning of the 21st century, was result of population growth, and entire period after 1948 was characterized by more live births than deaths, and number of immigrants was constantly lower than number of emigrants. As far as regions are concerned, total population increased in all three regions until census 1981, which has shown population decrease in Northern region of Montenegro by 0.5% compared to census 1971. Since 1971, or in last 40 years, the Northern region is characterized by constant decline of number of inhabitants and a strong trend of demographic ageing. This is due to the falling of fertility rate (to around 1.62 children per woman), falling of mortality rate as well as due to the outflow of young people from this region.⁹⁸ However, one have to bear in mind, that the Coastal Region, as the most developed region in the country, experiences stronger trend of demographic ageing compared to other two regions (an average population age was 37.1 years according to census in 2003 compared to 34 years according to census in 1991). According to the census from 2003, an average population age was 35.5 years in Northern Region and 35.3 years in Central one. The life expectancy, according to estimations for 2007, has grown in all three regions, but the highest life expectancy is related to the Coastal Region (73.3 years for men and 77.9 years for women), while the life expectancy was the lowest in the Northern Region (71.7 for men and 76.9 for women).

From the point of view of regional policy and following of demographic trends, it is important to analyze migration flows in all three regions. A negative migration balance, increase of number of people living or working abroad, a huge number of refugees and internally displaced persons, are characteristics of all three Montenegrin regions in last 15 years. Migration balance is since the year 1981 permanently negative in Northern and Central region, while it is positive in the Coastal region. Furthermore, according to census in 2003, around 12.5% of population of the Northern Region was working or temporarily living abroad. This was in particular related to several municipalities of the Northern Region: Berane, Bijelo Polje, Plav and Rozaje.

Statistical Office of Montenegro - Monstat in 2008 provided projections of population of Montenegro in total and in regions for the period by year 2050⁹⁹. Projections are based on presumptions on mortality, fertility and migration flows for

⁹⁸ Total working age population (age 15-64 years) in Northern Region declined from 141,834 in year 1991 to 128,756 in year 2003, while number of inhabitants over 65 years increased from 17,317 in year 1991 to 24,665 in year 2003. However, the share of working age population increased in year 2003 to 65.6% from 65.4% in 1991 in total population of Northern region, as well as the share of population above 65 years, from 8% to 12.6%. Also, the number of inhabitants of both groups increased in Central and Coastal regions. The fact one has to be worried about is, that the share of the population up to 14 years in total population is falling in all three regions of the country.

⁹⁹Monstat (2008): „*Demographic Trend in Montenegro from the middle of 20th Century until 2050*”, Podgorica

the period until 2050 and there were 7 scenarios of projections prepared. Out of all seven scenarios, the most realistic scenario was one related to the middle fertility. Accordingly, in scenario of middle fertility, expected mortality and expected migration, it has been projected permanent demographic growth in Coastal and Central region. In Northern region, it was projected decline of number of inhabitants until 2015, and growth afterwards until 2050. In case of low fertility rate (1.33 children per woman in 2050) and zero migration balance, there will be achieved decrease of number of inhabitants in Montenegro.

In general, demographic changes definitely represent one of the most important development factors of the Northern Region in Montenegro, which is besides the demographic ageing characterized by outflow of young people to other regions of the country and abroad. Demographic ageing is more evident in the Coastal and Central regions and such process represents a danger of development of these regions in a long run, as well as very important element for the leading of the fiscal policy on the national level. Above mentioned show that demographic trends in Montenegro are similar to those trends in the EU and it cannot be expected increase of population in a long run, with the fertility rate of 1.6 on the national level. However, Montenegro, similar to the EU, could possibly become a destination for immigrants from other countries, especially from Africa and Asia, which could cover demand on the labor market in a long run and become a part of Montenegrin population.

Recommendations for the Regional Policy related to “more even spatial distribution of inhabitants” and Conclusions

Trough the analysis of demographic dimensions of the regional policy, it is clear that there is growing influence of demographic trends on regional policy changes. The scope of regional policy is extending. A broad trend in regional policy in recent years has been for the focus on regional programming to increase. Demographic changes basically have inter-sectoral character and they can not be a subject of only one policy or strategy. Namely, different stakeholders of regional policy can under their responsibilities significantly contribute to the more even regional development trough growing possibilities of employment, housing policy, efficient services of public companies, improvement of knowledge of local people trough permanent training and education, adequate spatial planning, providing of social and technical infrastructure, etc.

As far as the EU member countries are concerned, there is a wide range of recommendations related to the leading of regional policy in order to achieve more even spatial distribution of inhabitants. These recommendations are related to the strengthening of *statistical evidence bases* concerning population and migration

flows. This has been already realized in a huge number of EU countries. The second, very important recommendation is related to using *demographic criteria to target regional aid*. Accordingly, e.g. in Germany, all of the main regional policy instruments aim to improve conditions for economic development in structurally weaker areas, including areas undergoing demographic decline, and thus aim to retain or attract people to live and work in these areas. Furthermore, in France, one of key criteria to target regional aid is demographic one, and it is related to the low population density, falling population or falling active population and share of agriculture in the local economy. The main benefits take the package of numerous fiscal measures relating to corporation tax, property tax and local business tax to encourage business and profession to set up in rural areas. In Norway¹⁰⁰ has been reintroduced an important social security concession which reduces (on a graduated basis but to zero in the far north) social security costs in areas of very low population density (less than 8 inhabitants per square kilometer). Such areas hold 17.7% of Norwegian population. In addition to zero-rated social security contributions, the aid package includes reduced personal taxes as well as personal benefits relating to student loan repayments, exemption from tax on the household use of electricity, higher family and children allowances and benefits for preschool teachers. Also, low population density in certain areas of Finland and Sweden are one of key criteria of regional aid targeting.

One of important recommendations for regional policy in order to achieve more even spatial distribution of inhabitants and accelerated development of less developed regions in the EU is *building of demographic issues into regional strategies and their action plans*. Also, very important recommendation for regional policy in this context is related to *permanent improvement of its coordination*. There are a wide range of other recommendations, possibilities and opportunities for leading of regional policy with the aim of its contribution to reduce outflow of young people from less developed regions and to contribute to the growth of fertility rate.

All before mentioned recommendations could be directly implementable for regional [policy in Montenegro, as the candidate country for the EU membership and some of them are comprised with the Regional Development Strategy and the Law on Regional Development of Montenegro are provided by:

1. Investing in construction, maintenance and improvement of the infrastructure – related facilities (transportation and communal infrastructure, health institutions, social and children care institutions, educational – upbringing institutions and higher educational institutions, sports facilities, housing

¹⁰⁰ Which is not the EU member country

- facilities, cultural facilities and other facilities of importance for regional development);
2. Improving local economic development (strategic management in the local self – government units for the purpose of providing local development or providing of managers and managing teams for the purpose of local development; encouraging public private partnership; encouraging, establishing and developing industrial parks, business incubators and attracting foreign investments);
 3. Improving industry branches (technology level, access to new technologies, research promotion and development);
 4. Establishing and developing small and medium – sized enterprises;
 5. Encouraging employment and decreasing negative demographic trends;
 6. Increasing educational level and quality, pursuant to the market needs and demand, particularly by developing and strengthening entrepreneurial skills among young people;
 7. Improving services in social and children care;
 8. Improving environmental protection;
 9. Adopting and implementing spatial – planning documents and improving the spatial area;
 10. Providing adequate quality of communal services and delivery of communal products, and
 11. Incentives for other needs pursuant to the Law.

With the objective of encouraging the development of less developed municipalities, pursuant to the same Law, additional incentives shall be provided such as the fiscal reliefs, subsidies, donations, guarantees and other measures etc.

For the purpose of leading the policy of more even regional development, the “bottom up approach”, or recognition of development objectives, measures and priorities on the local level and the way of their realization on the local level have high significance. It is obvious that Northern Region disposes with natural resources and its valorization could contribute to the development of energy, agriculture, wood industry in tourism and economic development in entire Montenegro. However, it stays open the question of linkage and conditionality of resources using and demographic trends in the region. Could we talk average age if population in this region is close to 40 years? How, even in case of significant inflow of FDI in the Northern region, to valorize its resources with disposable working age population? Are investments in basic and business infrastructure in the Northern region going to contribute to the coming back of young and educated people with active and project approach in development problems solving in this region? This is about a wide range of questions which could not be precisely answered in a short-term period. Anyway, it is completely clear that municipalities in Montenegro and the central government should consider in their development strategies an issue of demographic ageing and

negative migration balance, especially in the Northern region. In parallel, one have to bear in mind that population of the Coastal Region experiences the fastest demographic ageing in the country and that population growth in this and Central region is achieved due to the positive migration balance and not due to the fertility. If this trend would be continued in the future, and regional policy would not provide appropriate measures related to fertility rate growth and slowing of outflow of young working population from the Northern Region, demographic problem could become a barrier not only for more even regional development, then for entire economic development of Montenegro in a long run. Thus, intention of this paper is pointing out of demographic dimension of regional policy and recommending possible measures which will provide increase of population and more even spatial distribution of inhabitants.

LITERATURE:

1. Baldwin R. Wyplosz C. (2006): "*The Economics of European Integration*" Mc. Graw Hill Education Limited, UK
2. Directorate General for Regional policy (2008): "*Regions 2020: Demographic Challenges for European Regions*", Brussels
3. Eurostat (2011): "Eurostat Yearbook 2010", Brussels
4. Ferry M. Vironen H. (2010): "*Dealing With Demographic Change: Regional Policy Responses*", European Policies Research Center, Glasgow
5. Monstat (2008): „*Demographic Trend in Montenegro from the middle of 20th Century until 2050*”, Podgorica
6. Monstat (2011): "*Census of Population Households and Dwellings in Montenegro in 2011*", Release No. 83, Podgorica
7. Regional Development Strategy of Montenegro 2010-2014, Podgorica
8. Law on Regional Development («Official Gazette of Montenegro «, No.20/11).

Branko Bošković*

Balkan and European Welfare State: Opportunities and Outcomes

Abstract:

The paper discusses European welfare state in comparison to the traditional welfare, which used to characterize it until recently. It has been transformed due to the changes brought by globalization and other processes that changed the social environment we live in. These changes have influenced the welfare and social policies in the EU but Balkan region has been involved as well.

Balkan states have new welfare models and having in mind that the process of joining the EU is already running or has started for these states, the key aim of the paper is to disclose relations of the EU and Balkan in the field of social policies. Therefore, the first part of the paper discusses the traditional welfare state and the ongoing changes as well as welfare models in the Union while the second part goes more into details of the relation of the European welfare state and Balkan.

Keywords: *Balkan, welfare state, social policy, stability, European Union.*

Introduction

The connection between Balkan and Europe has always been present but today, most notably, it is the EU that drives Balkan closer by prospective membership in the Union. European welfare state is still a vague concept due to many different models that exist in it, however, it is the European social model that is the main embodiment of the whole process. Changes of the welfare and social policies that have occurred in the recent decades all point to the new models which are still developing. Balkan states will have to adapt to the new standards not only because of the EU requirements but because of their own citizens.

The paper aims to present what European welfare state actually means today and what is embraced by the concept. Balkan region is here implied as a whole and the paper does not go into details on each of the state due to the similarities in many aspects of the welfare. In order to explicate the relation between European welfare state and Balkan, the first section of the paper deals with the traditional welfare models, to provide historical background. The second part describes changes that were brought by globalization and which transformed the welfare state. The next section is dedicated to theoretical explanation of the European social model, while the last two parts discuss history of welfare state in Balkan and more specifically, opportunities for the region that will result from the membership in the EU. The whole debate is summarized in the conclusion.

* Faculty of Law, University of Donja Gorica

The space available will not allow elaboration of development of the welfare in Balkan after the communist breakdown so it will be only briefly discussed. It is the future relations of Balkan and the EU that are discussed more, in relation to the recent trends of the welfare and social policies in Europe, in order to realize potential gains of for this region.

Traditional Welfare State

Europe has for long been recognized as the guardian of its citizens, today the European Union being the embodiment of this achievement. One of the fields where these policies were especially apparent was social policy and welfare. Adnett and Hardy notice that “[A] distinguishing feature of economic integration in Europe has been a concern for social, as well as economic development”¹⁰¹. After the World War II traditional welfare state was based on the universal care and generous social entitlements were provided. Having in mind that freedom itself is not enough for a person to have satisfying conditions of living and that not all of us have the same starting opportunities, the EU takes special care in this aspect.

In the context of the new world order, it was necessary for the EU to accommodate its policy to the new circumstances in order to maintain growth and development. It is important to emphasize that socialism was never adequate because as Giddens notes “not only it underestimated the ability of the capitalism to reproduce ... [and also] ... socialism too did not understand importance of the market as means of information which equips buyers and sellers with important data”¹⁰². The same author adds that acknowledgment of this was not possible before technological changes took place as well as globalization.

On the other hand, traditional or classic social-democracy was distrustful towards the market and it was also the consequences of market mechanisms that were problematic. Negative impacts of the imperfectness of the market outcomes and unequal distribution were the key aspects in the process that needed to be modified. The welfare state of this kind had two-fold aims: to create equal society and the one where citizens will be protected for the longest period possible. Beside already mentioned, the classic social-democracy was characterized by domination of the state on the civil society, collectivism, full employment, egalitarianism, comprehensive welfare state, one-way modernization, internationalism and attachment to the bipolar world¹⁰³.

The context and the state of affairs of the European continent were favourable and encouraged the classic welfare state. Strong family bonds based on the male breadwinner, economic growth and stable society, fairly independent from the

¹⁰¹ Adnett, N., & Hardy, S. (2005). *The European Social Model: Modernisation or Evolution?* Cheltenham: Edward Edgar, p. xviii.

¹⁰² Giddens, A. (1999). *Treći put: Obnova socijaldemokracije*. Zagreb: Politička kultura, p. 13.

¹⁰³ Giddens, A. *Treći put: Obnova socijaldemokracije*.

political and economic currents in the rest of the world provided safety for such welfare state. However, as already mentioned, globalization (among other effects as well) and its consequences changed the context of the welfare state and in the last few decades it has been significantly altered. Balkan region can be accommodated in this picture only after the communist breakdown but this is questionable as well due to the frequent disruptions in the wider social and political climate. Too unstable environment led to the highly undeveloped welfare and it is only after the stabilization of the state that some constants of the social model can be observed.

New context

Globalization has changed the pace of the world and economic dependency has increased. Crises could no longer be only observed but as they were happening, no matter where, the influence was present all around the world. Empowerment of women and their stronger role not only in the family but also in the workforce, politics and the society in general made a significant shift. Such alteration meant that what used to be fairly individual and a family space which the state did not need to challenge now became a new policy per se. Women are no longer only child bearers and it is not only men who work but conditions are becoming equal for both sexes. Therefore, the concept of family has gained a new insight and women's independence often implied greater involvement of social care because they were more vulnerable to fluctuations in the economy.

The classic welfare state could no longer provide the full employment and growth as was the case before. Accordingly, impossibility of the state to provide social services to everyone who needed it was unsustainable. The risk is no longer on the state but is more individualized which implies that hardly can anyone be relieved and let the social services care about him or her. Today, the state must provide necessary means for creating equal opportunities and everyone must care about themselves later on. However, as there are specific social groups that need assistance permanently, the state will interfere and try to increase their potential.

Transformation of the economy also implies increasing importance of service sector. The instability of employment and inability of citizens to have permanent working places has put an often hard burden on the state. On the other hand, all of these depend crucially on the knowledge and life-long learning. It is no longer possible to make improvement and promotions in the job unless workers are skilled enough and possess necessary knowledge.

Finally, one of the key changes that influenced traditional welfare state was the communist breakdown and this is especially important for the Balkan states and their welfare systems. Due to the limited space, the basics of new social relations have been briefly mentioned here but enough to understand completely different environment of the welfare today.

The European Welfare State

The EU itself is differentiated on many aspects, therefore member states being different and it is the case with welfare as well. Future member states will also add to diversification in welfare models. Different characteristics of the European welfare states comparing to the rest of the world (despite inevitably similar aspects) are presented in the European social model (ESM). The ESM has for long been present in European social policy but have been defined in different ways. More precisely, it is used in different senses and these frequently conflated¹⁰⁴. One of the first instances of defining was in the 1994 Commission's White Paper on Social Policy and it comprises common values such as commitment to democracy, personal freedoms, social dialogue, equal opportunities, adequate social security and solidarity¹⁰⁵. On the other hand, Commission's Social Policy Agenda from 2000 asserts "modernising and improving social protection, promoting social inclusion, strengthening gender equality and reinforcing fundamental rights and combating discrimination"¹⁰⁶.

In general, it became clear that new model of welfare state must be adopted but more importantly, it will be crucial to incorporate welfare model into the wider social circumstances in order to make it effective and acceptable. In order to understand what the ESM actually means and how it is transferable into everyday policies, Hay, Watson & Wincott define it more conceptually, in four ways: first, it embraces common institutions; second, it comprises different national models which exist in Europe; third, they emphasize transnational aspect of social policy because it is not feasible anymore to discuss only national models and fourth, it is only one part of the more encompassing social and political processes which serve as drivers of integration¹⁰⁷. Describing European social model in this way contributes to the fact that it is not only the specific social policies that are part of it but it means much more than that. It is the outcome of not only national but also EU level politics and often implies more than one of the meanings that have been mentioned above. Even more, in most cases these are combined into structural social policies.

Depending on the author and characteristics of the welfare model or regime, there can be three, four or even five welfare regimes in Europe that can be identified. Esping-Andersen discusses three models: Scandinavian, Liberal and Continental¹⁰⁸.

¹⁰⁴ Hay, C., Watson, M., & Wincott, D. (1999). *Globalisation, European Integration and the Persistence of European Social Models*. ESRC One Europe or Several? Working Paper, 3/99.

¹⁰⁵ European Commission. (1994). *White Paper – European Social Policy – A Way Forward for the Union*. Luxembourg. Office for Official Publications of the European Commission.

¹⁰⁶ European Commission (2000). *Social Policy Agenda*, June 2000. Brussels: European Commission, p.2.

¹⁰⁷ Hay, C., Watson, M., & Wincott, D. *Globalisation, European Integration and the Persistence of European Social Models*.

¹⁰⁸ More in: Esping-Andersen, G. (1999). *Social Foundations of Postindustrial Economies*. Oxford: Oxford University Press; Esping-Andersen, G. (2000). *A welfare state for the 21st century*. Report to

He makes this distinction on the basis of three pillars of the welfare state – market, family and government. However, it must be emphasized that the three regimes or models that he lists are rather the ideal types in a way because there can be found many deviations among the states which belong to one of them.

The Scandinavian or social-democratic model is “internationally unique in its emphasis on government pillar”¹⁰⁹. It has been recognized as the model which seeks individual independence and tends to minimize effects of market misfortunes on the citizens’ welfare¹¹⁰. Therefore, it is characterized by strong role of the state and generous public spending on social services. As such, it is aimed towards equality. On the other hand, this model is very costly and high tax burden can constitute a problem, but more importantly, as it depends on the high growth and full employment, as has been the case for a long period for Scandinavian states, this could be a problem. However, Scandinavian model is often cited¹¹¹ as the most convenient and developing model because it is easily adoptable to the new social trends.

The liberal model is more market oriented and mainly present in the UK but also in the USA in which “means-tested assistance, modest universal transfers, or modest social insurance plans predominate”¹¹². Public provisions are limited and directed only to the neediest. Despite this probably being the most efficient model, its consequences can have rather different effects on citizens with lower incomes. This model is characterized by: social guarantees mostly restricted to “bad risks”, narrowly defined “social risks”, encouragement of market¹¹³. However, the same author questions its sustainability on the longer run due to high imperfections.

Finally, the third model is mostly present in Continental Europe and is labeled as the Conservative. Family and family relations are the key element of this model and the male breadwinner having the highest responsibility and importance. “Within this contest, the security of the chief (male) breadwinner assumes fundamental importance. The familialist bias is additionally reinforced by the dominance of social insurance”¹¹⁴. He finds this model often unable to reform and adapt to new trends, one of the more important being the stronger and more influential role of women, because it is too much directed towards the male. Therefore, independence can often be questioned, especially in the case of women. Beside this characteristic, this model

the Portuguese presidency, March, Lisbon; Esping-Andersen, G. (2002). *Why We Need a New Welfare State*. Oxford: Clarendon Press.

¹⁰⁹ Esping-Andersen, G. (2002). *Why We Need a New Welfare State*. Oxford: Clarendon Press, p.44.

¹¹⁰ Ibid.

¹¹¹ Giddens, A. (2007). *Europe in a Global Age*. Cambridge: Polity Press.

¹¹² Esping-Andersen, G. (1990). *The Three Worlds of Welfare Capitalism*. Cambridge: Polity Press, p. 26.

¹¹³ Esping-Andersen, G. (1999). *Social Foundations of Postindustrial Economies*. Oxford: Oxford University Press.

¹¹⁴ Esping-Andersen, G. *Why We Need a New Welfare State*, p. 16.

is characterised by compulsory social insurance, national health care and corporatism¹¹⁵.

Esping-Andersen's typology has been criticized as being too simple but many authors can actually fit into the three models typology¹¹⁶. On the other hand, Giddens adds fourth and fifth type so it is "the Mediterranean one (Spain, Portugal, Greece), which also has a fairly low tax base and depends heavily upon provision from the family"¹¹⁷. Later on he adds the fifth type which are the Post-Communist states¹¹⁸ which can on many aspects be labeled as specific but anyway in the future probably seeking to fit into one of the European models¹¹⁹. The key characteristics of these regimes will be discussed more in the later part of the paper because Balkan states in many ways resemble this pattern simply due to the common historical, communist background. Castells and Mitchell "propose an alternative, four-way classification of welfare states: Liberal, Conservative, Non-Right Hegemony and Radical"¹²⁰. Adnett and Hardy make a similar categorization, so there are traditional-rudimentary model (Southern Europe), liberal-individualist (Anglo-Irish), Romano-Germanic (conservative-corporatist) and Social democratic (Nordic states)¹²¹.

All of this implies that welfare in Europe has different meanings but more importantly that it has different ways of achieving. Stressing different aspects of the welfare state and persistence of specific social policies in some fields calls for attention if we are to construct the European social model. But, as has already been stated, not only in this field but as well in many others in the EU, preservation of differences is one of the greatest achievements of EU institutions and member states. It is crucial to understand the change of the classic welfare state to the new model that is being developed and adapted to current context because it is necessary to make the transition as smooth as possible, which entails sustainability and growth as the main targets.

New Welfare State in Balkan

Balkan states were having great difficulties in consolidation of the whole system and welfare and social policies did not escape the hard times. Communist legacies were not easily transformed and surpassed so it took a long period and great effort to

¹¹⁵ Esping-Andersen, G, *Why We Need a New Welfare State*.

¹¹⁶ More in: Fenger, H. J. M. (2007). Welfare regimes in Central and Eastern Europe: Incorporating post-communist countries in a welfare regime typology. *Contemporary Issues and Ideas in Social Sciences*, August 2007.

¹¹⁷ Giddens, A, *Treći put: Obnova socijaldemokracije*, p. 15.

¹¹⁸ Giddens, A, *Europe in a Global Age*.

¹¹⁹ Fenger, H. J. M. Welfare regimes in Central and Eastern Europe: Incorporating post-communist countries in a welfare regime typology.

¹²⁰ Castells&Mitchell, 1993, in: Fenger, 2007, Welfare regimes in Central and Eastern Europe: Incorporating post-communist countries in a welfare regime typology, p. 8.

¹²¹ Adnett, N., & Hardy, S, *The European Social Model: Modernisation or Evolution?*.

overcome them. Besides, social policy of the communist regimes in Balkan (but as well in other states) were completely different to the ones which are now established. Deacon states that “[C]ommunist social policies were characterized by “heavily subsidised foods and rents, full employment, the relatively high wages of workers, and the provision of free cheap health, education and cultural services”¹²². Enormous amounts were spent on social care and services, as well on high beneficences and these policies were unsustainable on the long run, especially after the system collapse. Balkan was as well hit by war and successful transition and EU membership were significantly delayed as a consequence.

State intervention and inefficient system were in stagnation for a long period and accompanied by high inflation and lowering of standard, but as well vast amount of refugees which needed at least some sort of social care, the welfare state of Balkan countries could not maintain the communist pace nor be easily adapted to the new circumstances. However, after stabilization and the end of war, the whole area (excluding Slovenia which is not discussed in this paper due to overwhelming contrasts with the rest of Balkan), there could be realized positive trends in welfare and social policies.

European perspective

As soon as Balkan was committed to becoming part of the EU, although firstly only rather informally due to the unreadiness and unprepared system and later by formally accepting the procedures of fulfilling criteria for the membership, it was clear that Balkan states will be strongly encouraged by the EU. The same applied to the social policies. This perspective is also possible having in mind the experience of post-communist states that are now members of the EU. Nevertheless, too high expectation of citizens that transition to market system often inhibited potentials of the whole process and negatively influenced it. Anyway, Balkan at that time and especially now, when Croatia is at the brink of becoming a member state and prospects for other states (especially Montenegro and Serbia) are more positive then ever, a strong influence of the EU on the social policies of these countries is visible. The rest of the paper will analyze where these opportunities are.

First of all, as in other areas, social policy and welfare are to become stabilized. Transition to market economy meant high rates of unemployment, therefore many citizens lost their incomes and their standard was lowered. As s consequence, there were greater inequalities. Also, for example, poverty rates were much higher then before which contributed to the even greater inequality, but even more, negative trends could be felt even harder and deprivation was present at higher levels¹²³. In

¹²² Fenger, H. J. M. Welfare regimes in Central and Eastern Europe: Incorporating post-communist countries in a welfare regime typology, p. 13.

¹²³ Stubbs, P. & Zrinščak S. (2009). Croatian Social Policy: the Legacies of War, State Building and Late Europeanization. In *Social Policy & Administration*, V. 43, No. 2, pp. 121–135.

order to prevent this, one of major aims of the EU was to strengthen the institutions and this process is still ongoing, especially now after the economic crisis. All of these reforms mean greater social protection, fiscal stability, stable institutions and welfare mechanisms that will contribute to not only growth and raising standard, but to more equality and lowering of poverty and deprivation. What Stubbs and Zrinščak entitle "welfare parallelism" which means existence of both official and unofficial social policies (carried out by the state and INGOs and NGOs distrustful of the state) needs to be transcended this way because "[I]n these conditions, any thoughts of long term social policy planning were put on hold as the government reacted through crisis management"¹²⁴.

Secondly, requirement set by the EU are obligatory and it is the *acquis communautaire* which needs to strengthen the legal environment in which the welfare policies should be implemented. Encouragement by the EU to adopt certain standards meant not only attainment of specific aims but also accepting criteria for managing successfulness of social policies (e.g. health care, pensions, labour policies). The very fact that there is no single European welfare state model but as has already been emphasized, there being at least three distinct welfare models implies that Balkan states as prospective members do not need to acquire the same standards. Conversely, it means that there can be certain and specific measuring standards and procedures which alleviate transformations and adaptations to new standards¹²⁵. For example, Open method of coordination has in many ways helped member states in the field of social policies to gain the best experiences, so this is one of the opportunities for Balkan states as well.

Thirdly, accession to the EU will not only mean gaining membership and formal status but in the social policies field it means creating more equal and just society where citizens should be able to realize their full potentials. In this way, social policies are inevitably interconnected with other fields, most notably technology and education which will in the forthcoming period be key elements of development and growth. Therefore, it will be necessary to invest in education and production in order to be able to compete with international contenders. In this context, the EU has very strict policies on specific areas (e.g. corruption) which are relics of the communist period and which are not tolerated in the West. This way, the level of trust of citizens will be much higher and institutions will more easily adopt new measures and implement them. Therefore, overcoming socialist values, in a broad sense, is perhaps one of the main aims that the EU has for Balkan because it can hardly transcend them without foreign assistance and often pressure.

Finally, the EU membership will for Balkan states mean strong welfare state which is sustainable on the long run and capable of overcoming historical burdens. The

¹²⁴ Stubbs, P. & Zrinščak S, *Croatian Social Policy: the Legacies of War, State Building and Late Europeanization*, p. 89.

¹²⁵ Seeleib-Kaiser, M. (2008). *Welfare State Transformations. Comparative Perspectives*. Palgrave Macmillan. Basingstoke, New York.

whole process should preclude the idea of “captured social policy” which “describes the particular attention given to specific social groups and their problems such as war veterans and pensioners, or to measures devoted to demographic renewal, while neglecting many other social policy issues”¹²⁶. Therefore, the Balkan states must coordinate all of the social policies, but most importantly, health care, pensions and social care for persons in need because they must have active citizens who are able to cope with the competition and not rely on the state subventions. The new welfare state which depends on active citizens thus contrary from the communist practices must therefore act in a way to create capable individuals aware of risks. Social assistance schemes must be transformed as well in accordance with the EU standards so public expenditures do not exceed acceptable amounts which could endanger the stability of the welfare state.

Conclusion

No matter how difficult it is to associate Balkan and the EU in some aspects, it is clear that the Union can provide a lot in terms of welfare and social policies. It is the only way of stabilization and keeping positive trends in care about citizens in Balkan countries. Dissociations and all the processes that led to negative experiences in the nineties swayed many citizens. Social exclusion as the major form of some sort of deprivation, therefore not only in terms of income but more widely discussed, in terms of being part of the society, must be seriously taken. Consequently, the welfare state of Balkan countries must be built on strong base which means that it must be sustainable and that it can manage to uphold equal chances for its citizens.

Although post-communist regimes for some characteristics fit in conservative welfare regime (in Esping-Andersen’s division) and the same can be stated for the Balkan welfare states, these can still be regarded as developing welfare states¹²⁷. It is therefore probably the best solution for these states to accommodate their social policies to the basic principles already present in these European countries and gradually evolve.

Problem of the social policies has in fact become important only after political and economic criteria have been successfully implemented. Wagener states that “[I]t is common knowledge that the transformation of the social security system was not among the priority objectives of the reform policy and could be treated as a second order phenomenon”¹²⁸. In order to overcome this deficiency Balkan needs Europe so

¹²⁶ Stubbs, P. & Zrinščak S, Croatian Social Policy: the Legacies of War, State Building and Late Europeanization, p. 21.

¹²⁷ Fenger, H. J. M, Welfare regimes in Central and Eastern Europe: Incorporating post-communist countries in a welfare regime typology.

¹²⁸ Sengoku, M. (2006). Emerging Eastern Europea Welfare States: A Variant of “European” Welfare Model, p. 232.

its citizens can have opportunity to have a good life, protected by the state but as well knowing what their responsibilities are.

References

- Adnett, N., & Hardy, S. (2005). *The European Social Model: Modernisation or Evolution?* Cheltenham: Edward Edgar.
- Castells, M. (2003). Global Informational Capitalism. In Held, D., & McGrew, A. (Ed.), *Global Transformations Reader*. (pp. 162-177). Cambridge: Polity Press.
- Esping-Andersen, G. (1990). *The Three Worlds of Welfare Capitalism*. Cambridge: Polity Press.
- Esping-Andersen, G. (1999). *Social Foundations of Postindustrial Economies*. Oxford: Oxford University Press.
- Esping-Andersen, G. (2000). *A welfare state for the 21st century*. Report to the Portuguese presidency, March, Lisbon.
- Esping-Andersen, G. (2002). *Why We Need a New Welfare State*. Oxford: Clarendon Press.
- Esping-Andersen, G., & Myles, J. (2008). *The Welfare State and Redistribution*. Unpublished papers. Gøsta Esping-Andersen official homepage. Accessed March 27, 2011, <http://www.esping-andersen.com/>.
- European Commission. (1994). *White Paper – European Social Policy – A Way Forward for the Union*. Luxembourg. Office for Official Publications of the European Commission.
- European Commission (2000). *Social Policy Agenda*, June 2000. Brussels: European Commission.
- European Council. (2000). *Presidency Conclusions: Lisbon European Council 23 and 24 March 2000*. Brussels, European Council.
- Fenger, H. J. M. (2007). Welfare regimes in Central and Eastern Europe: Incorporating post-communist countries in a welfare regime typology. *Contemporary Issues and Ideas in Social Sciences*, August 2007.
- Giddens, A. (1999). *Treći put: Obnova socijaldemokracije*. Zagreb: Politička kultura.
- Giddens, A. (2007). *Europe in a Global Age*. Cambridge: Polity Press.
- Hay, C., Watson, M., & Wincott, D. (1999). *Globalisation, European Integration and the Persistence of European Social Models*. ESRC One Europe or Several? Working Paper, 3/99.
- Jepsen, M., & Serrano Pascual, A. (2006). The concept of the ESM and supranational legitimacy building. In Jepsen, M., & Serrano Pascual, A. (Ed.), *Unwrapping the European Social Model* (pp. 25-47). Bristol: Policy press.
- Rosanvallón, P. (2000). *The New Social Question: Rethinking the Welfare State*. Princeton: Princeton University Press.
- Rumford, C. (2002). *The European Union: Political Sociology*. Oxford: Blackwell Publishing.

Seeleib-Kaiser, M. (2008). *Welfare State Transformations. Comparative Perspectives*. Palgrave Macmillan. Basingstoke, New York.

Sengoku, M. (2006). Emerging Eastern Europea Welfare States: A Variant of "European" Welfare Model. Available at

http://srch.slav.hokudai.ac.jp/coe21/publish/no2_ses/3-2_Sengoku.pdf, Accessed on April 18.

Sotiropulos, D., A., Neamtu, I. & Stoyanova, M. (2003). The Trajectory of Post-communist Welfare State Development: The Cases of Bulgaria and Romania. In *Social Policy & Administration*, V. 37, No. 6, pp. 656–673.

Stubbs, P. & Zrinščak S. (2009). Croatian Social Policy: the Legacies of War, State Building and Late Europeanization. In *Social Policy & Administration*, [V. 43, No. 2](#), pp. 121–135.

Ivan Jovetic, MSc*

Balkan and European Union – The Second Journey

Abstract: *The European integrations process represents a process of providing security and creation of opportunities for free exchange. These are the core reasons for the success of integration's process of the 20th century. However, respective process is being highly mystified at the Balkans. First in the context of what is the essence of the EU and second as why integration process is desirable. Therefore, it is important to try to define the EU in order to make personal qualification of it possible. Besides, it is required to know what the EU can provide to us, individually. As there is no free lunch it is crucial to identify potential costs of the integration but also of potential alternatives. The key for the EU demystification at the Balkans is reinterpretation of the integrations' core ideas alongside emphasizing the freedom. Simultaneously, it is prudential to consider possible transition of the EU itself as well as such transition's consequences.*

Key words: *The European Union, Balkan, integration, security, expenditures, benefits, idea, reinterpretation, freedom, transition.*

Words of introduction

„ In the beginning was the Word...“¹²⁹ even though it is being forgotten quite often within observations on Europe. However, there are several notions of the word Europe despite the incompletely clear origin of the word. *Science* considers that its origin is from the Phoenician word “ereb” meaning dark, setting. As Greece was on the sunset-side from the Phoenician point of view there is no surprise why that part of the world got such name. *Literature* connects continents' name with Hesiod which had mentioned in “Theogony” (700 BC) goddesses Europe and Asia. *Mythological*, Europe has been daughter of Crete's king Agenor in which Zeus, supreme Greek god, felt in love.¹³⁰ Pretending to be white, calm bull Zeus has approached to the Europe. As she was appealed by the saffron's scent, it did not take long to ride bull's back. Suddenly Zeus flew away and took her from the Crete.

* UDG-Faculty for International Economy, Finance and Business; Institute for Strategic Studies and Prognoses, Podgorica.

¹²⁹ Holy Bible (New Testament – Book of John 1:1): „In the beginning was the Word, and the Word was with God, and the Word was God.“

¹³⁰ Grevs, Robert (1995): „Grčki mitovi“, Nolit, Beograd.

Finally, because of love to Europe, Zeus gave her name to that part of the world where her Crete was. Mythology knows this story as *myth of Europe's kidnapping*.

Relation of Ancient Greece with the European Union (EU) does not stop in the plain of the potential name's origin. Greece of Alexander the Great had been first form¹³¹ of integration of the European continent.¹³² The following integration's attempt had been in the form of the Roman Empire. Similarity of the EU with the Ancient Rome is even more evident. Their mutual elements are *free trade, common currency, common defense system, legal system, foreign policy and certain region's autonomy*.¹³³ Centralization of institutional solutions and decision making processes should also be added to this assembly of common features. After these aforementioned, there were three more also violent attempts of integration: Charlemagne (IX century), Napoleon Bonaparte (XIX century) and even Hitler (XX century).

Europe?

Nearly after 2300 years the Union has been formed in Europe. Immanuel Kant and his *no peace no prosperity* thesis has been a philosophic predecessor of the peaceful integration. In addition, prominent European philosophers have given new cornerstones to that idea throughout from 16th till 20th century. Essence of such integration may be indentified as prevention to the future armed conflicts but also creation of economic cooperation area.

Nowadays, the EU is a unique experiment quite difficult for defining. However, there are quite interpretation, definitions and notions of the EU and its structure but also its mission. Out of them, three that relatively precise *defines* it have been extracted in accordance with freedom of choice and preferences.

According to the first chosen definition the EU is being observed as *getaway from the national state through creation of mega-national state ("state of the states")* where it is about expansion rather than elimination of the borders.¹³⁴ Validation of such point of view can be found in the fact that the EU has created its single market but simultaneously has closed it for third countries. An outcome of such approach

¹³¹ Respective form of integrations has been violent and it extended even beyond borders of the European continent.

¹³² Moreover, it is possible that certain elements of Ancient Greece such are city-states may become directions of the XXI and XXII century's EU.

¹³³ Common defence exists mainly due to the existence of North Atlantic Treaty Organization (NATO) although there are some attempts of the European cooperation models. Foreign policy is still not common and unique although there are indices that it may become in the future. Finally, it is quite possible that regions will have higher significance in the future.

¹³⁴ Veselin Vukotic, „Opasne rijeci”, p. 41-42

has been lower economic success in comparison with assumed performances of totally free and open market. As an addition to the *only expanded borders* is fact that approximately 67% of the EU trade is an internal member states trade.¹³⁵

Furthermore, Vukotic concludes that „...*wish for the EU accession is conscious or unconscious acceptance of libertarian theory and libertarian market although in practice the greatest libertarianism criticizers are great proponents of the EU accession*“.¹³⁶ According to Vukotic the EU is *the way of bureaucracy's survival and belief in welfare state* but in the same time it is *consequence of strategic and global competition and represents the essence of the globalization*.¹³⁷ Starting from the idea of conflict prevention at the European soil the EU has become the competences and decision transfer process – from national to supranational level.

According to the second definition, the EU is *unique experiment* which is *political system but not the state*.¹³⁸ Hix concludes that EU comprehends every element of democratic political systems¹³⁹ adding that „*the level of stability and complexity of the EU institutions is far beyond any other international regime*“¹⁴⁰ and that even higher EU institution empowering have created „*highly developed system of rules and procedures that govern those empowerments by the EU institutions*“.¹⁴¹ Furthermore, Hix concludes that alongside the growth of the EU institution empowerment increased the number of groups that tried to achieve own interests within the system¹⁴² as well as that EU's decisions are extremely important and that they create consequences throughout the EU.¹⁴³

¹³⁵ World Trade Organization; Daniel S. Hamilton, Joseph P. Quinlan, „Globalization and Europe: Prospering in the New Whirled Order“, 2008.

¹³⁶ Veselin Vukotic, „Opasne rijeci“, p. 41-42

¹³⁷ Vukotic also considers that is highly important to emphasize the EU exit conditions rather than only entry conditions as it is at the moment. Voluntary joining must be *followed* with simple and efficient procedure of dissolution. Even dough exit mechanism has been prescribed by the Lisbon Treaty it is not efficient enough due to obstruction opportunities (*author's remark*).

¹³⁸ Sajmon Hix, „Politicki sistem Evropske Unije“, p. 24-27.

¹³⁹ According to Gabriel Almond and David Easton those are: *stable and clearly defined institutions and certain rules* aimed for definitions of relations among them; *individuals and social groups* that are trying to achieve own political aims throughout political system; *collective decisions* which have significant influence on economic resources reallocation as well as on social and political values allocation and *constant interaction* among those political outcomes, new demands towards system, new decisions and etc. More details: Hix, 2007.

¹⁴⁰ *Ibid*, p.24

¹⁴¹ *Ibid*, p.25

¹⁴² Hix considers that as in all democratic systems, demands within the EU incur due to the complex network of public and private group out of which each rivals to influence decision making and policies creation and execution processes with the aim to promote own interests and goals. Exactly that dimension related to governed democratic systems determines the EU as *political system*.

¹⁴³ The EU policies comprehends almost every area of public policy; it is estimated that more than 80% regulation within goods, services and capital exchange is being defined by the EU; average annual number of proposed legal solutions within the EU is more than 100 which is significantly more than in other democratic systems; EU's law primacy over national and fact that it becomes partially part of national law; EU budgetary transfers to the member states; strong indirect influence of EU regulation to individuals, groups and member states; gradual member states jurisdictions takeover by the EU in different area.

It can be noticed that EU in Hix definition does not have traditional mechanism of nation state – *monopoly over legitimate coercion*.¹⁴⁴ However, if distinction between state and political system¹⁴⁵ is being accepted then it can be considered that *authorities, policies creation* as well as *policy itself* can exist without classical state and classical state authorities.¹⁴⁶

According to the third definition the EU is “*community of the states based on different model's elements*”.¹⁴⁷ Prokopijevic defines reality in which the EU is not state and it does not have characteristics of any unique and so far known model. In addition, that confirms its experimental nature. More precisely, the EU combines many different models having in mind that EU is neither unitarian state nor confederation nor federation but poses elements of all these models. As unitarian state it has common currency. However, that is also characteristics of federal states which also have other characteristics such are customs union, common market and common economic policies. The three latest characteristics are also characteristics of confederations whose another characteristic is evident in the EU – higher power of member states than EU itself at least so far. Prior to enforcement of the Lisbon Treaty there were three pillars of the EU and on such example elements of different models can be identified. Intergovernmentalism is element of confederal model that prevailed in former second and third pillar while in the first pillar prevailed federal elements in the context of organization and jurisdictions centralization of the EU institutions.

The Lisbon Treaty has eliminated pillars and therefore federal elements dominates nowadays even though (at the very end) decisions have been made by member states through (still) dependent community's institutions. Additionally, the EU is not closed club as some authors and politician suggest and presents but it is club in the context of possibility for particular member states to run own policies while some common

¹⁴⁴ Some political system author considered that political system cannot exist without the state. Therefore, Almond believes that legitimate coercion is state's monopoly and that political system should deal only with directions, volumes and conditions that affects legitimate coercion execution.

¹⁴⁵ Badi and Birnbaum for example refuse such compound and believe that state should be observed as unique phenomenon, innovation that occurred in specific geo-cultural contexts and therefore it is not the only and omnipresent manner of society management. Compare Hix (2007).

¹⁴⁶ The EU is new and complex political system which is quite decentralized. Decision making process is becoming more and more centralized in Brussels while coercion and other state duties mechanisms administration are still in force of each member state. European integration will apparently redefine the state's role within Europe but obviously transformation of the EU into the classical state will not be necessary. Although such transformation may not be politically feasible, it can also be noticed that globalization influenced beginning of state's role transformation (not only in Europe but beyond). Having in mind that European integrations are part of global transition it is possible that the EU will *become system of rules* within numerous region-states i.e. different economic units will function.

¹⁴⁷ Miroslav Prokopijevic, „Evropska Unija-uvod”, 2005.

policies have been adjusted only among those members states that had voluntarily accepted them.¹⁴⁸

Attempt of personal contribution to the EU defining based on *combination of elements* of previously mentioned points of view as well as *attempts of solving* numerous dilemmas has resulted with the fourth definition. It observes EU as *libertarianism (currently) restricted by the political system*. Creation of the EU i.e. first communities¹⁴⁹ as well as the process of further integration represented essential realization of the libertarian philosophy – creation of open society based on economic cooperation and conflicts prevention as respect of basic human right – *right to live* and all other from it derived rights. However, continuation of integrations process alongside higher domination of politics and creation of excessive regulation zone led to restriction of libertarian philosophy idea realization. Having in mind that such regulation is part of the political system and not new state (at this very moment), it is being considered that newly established political system restricted libertarianism on the EU's example. Native idea's regression implies creation of more abet system of rules.

Why?

The history of Europe has been determined by numerous armed conflicts. Simultaneously, the history of the Balkans points out that it is possible to boost European antagonisms to even higher level and continuously beset prosperity. The EU example indicates that establishment of the security defined area is the precondition of the economic recovery but also development of the respective actors.

Integration of the Western Balkans into the EU is almost identical process as integration of Europe after the Second World War but with time delay of half century.

Security defining and protection of the European area begun with 1948 and Western Union Defense Organization while encompasses with 1949 and creation of NATO which will remain European's security guarantee till today. However, it does not mean that EU itself as well as accession process do not have security dimension. Security contribution of the EU exists as influence on institutional, political, economic and social reforms process in potential member states. Potential conflicts can be prevented throughout broadening of European values, free exchange opportunities, creation of common interest area but also through functioning of the European institutions.

¹⁴⁸ It is about examples of Great Britain, Sweden and Denmark related to the EMU and Great Britain, Poland and Czech Republic related to the provisions of the Charter of Fundamental Rights as part of the Lisbon Treaty (Charter was also part of the Constitutional Treaty)

¹⁴⁹ ECSC, EEC and EUROATOM

Security represents an economic resource. Political, internal and external security produces direct economic benefits. Within European integration context respective benefits have been quite significant. First benefits assembly comprehends Foreign Direct Investments (FDI) inflow, Gross Domestic Product (GDP) increase, economy of scale increase, transaction costs decrease, elimination of internal customs expenditures, access to common market, trade creation within the Union, potential decrease of countries debt value as well as internalization of certain externalities. In addition, there are authors which add another element to this assembly – European budget transfers to the new member state.¹⁵⁰

The history of European integrations process points out benefits from its economic part. Each phase within economic integrations has resulted with the GDP increase as well as member states development (not identically, of course). Economic integrations phases have not meant economic growth per se.

Emergence and dynamic of economic growth have been positively correlated with the institutions development, liberalization and market opening. However, customs union, single market creation as well as monetary union creation have influenced continuous GDP increase.

Customs union has been created in 1968 and her long term effect was trade creation within the Union. Even though she had faced with two oil shocks, US dollar depreciation towards gold as well as of widening of the European currencies fluctuation margins¹⁵¹, customs union boosts EU trade to today's two-thirds of intra-European trade (out of total EU27 trade). Common market creation¹⁵² in 1987 also had positive impact on EU6 economies.¹⁵³ If first six states have been observed it can be noticed that during first five years (since creation of common market) every state experienced GDP increase.¹⁵⁴ GDP increase in comparison to previous year was within 0.78% (Italy, in 1992) to 9.8% (Luxembourg, in 1989). Average increase of GDP during observed period in Belgium, France, the Netherlands, Italy, Luxembourg and Germany was 2.9%, 2.7%, 3.1%, 2.4%, 6.8% and 3.1%, respectively. Based on EU6 example two dimensions can be identified. First, each member state has had GDP increase after common market creation. Second, GDP increase has varied from state to state. Aforementioned leads to the conclusion that GDP increase beside general positive effects of economic integration also

¹⁵⁰ Due to belief in market allocation and coordination mechanism it is considered that this element is not in the same rank with aforementioned elements of benefits assembly.

¹⁵¹ It relates to the situation as among European currencies as among them and US dollar.

¹⁵² Single market creation is being individually observed due to the fact that it represented elimination of major barriers. Additionally, on EU6, EU9 and EU12 examples are not being observed GDP changes periods just after membership due to pre-membership conditions in respective countries.

¹⁵³ Belgium, France, the Netherlands, Italy, Luxembourg and Germany

¹⁵⁴ Internationally Monetary Fund data (WEO Databases April 2011) for EU6, EU9, EU12 i EU15

significantly depends on type of the economic system and character of institutions within it.

First enlargement happened in 1973 when Denmark, Ireland and Great Britain joined and made EU9. The EU12 came to the scene after 1981 (Greece) and 1986 (Spain and Portugal) enlargements. Observing EU12 during five years period post 1987 can be concluded that these countries also had benefits from common market creation. Out of new EU12 member states the highest growth rates (in particular year comparing to the previous) were identified in Portugal (7.9%) and Ireland (7.7%) in 1990.

The average growth in the observed period in Denmark, Ireland, Great Britain, Greece, Spain and Portugal was 1.1%, 4.3%, 1.4%, 2.4%, 3.5% and 5.3%, respectively. It can also be concluded that more developed and economically powerful states have more benefits from the enlargement process. However, new member states also have benefits from accession and economic integration development. This has been confirmed in all enlargement phases.

In 1992 the decision about economic and monetary integration has been finalized. Besides, in 1995 happened new enlargement (Austria, Finland and Sweden) and EU15 has been formed. After final phase of monetary integration (2002) and introduction of euro as payment currency in notes and banknotes expectations were towards positive economic effects. Even though euro has been (and still is) a monetary experiment his contribution up to date is not doubtful. During first five years since euro introduction, first twelve euro zone members record positive GDP changes. The average GDP growth rates were at the level of 1.04%, 1.12%, 1.6%, 2.01%, 2.3%, 2.4%, 2.6%, 3.5%, 3.8%, 4.4%, 4.6% and 5.2% in Portugal, Italy, Germany, France, Belgium, the Netherlands, Austria, Spain, Finland, Greece, Luxembourg and Ireland, respectively. Denmark, Great Britain and Sweden which remained outside the euro zone (although they have fulfilled criteria) also recorded growth in the respective period. Respectively, that growth was at the level of 2.02%, 2.7% and 3.5%. However, in case of each country it is about quite important economies that have already been integrated into the European market as formally as essentially. Moreover, they also had positive effects from euro introduction due to new trade and resource allocation easiness. Finally, the fact that states out of euro zone record growth alongside different growth dynamics within euro zone can lead to the conclusion that monetary union but also membership per se solely the preconditions of potential growth.

Direct and fully precise quantification of benefits set is quite questionable ex ante. Aforementioned elements represents potential benefits that individuals, companies and society may have based on the EU membership.

Nevertheless, respective benefits achievement primarily depends on specific system's¹⁵⁵ institutional competitiveness and overall business environment. Data points out that states with more efficient and competitive institutions that favors the rule of law, efficient judiciary and equality upfront the law as well as protection of individuals from *majority's tyranny* achieve more significant results after the formal integration.

Accuracy of the thesis about positive correlation between institutions and business framework and achieved benefits based on membership can be found in experience of ten post-socialist member states. These countries became part of the EU in 2004-2007 enlargement.¹⁵⁶

The EU accession has been followed by abet development mechanisms such is FDI inflow increase. Having in mind respective countries experience and FDI inflow increase after the NATO accession it can be concluded that post EU accession leads to second FDI inflow increase wave. The very best examples are Czech Republic, Poland and Hungary as they joined the NATO in 1999 and joined the EU in 2004.¹⁵⁷ Even if it represents an abet mechanism it does not mean that membership (both, in EU and NATO) is attractive for FDI per se. Analysis of Czech, Polish and Hungarian data identifies FDI inflow increase in post membership period. If two years just after membership are observed it can be identified average FDI growth of 39.7%, 28.7% and 4% in Czech Republic, Poland and Hungary, respectively.

Post-socialist member state experience analysis indicates GDP growth in all respective countries after the EU accession. However, GDP growth has not been equal. During the three year's post accession period average growth rate varied from 2.5% to almost 11%.¹⁵⁸ The lowest average growth in respective period was in Hungary (2.52%). It has been followed by group of countries (Poland, Slovenia, Romania, Bulgaria and Czech Republic) with average growth rates of 5.5%, 5.73%, 6.12%, 6.4% and 6.42%, respectively. Finally, the highest GDP growth was recorded in Latvia, Estonia, Slovakia and Lithuania and in average it was 10.94%, 8.98%, 8.6% and 8.5%, respectively.

Beside aforementioned there are also other benefits.¹⁵⁹ Larger market access, economy of scale, lower transaction costs, innovations enhancement, country's debt

¹⁵⁵ The current system relates to nation state but in the future can be expected that regions or even cities become "system" with institutional competitiveness and attractive business environment. It is not a new development at all historically observed.

¹⁵⁶ It is being observed as unique enlargement due to same number of negotiation chapter. However, promise made to Bulgaria and Romania about their accession is not neglectable in this case at all. In addition, it is not neglectable especially in the context of enlargement process's demands in the case of the Western Balkans (it can be proved by Croatia's example).

¹⁵⁷ The remaining eight post-socialist countries joined the EU and the NATO in the same year – 2004.

¹⁵⁸ IMF data (WEO Databases April 2011); Eurostat data are partially different although it does not change rank in the most successful countries structure.

¹⁵⁹ More about benefits: Prokopijevic, Miroslav (2009) „Evropska unija uvod“, JP Sluzbeni glasnik, Beograd.

decrease, trade creation and externalities internalization encircles benefits set. However, respective benefits have different level of significance.

Access to common market is one of the main benefits from the EU membership. Founding and accession (prior to common market creation) countries experience analysis can confirm that. Moreover, the benefits are higher as respective state(s) has more competitive, more innovative and more flexible companies but also which has business enhancing environment. *Economy of scale* is an outcome of the EU's market size. It occurs due to the market's size and opportunity for higher sales alongside lower investments' fixed expenditures. *Transactions costs decrease* is the result of elimination of barriers and administrative procedures and processes. Respective benefit's effects have been analyzed in accordance to custom union, common market and euro zone creation experience. The key effect from this benefit's set element is increased profit due to the lower transaction costs followed by higher investments volume. *Trade creation* is also an important integration's effect. Expected and logical follow up of customs union existence is member states internal trade increase according to lower transaction costs.¹⁶⁰ Local level *externalities*¹⁶¹ can be internalized due to low transaction costs and marketable property rights.¹⁶² However, there are externalities that exceed marketability and property rights exchange possibility. Such externalities relates to situations that involves numerous states and whose objects are issues of vital importance for numerous individual and organized actors (terrorism, organized crime in border and cross-border areas, ecological incidents, traffic infrastructure and etc). *Internalization of these externalities* is possible in the EU according to principle of subsidiarity.¹⁶³

The EU budget transfers to the member state's budget have quite often identified as one of the benefits that Montenegro may have. Despite to the belief that their contribution is significantly lower comparing to the aforementioned benefits, their potential contribution should also be identified. Moreover, it is quite important to

¹⁶⁰ However, totally free trade would have even higher benefits. Totally free trade comprehends free trade without customs and non-customs barriers with the whole world. Free trade zone comprehends the same but only precisely determined territory and assumes free custom arrangements of its members with third countries (outside of the zone). Customs union assumes common custom policy toward third non-member countries.

¹⁶¹ Externalities represent certain activity's effects which are not covered by that activity's expenditures. Internalization of externalities implies inclusion of externality into the expenditure either by technology change or filter embedding or pollutions compensation payments.

¹⁶² Coase theory; Ronald Coase is an institutional economist that gave significant contribution with its property rights theory. He won Nobel Prize for Economics in 1991.

¹⁶³ Principle of subsidiarity is being usually interpreted as EU actions driver only if certain tasks can be efficiently solved through common activities than through individual states activities. Gordon Tullock considers this principle as part of wider principle of fiscal federalism due to which jurisdictions of the state should not be either lowered or increased from the level on which can be efficiently accomplished. Victoria Curzon-Price believes it should not be allowed to the higher level institution to take over task that can be equally solved by the lower level institution. (See: Prokopijevic, EU Uvod, 2005, p. 76-77.). In other words, state should not solve tasks that can equally successful or even successfully can be solved by individuals alongside the assumption of lower transaction costs and property rights marketability.

emphasize that they do not have influence per se and that sole reliance on transfers has long term negative effect.

Having in mind that Financial Perspective 2007-2013 is in force, that Montenegro will not become an EU member till its end as well as officially unknown content of 2014-2020 financial perspective, it can be concluded that precise quantification of EU's budget transfers to Montenegro is quite demanding.¹⁶⁴ However, it is possible to do that in hypothetical scenario of current Montenegrin membership in the EU and based on 2004/2007 accession states experience.¹⁶⁵

The assumption is that European transfers (as GNI percentage) to Montenegro¹⁶⁶ will be at the level of Bulgaria and Romania. This is due to the approximately similar development level.¹⁶⁷ However, three scenarios of potential average GDP percentage based transfers have been assumed for 2008-2013 period.¹⁶⁸ *First* is being based on aggregated experience of ten new member states. In average it is at the level of 2.34% of GDP (€70 million in absolute figures) and can be considered as pessimistic. *Second* or *optimistic* scenario is being based on experience of Bulgaria and Romania at it is at the level of 4.29% of GDP. Average absolute transfers value is at the level of €130 million. *Third* scenario is being based on the assumption of potentially higher transfers for Montenegro. It is *optimistic* scenario and in average it is at the level of 5.65% of GDP or average €170 million in absolute figures.¹⁶⁹

Regardless of the projections, it is assumed that absorption capacity of Montenegro is at the maximal level. Otherwise, the EU budget's transfer inflows will be significantly lower.¹⁷⁰

Cost price

¹⁶⁴ The EU public finances are divided into budgetary and credit part. Budgetary part comprehends *Midterm Financial Perspectives* (MTFP) and the *EU budget* as MTFP's implementation and practical execution. Precisely, MTFP are arrangement about 5-7 years budget priorities, planning instrument in the midterm and EU expenditures estimation instrument. Up to date MTFP's: Delors I package (1988-1992), Delors II package (1992-1999), Agenda 2000 (2000-2006) and Financial Perspective 2007-2013. Within Financial Perspective 2007-2013 have not been precised resources for Montenegro based on membership which indicates that Montenegrin membership will be defined in new financial perspective 2014-2020 as from budgetary as from financial aspect.

¹⁶⁵ It is assumed that Montenegro joined the EU in 2007 and average estimations are given for 2008, 2009, 2010, 2011, 2012 and 2013.

¹⁶⁶ According to the FP 2007-2013 it is definite that Montenegro will be net EU budget resources recipient during the first three years of membership due to the fact that Montenegrin GNI per capita is below 75% of EU GNI average. Probably Montenegro will remain net EU budget recipient for some more years.

¹⁶⁷ GDP as indicator is being used due to the lack of precise data for Montenegro. IMF's data ("World Economic Outlook Database") have been used for Bulgaria and Romania.

¹⁶⁸ Scenarios have been developed through research under papers and projects creation activities at Institute for Strategic Studies and Prognoses.

¹⁶⁹ These scenarios are optimistic i.e. pessimistic from the budget inflows rather than development effects.

¹⁷⁰ It is also true that outflow from the Montenegrin budget will be lower due to obligations such are co-financing what may influence better budgetary position of Montenegro comparing to the EU. However, certain expenditures borne by integration do not have correlation with absorption capacity and may be progressive throughout the years.

The European integrations process is usually being observed as costless process as for individuals, companies, states as for overall society. However, the starting premise in economy and society is that “*there is no free lunch*”¹⁷¹ Montenegro's development philosophy which has been defined owing to the Montenegrin Economic School¹⁷² believes that each form of flows¹⁷³ has been followed by certain expenditures.

Respective view should also be a guideline for the EU integrations assessment as in pre-accession as in post-accession i.e. full membership period. However, post-accession expenditures may be more interesting especially when *direct* - Montenegrin tax payers' duties - but also *indirect* obligations - potential membership outcomes - are observed. Expenditures justification analysis must not be based only on investment and return ratio but more on identification and comparison between *level* and *expediency* of investment and profit. In that context it is possible to anticipate direct costs ex ante while indirect costs are not possible to identify precisely ex ante.

Direct expenditures of Montenegrin membership in the EU can be identifies as direct contributions to the European budget.¹⁷⁴ The EU member states contribution are the basic mechanism for the EU policies financing. Each member state is obliged to make payment into Own Revenues System i.e. European budget. These revenues have been contributed in accordance to four bases: *Traditional Own Revenues* (customs, agricultural levies and sugar levies and they make approximately 13% of EU's budget revenues)¹⁷⁵, *VAT based contributions* (approximately 11% of revenues), *GNI based contributions* (approximately 75% of revenues) and *correction and other mechanisms* (approximately 1% of revenues).¹⁷⁶

¹⁷¹ Sentence is belongs to the Robert Heinlein author of the „The Moon is a Harsh Mistress“ but it was also used and popularized by Milton Friedman.

¹⁷² Montenegrin Economic School is a school of libertarian philosophy founded by Veselin Vukotic. Alongside unique approach especially when specific institutional solutions implementation in Montenegro is about this school is founded on Austrian Economic School (Menger, Mises, Hayek), monetarism's ideas (Friedman), property rights theory (Pejovich, Gams) and new institutional economics (Coase) principles. Montenegrin Economic School positioned as its aim to develop new paradigm that comprehends holistic approach, synergy and risk and is based on philosophy of openness.

¹⁷³ This includes as *transaction* (two-side and voluntary) as *transfers* (one-side and without voluntary principle).

¹⁷⁴ The remaining integrations' expenditures are considered as indirect.

¹⁷⁵ These are not EU's revenues due to the fact that fiscal systems are under member states control. However, it is a usually used phrase.

¹⁷⁶ Data are from the Directorate General for Budget: „European Union-Public Finance“. Correction mechanisms comprehend so called *British rebate* but also some correction mechanisms for the Netherlands and Sweden. Share of mentioned categories of budget revenues is estimation for 2011. There are also some other revenues such as previous year budget surplus, interest rates from member states due payments delays, fees, personal income tax for the EU official as well as non-member states contributions to certain programs.

According to estimations Montenegro would – in hypothetical membership scenario – pay 1.06% of its GDP in Own Revenues System.¹⁷⁷ Neglecting of optimistic and pessimistic scenarios of the EU budget transfers to Montenegro lead to realistic *net budgetary balance* between the EU and Montenegro of 3.23% of GDP.¹⁷⁸ Respective position in absolute terms would be approximately €98 million during observed period.

Such observation would lead to the conclusion that EU integration is economically profitable process in the first iteration. Nevertheless, net budgetary balance is not reliable indicator of financial benefits from membership.

Beside direct expenditures which can be quite precisely quantified the integration's process overwhelms indirect i.e. *hidden* integration's expenditures.¹⁷⁹ *Net financial position* concept enables their up to certain extent identification.

Nevertheless, *net financial position* may quantify only certain indirect expenditures of membership such are expenditures related to the EU law implementation, tax revenues loss due to transfer to partially inefficient VAT collection system (without border control), co-financing of EU budget funded projects, pre-financing of direct CAP payments, national contributions to direct payments to farmers as well as the EU institutions payments.¹⁸⁰

Therefore, estimation is that Montenegrin net financial position will be negative and the level of 2.2% of GDP during the first three post accession years.¹⁸¹ Absolute levels of aggregated Montenegro's expenditure would be approximately €67 million during hypothetical membership period. On the other hand, it is possible to record indirect expenditures decrease in the following membership period.

Nevertheless, not even net financial position can fully quantify the remaining indirect expenditures and their influence to Montenegro. The only comprehensive manner is ex post quantification of these expenditures. Such quantification would be

¹⁷⁷ Calculation differences are neglectable and all are at the level above 1% of GDP as direct expenditure level. It is assumed that Montenegro joined the EU in 2007 and therefore estimations are for the stated five year period.

¹⁷⁸ *Net budget balance* is difference between member state's payments into Own Revenues Systems and EU budget payments to the member state's budget (Montenegro hypothetically). Positive net budgetary balance means higher payments from the EU budget.

¹⁷⁹ Quantification is possible in hypothetical case of Montenegrin current membership i.e. application of FP 2006-2013 due to the fact that new financial perspective's details (2014-2020) are not officially announced.

¹⁸⁰ Tax revenues loss can partially be substituted with environments attractiveness and business activities increase (therefore VAT budget revenues); insufficiently efficient control can cause revenues losses due to the fact the Montenegro has more that 70% of its VAT revenues from the import sources (in 2007 and 2008 VAT represented 55.3% and 53.14% of the total tax revenues in Montenegro); projects co-financing means direct expenditures as from budget as from certain participants in the projects while it can also mean continuous state's paternal behavior due to state's co-financing obligations; Montenegro receives resources for CAP direct payments from the EU budget with a year delay while it is obliged to give subsidies to the farmers in a current year; national direct farmers payments supplements can be subject of politicians discretionary power and can be used for interest groups attaining; ECB payments are done by Central Bank of Montenegro while EIB payments have been done through Ministry of Finance.

¹⁸¹ Mrak, Mojmir; Rant, Vanja (2007); Vojinovic (2007); Own calculations.

based on experience analysis and would have non premises. Main deficiency of ex ante cost-benefit analysis is insufficient accuracy of certain expenditures quantification. The remaining indirect expenditures are such that their decrease cannot be expected throughout membership period increase. On the contrary, their increase can be expected in the long term at least based on the current developments within the EU. The most protruded among them¹⁸² are tax harmonization and the EU law development.

Tax harmonization within the EU is an indirect expenditure that cannot be quantified and its influence to the economic and social development is quite negative. At the very beginning, distinction between tax harmonization, tax cooperation and tax competition should be made. Tax harmonization is a process of establishment of unique tax rates in the EU for specific taxes while tax cooperation includes issues such are similar manner of profit calculation or the same VAT rules appliance. At the end, tax competition represents institutional competitiveness mechanism oriented towards capital attraction and business development.¹⁸³ Creation of unique tax rates on the EU level i.e. unification of fiscal policies has and will have negative effects as on businesses as on individuals. According to significant capitals' tendency to identify new earning margins, the loss of corporate and individual tax revenues can be an unintended harmonization's consequence. Moreover, if tax is being considered as price for state's services provision than it is not even *morally* to consider tax systems unification. The key reason is different quality of provided services between the states. Exactly this is seen as deficiency from the tax repressive states administration point of view. And again the reason for such point of view is quite simple – such rigid administrations see flexible political elites in institutionally competitive states as competition which will assess their decisions quality through own activities. Finally, it is necessary to answer can someone and if yes, who to stop tax burden increase in the EU if it coerced harmonization start eventually? The importance of this expenditure can be additionally observed if the EU's current tax burden level is perceived but also that taxes reductions cannot at least be expected in France and Germany – integrations' drivers. The European integrations' general trend since the first enlargement is overall tax burden increase. However, a bit encouraging is situation in certain old but especially certain new member states.¹⁸⁴ Those member states may create the *blocking minority* towards tax harmonization.

The EU law development is relatively measurable expenditure. Estimations points out is potential trend to even 4% of GDP in case of Montenegro while 2-3% of GDP out of that can be related to the environment protection issues.¹⁸⁵ Respective expenditure relates to legal infrastructure's development especially in the areas of

¹⁸² Besides aforementioned also are possible sovereignty loess, veto right elimination, complicated the EU exit procedure as well as rent-seeking increase.

¹⁸³ Lambert, „Red Lines, White Flag, White Lies, Blue Flag? - The truth behind Tax Harmonization“, 2007.

¹⁸⁴ The total tax burden in EU27 is being slightly decreases after the final enlargement

¹⁸⁵ Tupy: „EU Enlargement – Costs, Benefits and Strategies for Central and Eastern European Countries“, p. 2; Vojinovic: „Fiskalni tokovi izmedju Crne Gore i Evropske Unije u uslovim pridruzivanja“.

environment protection, consumers protection, social rights, judiciary, agriculture and etc. Efficient rights protection mechanism is the precondition of further Montenegro's development. Nevertheless, excessive regulation and control can be net economic expenditure for Montenegro. In addition, it has been estimated that further development and future implementation of the EU law can cost Montenegro up to 2% of GDP annually. The key problem is that excessive and repressive regulation and market solutions withdrawal can repel investors which could cost Montenegro even over 2% of GDP annually. Besides regulation's implementation expenditure level its purpose is quite often unclear. As one of protruded examples in respective context is Regulation 2257/94 which prescribes size and shape of bananas that can be sold within EU.¹⁸⁶ Such solutions alongside any other quota, non customs barriers, subsidies and etc. introductions can have significant negative economic results. Estonia for example had to do aforementioned after the EU negotiation and also had to introduce new customs tariffs towards the third countries.¹⁸⁷ Results were visible regulation's implementation expenditure but also more invisible but expected increase of food prices and life quality decrease in Estonia.¹⁸⁸

The European idea's reinterpretation

The famous Balkan's tendency to and fascination with myths repeats in the case of the *EU myth*. Precisely, it is about aggregated myths related to the European integrations process. Mythological holding starts with the myth that the EU is about to solve all social but also problems of different separate interest groups which will financially contribute on that bases. It continues with severe belief into the European's social model ideal as well as its high "*morality*". Finally, it encircles with unquestionable belief in Europeanism as Montenegro's transitions final destination. Existence of respective mythological holding related to the European integrations idea leads to the necessity of idea's reinterpretation.

The Europeanism's mythology basic myopia is related to the *problems solution*. Solely institutional design whose philosophic, ideological and practical framework is freedom can efficiently solve social problem. The European integrations process is enhancing mechanism but not guaranty of such system's creation. In addition, when interest groups profits are about that can be quite dangerous for those groups unless it is additional mechanism of their qualities and capacities development.

¹⁸⁶ Regulation prescribes that bananas must be at least 14 cm long and that must not be *irregularly shaped*. It is unclear how and by whom *regular* banana shape is being prescribed. In addition, this may lead to the conclusion about certain discretion power decision which favors banana import from certain state for example Ecuador because of certain interest groups.

¹⁸⁷ It is about 10 794 custom tariffs in total.

¹⁸⁸ Sally, „Free Trade in Practice, Estonia in the 1990's“, 2000.

Mythological holding also comprehends *belief in the European social model*. Nevertheless, it is overseen that there is no unique social model either in the EU or in Europe. Historically, social models have been diverse while antagonism of British and French model is being emphasized. Nowadays situation is even more diverse throughout Europe. Erhard's and Adenauer's German social-market model, Norwegian social resource based model¹⁸⁹, Celtic liberal model, Italian socialism model, Estonian market model and many other welfare state models represents social model's holding within the EU. Majority does not see inconsistency and nonexistence of unique social model but rather incline to the most acceptable model for certain interest groups (farmers, unions and etc.) which also creates discretionary business enhancement network. As Klaus noticed majority can accept market models only alongside disqualifying adjectives. Ironically, exactly then those models cede to be market oriented.

European integration's process is principally journey rather than final destination. Destination is quest for possible solutions and constant changes as in general as in the respective model. Simultaneously it means that even Europeanism (as every previous *-isms*) represents latent danger due to its positioning as unquestionable, ideal and only ideological platform of existence and success. Europeanism represents belief in centralization, creation and existence of unique European identity (beyond national identities), administrative replacement of the nation states by supranational institution, further policies regulation (especially financial, economic and fiscal sphere) and comprehensive coordination. The key myopia is related to replacement of Europeanization with the Europeanism. It is exactly the same as in case of replacement of globalization by globalism. Europeanization as well as globalization implicit nation state borders erosions, partial sovereignty loss, identity's importance strengthening, freedom increase, wealth increase and life quality's development and growth. Precisely that freedom increase up to *n-1* is Europeanization's and globalization's label.¹⁹⁰

Finally, the impression about European integrations and that overall process should be based on belief in European integrations rather than in sole European institutions.¹⁹¹ Precisely, European institutions are not and must not be motive for and essence of integrations. However, they are necessary and their quality and existence essence can be estimated based on free market and free exchange development and defense from protectionism; based on positive balance in favor of positive effects they produce versus their functioning losses and based on whether the European integrations idea will ever reflect real citizens' interest rather than only of the political elites.¹⁹² If European institutions functions in the respective direction

¹⁸⁹ Formally not a part of the EU but due to the involvement in European economic area as well as acceptance of the EU's law can be considered as its part.

¹⁹⁰ If it is possible at all to divide these two processes and to observe them separately.

¹⁹¹ Klaus, Vaclav (2010) „Evropa i EU pogled politicara i pogled ekonomiste“, Official Gazette, Belgrade, p. 44-

¹⁹² Ibid, p. 41.

it can be expected to have n level of freedom within integrated Europe. Freedom of coercion, freedom of exchange, freedom of opinion, freedom of difference and all other freedoms should be the bases of the transformed European but also Montenegrin social system.

Words of conclusion

Transition and the EU journey is a process of economic, political, security and mental reforms. Transition's motive should be establishment and strengthening of rule of law, establishment and strengthening of individual, economic and political freedoms as well as higher life quality. Solely than cost price of the EU integration has its counter value – freedom and wealth.

Additionally, it is more than evident that imposition of *one size fits all model* can limit freedom of the member states. That key European “export product” is facing with the failures in the context of development and growth provision. Therefore, the only mechanism that can “secure” development within the EU system is creation of opportunities for friction of ideas and institutional solutions.

During its European journey Montenegro is about to face with significant challenges as in pre-accession as in post-accession period. Pre-accession challenges comprehend current individuals' activities and preparation for open market play, negotiation process, explication of benefits and costs to the public and extremely competition waves. In other hand, within post-accession challenges outshines the challenge of protection and further enhancement of libertarian institutional environment. Potential positive responses to the respective challenge forms are *external* (cooperation among states – and their parts and regions – that favors such solutions) and *internal* (constitutional and legal mechanisms of protection such is referendum for institutional sovereignty's vital issues). Current developments indicate that external forms of response may have higher chances to succeed especially due to the future changes.

Beside aforementioned, individuals and society must be ready for the potential transition of 21st century's EU. Potential EU's future estimation identifies transition of the EU into the *region-state* assembly as economic (not political) units which will be *framed by the European system of rules*.¹⁹³ Region-states can be part or even whole nation-states¹⁹⁴ but also can be beyond their frames creating special *economic unit of openness*.¹⁹⁵ Their key determinants are openness, difference and inclination

¹⁹³ Is it a new Brussels „Empire“ as defined by Vukotic?

¹⁹⁴ Ireland is a region-state example that matches the nation-state borders. Nation-state is being used as a term even citizen's concept of each one is being accepted.

¹⁹⁵ Ohmae: „Nova globalna pozornica, Izazovi i prilike u svijetu bez granica“, MATE (2007.), p. 92-95. Ohmae adds that *powerful definition of the region-state* the one that describes her as *unit for creation of positive practical cycle; the more people come the higher differences in their education and skills are, difference of the*

to changes. It seems that new European transition is desirable future trajectory. This is especially valid when the great failed civilization forms (The Roman Empire, Charlemagne's Europe, Napoleon's Europe, Hitler's Europe) based on so called *hedgehog logic*¹⁹⁶ are being observed. Finally, development requires from the EU (therefore, from Montenegro) and its elements to adopt flexibility, openness and voluntary and free forms of integrations.

LITERATURE:

1. Brenton, Paul: „*The Economic Impact of Enlargement on the European Economy: Problems and Perspectives*“, Centre for European Policy Studies, Working Document No.188, Brisel, oktobar 2002.
2. Colombatto, Enrico: „*International Trade and Money*“, predavanja, handout i biljeske, Postdiplomske studije „Preduzetska ekonomija“, VIII generacija, Podgorica, 2007.
3. Ekonomski institut Zagreb: „*Pristupanje Europskoj uniji: ocekivani ekonomski ucinci*“, Zagreb, 2007.
4. European Commission, Directorate General for Budget: „*European Union – Public Finance*“, 2008.
5. European Commission: „*EU integration seen through statistics*“, 2006.
6. European Commission, Directorate General for Economic and Financial Affairs: „*Convergence Report 2008*“, Provisional layout of European Economy No. 3/2008, Brisel, 2008.
7. Eurostat: „*Key figures on Europe*“, 2007.
8. Grauwe, Paul De: „*Economics of monetary union*“, Oxford University Press, Oksford, 2003.
9. Grevs, Robert „*Grcki mitovi*“, Nolit, Beograd. 1995.
10. Hamilton, Daniel S; Quinlan, Joseph P: „*Globalization & Europe: Prospering in the New Whirled Order*“, Centre for Transatlantic Relations John Hopkins University, Vasington, 2008.
11. Hiks, Sajmon: „*Politicki sistem Evropske Unije*“, Sluzbeni glasnik, Beograd, 2007.
12. Hindley, Brian; Howe, Martin: „*Better Off Out? The benefits or costs of EU membership*“, Institute for Economic Affairs, London, 2001.
13. Jovetic, Ivan: „*Razvoj Evropske Unije – od ideje do integracije*“, Preduzetska ekonomija, Vol.11 (ISSN 1451-6659), Postdiplomske studije „Preduzetska ekonomija“, Podgorica, 2006.

region itself is being increase throughout time (p. 95). Ohmae reminds that region-states existence is not new form at all due to the past forms such are Venice or Hanseatic League in the Northern Europe (p. 93). Moreover, first forms of govern society organizations were city-states (Uruk, Nippur, Babylon and etc) in early Egyptian and Mesopotamian civilization (*authors remark*).

¹⁹⁶ Vukotic (2004)

14. Jovetic, Ivan: „*Transatlantska ekonomija i Crna Gora-potencijalni benefiti*“, magistarski rad, Ekonomski fakultet, Postdiplomske studije „Preduzetnicka ekonomija“, Podgorica, 2010.
15. Klaus, Vaclav: „*Evropa i EU pogled politicara i pogled ekonomiste*“, JP Sluzbeni glasnik, Beograd, 2010.
16. Klaus, Vaclav; Schwartz, Pedro: „European Union or Not?“, The Centre for Research into Post Communist Economies, London, 2001.
17. Laar, Mart: „*Leading a successful transition: the Estonian miracle*“, European View – Transition to Democracy Vol.7, str.67-74, Springer, Hajdelberg, jun 2008.
18. Lambert, Damon: „*Red Lines, White Flag, White Lies, Blue Flag? - The truth behind Tax Harmonisation*“, Global Vision, London, 2007.
19. Mrak, Mojmir; Rant, Vanja: „*Financial Perspective 2007-2013: Domination of national interests*“ EU-Consent, EU-Budget Working Paper No. 1, jul 2007.
20. Ohmae, Kenichi: „*Nova globalna pozornica, Izazovi i prilike u svijetu bez granica*“, MATE d.o.o., Zagreb, 2007.
21. Prokopijevic, Miroslav: „*Evropska Unija - uvod*“, JP Sluzbeni glasnik, Beograd, 2005.
22. Sally, Razeen: „*Free Trade in Practice, Estonia in the 1990's*“ Central Europe Review, jul 2000.
23. Tupy, Marian L: „*EU Enlargement – Costs, Benefits and Strategies for Central and Eastern European Countries*“, CATO Institut, Policy Analysis No.489, Vasington, septembar 2003.
24. Vojinovic, Ivana: „*Fiskalni tokovi izmedju Crne Gore i Evropske Unije u uslovim pridruzivanja*“, magistarski rad, Ekonomski fakultet, Univerzitet Crne Gore, Podgorica, 2007.
25. Vukotic, Veselin: „*Koncepcijske osnove novog ekonomskog sistema u Crnoj Gori*“, Institut za strateske studije i projekcije, Podgorica, 2005.
26. Vukotic, Veselin: „*Teorijske osnove crnogorske ekonomske skole*“, decembarsko predavanje studentima svih generacija „Preduzetnicke ekonomije“ u okviru programa „21.vijek-Docek Novog Milenijuma“, Podgorica, 1999.
27. Vukotic, Veselin: „*Opasne rijeci*“, CID, Podgorica, 2006.

Tanja Bošković^{197*}

The European Union as determinant of economic cooperation in the Balkans

Abstract: *Old CEFTA played a very important role in EU accession. This paper argues that the purpose of CEFTA is to enable its members to enter the EU more easily, and thus serves as an instrument of EU accession. Reference is made to the most important benefit of the old CEFTA, which was the common preparation for integration to the EU's market. By analysing the impact of the old CEFTA as a pre-accession instrument, an analogy is made with the new CEFTA, where emphasis is placed on its role as a regional cooperation instrument. The question arises whether new CEFTA will be able to follow old CEFTA's role in offering a step towards the EU. To put the question another way, whether it will reproduce its central European role or redefine itself in South East Europe.*

Keywords: *trade liberalization, regional trade agreement, CEFTA, EU integration.*

Introduction

Despite all differences and frequent conflicts, the Balkans is the region in Europe where attempts have been made for more than hundred years to establish multilateral cooperation of the countries in many fields. The European Union policy has here a special importance and makes efforts to improve cooperation in the Balkans by regional policy within the stabilization and association process as a framework for EU negotiations with the Western Balkan countries. The stabilization and association process is at the same time bilateral and regional process which establishes relations between comprised countries on the one hand, and on the other hand encourages their mutual regional cooperation.

One of the chapters of the Stabilization and Association Agreement is devoted to the regional cooperation with the statement that the party shall actively promote the regional cooperation. Constructive regional cooperation is accepted as an indicator that indicates a willingness of a country to integrate into the EU. In order to show the willingness of the countries, the European Union proposed a creation of a several regional integrations. One of them is the Central European Free Trade Agreement (CEFTA). Experience from other countries suggests that regional networking and developing of regional forms of cooperation are good preparation for European

* GIZ Open Regional Fund Foreign Trade Promotion

integration. CEFTA is not only about trade. It also calls for crucial structural economic reforms that are also necessary for EU accession process. The more aligned a party is with the *acquis*, the closer it is to smooth implementation of CEFTA agreement and vice versa.

It is evident from the Preamble of this Treaty which states that the goal of the signatory countries is to join the European Union and that CEFTA is a proven way for the EU membership, as best shown by the example of the Czech Republic, Hungary, Poland, Slovakia, Slovenia, Bulgaria and Romania.

Historical dimension of the cooperation in the Balkans

For a long time, the former socialist bloc countries were isolated from the international division of labor. Almost the entire foreign exchange trading has been done through the Council of Mutual Economic Assistance (CMEA).

The loss of this market provoked transition economies to face the decline or have undertaken significant reforms, which gave a crucial role to foreign trade in development programs. Transition economies that have managed to liberalize trade to a great extent and to direct it in a higher degree towards developed market economies now have better economic performance.

Centrally planned economies were in a special position from the point of the international division of labor and technological revolution. From an overall perspective, they were relatively less involved in the world economy. Most foreign trade, financial and other flows have been carried out within the Council of Mutual Economic Assistance (CMEA), which guaranteed a stable external position, but on the other side, it reflected also a certain commodity in economy due to the absence of effort in terms of determining powers in the market. In fact, one of the important reasons of stagnation and inefficiency of the economy should be linked with the self – sufficiency concept of development and avoidance of objective laws of the world market.

Reasons for exclusion of socialist countries from the international trade are in the nature of relations within the CMEA:

- bilateralism in international relations;
- derogation of economic dependence (the price was a calculating unit only);
- state monopoly on foreign trade;
- dominance of central planning that had to be adapted to all subjects.

Foreign trade relations were, in fact relations between national states as entities. For a long time any form of trade with developed capitalist countries has been treated as a necessary evil. The fact that about 60% of the total foreign trade exchange of centrally planned economies has been carried out within the CMEA is more about the self-sufficiency development of these economies than about the

internationalization of production processes on the basis of the principles of values. Foreign trade has been fully subordinated to the internal development. Export has served only for the payment of import. The effects of export on domestic economic activity - the volume and structure of production, employment levels were negligible. The logic of central-planning systems was the logic of quantity and not the logic of value and quality.

Ignoring the quality was one of the ways to ensure in the short-term period a large production and impressive statistical results. This led to the economic, technical and technological stagnation compared to the Western countries. The economies of these countries were becoming less competitive what made a retroactive effect on their closing. This was possible in terms of self-sufficiency development when there was no compulsion to make production that is more efficient. Central planning and self-sufficient development have resulted in the absence of competition, and competition is one of the most important factors that promote the increase of efficiency and making of innovations.

In the seventies, socialist economies have resorted to borrowing in the West in order to thus accelerate technological progress. However, technological progress has not been made, but the socialist countries increased indebtedness. Exchange within the CMEA is reduced to economic relations between the countries in which use-values dominate, but not values.

Structural imbalances are common occurrence in the conditions of closed economies. They occur when the export sectors, or even larger companies could not sell their products, whose unit costs are so high that they cannot compete in foreign markets, not even without high protection in the domestic market. In this way, they spent scarce investment resources, and costs are passed on to customers.

The system itself has encouraged a greater closure of the CMEA countries. A particular problem was the need to expand the market due to suddenly overflowing capacities whose placement was not possible in the markets of the CMEA countries because of the almost identical lines of development. In this way, the system has encouraged the breaking but has not encouraged the tight relationship, as a primary objective.

One of the main goals of the CMEA, to accelerate the economic growth of member states by developing the international socialist division of labor based on specialization and cooperation, was never realized. The share of foreign trade in GDP in capitalist countries was constantly growing, while stagnating or even declined in the CMEA countries. As illustration, the centrally planned economies accounted for 1/3 in world production, and in global foreign exchange with less than

10%. Likewise, the Soviet Union created 20% of world industrial production and its share in world exports was about 5%.

On the other hand, economic relations and integration processes within the CMEA took place very slowly and with scarcer commodities, financial and technological connections than those in the European Union.

Self-sufficiency development of centrally planned economy could only be overcome by more rapid inclusion of these economies into the global division of labor and international relations that are based on production and exchange value.

Transition and trade integrations

After the collapse of central planning system and the disintegration of former markets, their integration into the world economy became the priority. Despite many dilemmas associated with the transition process, one thing on which everyone agrees is: foreign trade liberalization is an essential part of the reform process.

Among the former socialist countries, cognition related to the necessity of foreign trade liberalization was first manifested in Czechoslovakia, Hungary, Poland, the Baltic republics and Yugoslavia. These countries confirmed the rule that the highest economic performance achieved countries that had export-oriented development, which were the most opened for foreign investment and with liberalized imports. In fact, it turned out that between the liberalization of foreign trade and the success of the transition there is a great conditionality and interdependence.

Thus, the general level of liberalization that some transition countries have achieved was a decisive factor for long-term growth of their economies. It is for this reason that today two groups of countries are clearly separated. First group includes Slovenia, Hungary, Slovakia, Czech Republic, Poland, Lithuania, Latvia and Estonia, and in this group, although with the significant lag can be included Bulgaria and Romania. These countries are indeed, some of them more some of them less, a confirmation of successful completion of the transition. Regardless of how much they were initially affected by anti-communism and nationalism, they succeeded to shorten the time, curb the negative socio-economic and political developments and perform key internal economic and political reforms.

To the second group of countries belong the SEE countries - Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro and Serbia. These countries were much more difficult to address the increased tensions, both at political as well as at the socio-economic level of society. The relatively modest democratic potential and

capacity, as well as a deeply problematic social capital, slowed the crossing from one system to another.

It is clear that SEE countries have the same legacy of economies in transition, but also that they were economically dependent on each other over a long period of time. Economies have weak competitiveness on the world market, high unemployment rate, labor force is not educated enough or trained, and social problems are high. Although they had high growth during the last period, the rate of such growth is more a consequence of low initial base. It is therefore justified the need for the regional connection on the road towards European integration. It can be said that economic and social structures of the countries of this region have the character of connected vessels, because the condition of one economy is very much reflected on the economies in the neighborhood because of the high level of mutual trade exchanges, and the same or similar vulnerabilities.

The cornerstone of the integration process of these countries into the world economy is the multi-level liberalization aimed at liberalization of trade, by removing barriers to trade flows. In the beginning, this dynamic has taken shape of a gradual re-integration of Southeast Europe into the World Trade Organization, but more important than that is that this process occurred even at the regional and sub-regional level, by trade liberalization with the European Union and among the countries of Southeast Europe.

EU as a factor of regional cooperation in the Western Balkans

The European Union has been founded on the principle of regional cooperation and the same principle is set as a mandatory precondition for further integration of Southeast Europe into the European Union. The Stabilization and Association Process was launched in May 1999 expressing the long-term commitment of the European Union to help countries on the path towards full membership.

Albania, Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia and Kosovo (under UNSCR 1244) are covered by the SAA as part of the EU's enlargement policy, which prepares the entire Western Balkans' EU integration. The process is both a bilateral and regional on the one hand, which establishes relations among the countries covered by the EU and on the other hand, encourages regional cooperation among them. If we consider it as an instrument for a regional approach and for a regional policy, we can see CEFTA as a mechanism for regional cooperation, a condition set in the SAA and in the Stabilisation. Not contrary to the notion of CEFTA as an instrument of the SAA, economic cooperation in the region strengthened by CEFTA is at the same time the foundation, the instrument and the purpose of CEFTA.

It helps countries of the region to build their capacity to adopt and implement the European standards, including the *acquis communautaire* as well as the international standards.

In the Annual Progress Report, the European Commission annually assesses about the extent to which the Western Balkan countries are ready to move closer to the European Union. The first stage in this process includes various steps towards the establishment of formal contractual agreements of each country with the EU in the form of the Stabilization and Association Agreement. Conclusion of such agreement depends on whether the country has made sufficient progress in political and economic reforms and if sufficient administrative capacity is shown. The Stabilization and Association Agreement is a political commitment also for signatory countries and the EU. Signatory country is bound to achieve during transitional period a series of reforms in order to meet EU standards, with the prospect of achieving the status of an associate and then, finally, and the full integration.

One of the chapters of the Agreement is devoted to the regional cooperation with the statement that the Signatory country shall actively promote regional cooperation. Constructive regional cooperation is accepted as an indicator that indicates the willingness of some countries to integrate into the EU. Experience from other countries suggests that regional networking and developing forms of regional cooperation is a good preparation for European integration.

All countries of South-East Europe have declared that they want to be members of the European Union. In order to become the members, they must meet many conditions and to prove themselves in everyday life and show their commitment to European values. One of these values is also regional cooperation. In order to test the readiness of the Western Balkan countries to meet the value, the European Union proposed the creation of a several regional integrations. One of them is the Central European Free Trade Agreement (CEFTA).

CEFTA as an instrument of regional cooperation

CEFTA was founded in 1992 in Krakow when the founders, Poland, Czechoslovakia and Hungary, signed the Central European Free Trade Agreement. CEFTA's main objectives were to establish a free trade area promote investments, and integrate economies. In parallel with CEFTA, the founders liberalized their trading relations with the EU. Trading integration is very important with regard to relations with the EU, since it represents the indicators of economical integration.

Implementation of the Agreement began in July, 1994 and was related only to non-agricultural products. Initially, it was envisaged to do a complete liberalization of

trade in agricultural products in 1998. It did not happen because all countries had surpluses of agricultural products and all had various measures to support agriculture, so no country wanted to pose a risk that agricultural products from other countries would suppress domestic. Thus, trade barriers for agricultural products were partially reduced in the second half of the nineties, but have also remained relatively high.

CEFTA has spread later to some Balkan countries. Slovenia joined in 1996, Romania in 1997, Bulgaria in 1998, Croatia in 2002 and Macedonia in 2006. After 2004, when the Czech Republic, Slovakia, Hungary, Poland and Slovenia joined the EU and abandoned CEFTA agreement, the name CEFTA became a synonym for Balkan integrations and the agreement was finally signed in December 2006.

By signing the Memorandum of Understanding on Trade Facilitation and Liberalisation, the SEE countries have opted to create a network of bilateral free trade agreements. However, approaches have varied greatly, creating complicated trade relations. In an attempt to harmonize the agreements, some important elements have remained unregulated, such as public procurement, services, investments and intellectual property rights. In the Action Plan for 2005 and on the meetings of the Working Group on Trade of the Stability Pact, the countries decided that bilateral agreements would be replaced by unique regional free trade agreement and that CEFTA can serve as a good basis for such an agreement.

The new CEFTA, which was adopted in 2006, is a comprehensive, modern and ambitious agreement. The agreement contributes greatly to the economic and political development in SEE countries, but is at the same time a test for administrative capacities and political will.

CEFTA is not just a trade agreement that has economic significance but also the way for the countries in the region to achieve its goal towards EU accession. It is evident from the Preamble of this Treaty which states that the goal of the signing countries is to join the European Union and that CEFTA proved to be the right way for EU membership as the best shown in the example of the Czech Republic, Hungary, Poland, Slovakia and Slovenia, and Bulgaria and Romania .

New modern rules have been taken from the EU rules and are intended to allow faster inclusion of the region in the EU. Also, in the agreement are gradually introduced services, investments, intellectual property and public procurements. These items have been taken from the World Trade Organization and with the aim to provide access of region to this organization.

Although the role of CEFTA in the economy is very important, it is certainly of particular importance its political role. CEFTA 2006 provides easier integration in

the EU, which highlighted conclusion of this agreement itself as one of the priorities of its regional policy in the Balkans. Free trade in the region is even a precondition for further integration into the EU. Parts of CEFTA 2006, which is directly inspired by articles of the EC Treaty (competition, state subsidies and monopolies, public procurements) have also an effect on countries in preparation for entry into the Union.

CEFTA agreement creates the conditions for more balanced development of the entire Western Balkans region, strengthening of cooperation, harmonization of development policies, improving infrastructure and the general image of the region abroad.

However, such an agreement by itself does not encourage trade, it is necessary to develop other instruments through joined projects.

Greater success of the Agreement requires deeper cooperation of the competent institutions on various projects. Application of the Agreement demonstrated the weaknesses of insufficient cooperation between institutions, lack of projects for joint access to third markets, slow and poor performance of administration and lack of political pragmatism in order to take advantage of closer regional cooperation in general, not only to political preferences. One of the biggest problems in implementing the Free Trade Agreement proved to be non-tariff barriers. Numerous administrative and technical barriers are more harmful than tariffs because these are what entrepreneurs often meet at the border crossing point. They affect the trading price hike and make products not competitive enough in another state.

Conclusion

CEFTA 2006 has economic and political significance because it implies a condition for membership in the EU and aims to attract investments, develop infrastructure but also to improve business image and competitiveness of the region. CEFTA agreement is an important component which supports the process of internal economic reforms, as well as a necessary step towards EU accession process, since the Agreement encourages harmonization of principles, provisions and regulations that are applied in the EU and WTO, as well as building institutions that are necessary for EU accession and the WTO.

The very experiences of the signing countries of the first CEFTA agreement are the proven way for EU membership which was best shown in the example of the Czech Republic, Hungary, Poland, Slovakia and Slovenia, and Bulgaria and Romania. These countries have used this kind of regional cooperation as the most appropriate framework for the formulation of national regulations and tracing directions for a

long-term policy for opening domestic markets to competition. In fact, the experiences of these countries have shown that between the success of foreign trade liberalization and success of the transition there is a strong interdependence and conditionality.

CEFTA 2006 is a good instrument that provides a safe path towards EU membership and provides a good preparation for EU accession.

References

1. Bajec, J. and Joksimović Lj. "Savremeni privredni sistemi", Ekonomski fakultet, Beograd, 1997
2. Berkowitz, M. Daniel and Cooper, J. David, "*Start-ups and Transition*", The William Davidson Institute Working papers, 1997
3. Colombatto, E. "*Was Transition About Free Market Economics?*", Universita di Torino and ICER, 2001
4. Csaba, L. "*The political economy of trade regimes in Central Europe*", Foundations of an open economy: Trade Laws and Institutions for Eastern Europe; Center for Economic Policy Research, London, 1995
5. Dabrowski, M. "*Different Strategies of Transition to a market Economy: How Do They Work in Practice*", Policy Research Working Paper 1996, World bank, Washington DC, 1996
6. Friedman M. "Kapitalizam i sloboda", Global book, Novi Sad, 1997
7. Friedman, Milton and Rose, "Sloboda izbora", Global Book, 1998
8. Hayek A. Friedrich, "Poredak slobode", Global book, Novi Sad, 2000
9. Ludvig von Mises and Friedrich A. Hayek, "O slobodnom tržištu", Mate, Zagreb, 1997.
10. Madžar, Lj. "Suton socijalističkih privreda", Ekonomika, Beograd, 1990
11. Pejovic, S. "Osnovi kapitalističke ekonomije", Naučna knjiga, Beograd, 1992
12. Pejovic, S. i Vukotić, V. "*Tranzicija i institucije*", Zbornik radova, IDN, Beograd, 2002
13. Preduzetnička ekonomija, Volume I - X, Postdiplomske studije Podgorica
14. Regionalna saradnja za razvoj i evropsku integraciju, Evropski pokret u Srbiji, Beograd 2007
15. Siebert, N. "*The Transformation of Eastern Europe*", Kiel Discussion Paper No. 193, 1991
16. Smith, A. "Istraživanje prirode i uzroka bogatstva naroda", Global book, Novi Sad, 1998
17. Sporazum o izmjeni i pristupanju Centralnoevropskom sporazumu o slobodnoj

18. trgovini (CEFTA 2006), Podgorica, april 2007
19. Vukotić, V. "*Država i tranzicija*", Miločer, septembar 2001
20. Vukotić, V. "Makroekonomski računi i modeli", CID, Podgorica, 2001
21. Vukotić, V. "*Svjesni i (ili) spontani poredak*", Institut društvenih nauka, Beograd, 1999
22. World Bank, "*From Disintegration to Reintegration*", World Trade Report, Washington DC, 2005

Nina Drakić*

The Common Agricultural Policy of the EU as Determinant of Montenegrin Agriculture

Abstract: *Strict EU requirements in politics, legislation and economics on new and future member states pose a great challenge for Montenegro, which strives to become its member. Agriculture, being an important economic sector, needs to be considerably reformed in the process of adjustment to the Common Agricultural Policy. In this regard, the aim of this paper is to present the emergence and development of the Common Agricultural Policy, the process adjustment to the Common Agricultural Policy and changes that will bring EU membership in this area.*

Key words: *European Union, Montenegro, agriculture, Common Agricultural Policy*

Introduction

The European Union, community of twenty seven European countries, is the largest integrated economic area in the world, which covers 30% of world GDP, 60% of international development assistance and more than 17% of world trade. Within “internal market”, EU achieves the highest GDP in the world through free movement of people, goods, services and capital.

In December 2010, Montenegro was granted candidate status for the EU membership, which is significant moment in its economic development. Emphasizing its desire to join the EU, Montenegro abandons efforts for national self-sufficiency and prepares for competition on the EU single market of 500 million consumers and 25 million farmers.

When Montenegro becomes a full member of the EU, there will be no barriers to trade with other state members. There will be a competitive agricultural sector, together with differences in support, which will determine the type and level of agriculture production. Therefore, the Common Agricultural Policy of the EU (CAP)

* Chamber of Economy of Montenegro

and administrative requirements should have primary importance in the development of Montenegrin agriculture policy.

The Common Agricultural Policy

The Common Agricultural Policy is one of the most important areas of activity and concentration of the EU financial resources. This policy defines the rules and mechanisms that regulate production, sale and marketing of agricultural products in the EU, as well as rural development.

The Common Agricultural Policy was established in fifties years of the 20th century as response to lack of food in European countries after World War II and was aimed to create a self-sufficient and sustainable food production. For establishment of the CAP in particular are significant:

- the Treaty of Rome signed in 1957, which provides for agriculture one of the central role in the integrated West European societies, and
- the Stresa Conference signed in 1958 that sets out the future framework of agricultural policy of the European Economic Community.

The objectives of the CAP were increasing agricultural productivity, insuring acceptable standard of living of farmers, stabilizing market and providing availability of supplies and food at reasonable prices. Achievement of objectives is closely linked with the principles of the CAP as follow:

1. *Market unity* – all EU member states has created a single market. The unity of this market is reflected in both markets, domestic as well as external market. Internal unity means that within the EU all goods can move freely between member states without customs and other duties. On external market this means that same tariffs which are determined at EU level are applied on imported products from all countries.
2. *Community preference* – this principle reflects striving to avoid market disruptions and insure stability in supply. Also, the principle provides protection of the domestic market from foreign goods by using special instruments (special import levies). In addition, this principle insures assistance in placing the goods produced in the EU on foreign markets through export subsidies (if goods are not price competitive).
3. *Financial solidarity* - all member states of the EU, without exception, participate in the cost of the CAP, although the share of the cost of financing is not equal for all member states.

Agricultural policy founded on such grounds and guided by these principles has effectively started to live in 1960. Its development can be conditionally divided into:

1. *period from its beginning to sixties of the 20th century* - as a period of formation and initial establishment of the CAP;
2. *period from sixties to early eighties* - very prosperous period of the CAP, having in mind high volume of funds that was spent on support of agriculture, price support and increasing overall productivity;
3. *period from the early eighties to 1992* – period of facing with large market surpluses, and efforts to decrease benefits for agriculture in the total budget of the European Union;
4. *period from the Maastricht Treaty in 1992 to 2004/6* - characterized by the introduction of policy direct payments and the beginning of the establishment of rural development policy;
5. *period from 2005 to today* - which is characterized by introduction of the single payment scheme and decoupling payment from the production of certain crops.

Since their introduction the CAP reforms are continuously. They were a reaction on certain market problem - it had usually been increase supply and fear of falling producer price.

The first reform started in 1992 with changing in support, from price support to direct payment: price support was reduced, appropriate direct fees were designed and new measures for supply control were introduced. Further changes included converting of variable import duties in the tariff equivalents and had been implemented in 1995 as part of the EU commitments under the Uruguay Round Agreement on Agriculture. There was considerable resistance because of changes that reforms brought, and lowering prices and covering products were not sufficient to resolve long-term problems of the sector.

Second reform (Agenda 2000) in which the European Commission introduced “European model” of agriculture was unavoidable. The elements which represent basis of this model are:

- a competitive agricultural sector;
- the production focused on quality products and environmental protection;
- diversification of agriculture;
- active rural community;
- reasonable and single agricultural policy,
- clear sharing of responsibilities between the EU and member states and
- a clear benefit to society from spending EU budget on agriculture.

Also, it was introduced the division of the CAP into two pillars – market support through a system of guaranteed prices and rural development.

The last major the CAP reform, conducted in 2003, sets out basis for current EU policy in this area. Within Pillar I of the CAP (Market Support) introduced so-called the CAP reconnection (decoupling) which had purpose to allow farmers direct payments instead payments that had previously been linked to certain types of products. This new measure is called the Single Payment Scheme. In order to be able to receive these payments it was required that farmers had received subsidies at the time that is specified as the reference period (from 2000 to 2002). However, beside this general requirement, special standards had been introduced which farmers have to meet in order to receive direct assistance (subsidies). These are the standards of public health, animal health and welfare, plant health, environmental protection and conservation of productive land in good conditions.

This reform is not completely abolished binding of support for certain products. Member states had the right that can choose old form of payment for a particular culture when want it (in addition to a single payment scheme). The reason for this was attempt preventing farmers to abandon cultivation of particular crops and thus lead to market distortions. Also, a great emphasis has been put on the modulation, introduced by Agenda 2000, which allows EU member states that transfer funds under Pillar I in funds under Pillar II. The novelty is mandatory implementation of modulation which means obligatory allocation of funds from one fund to another.

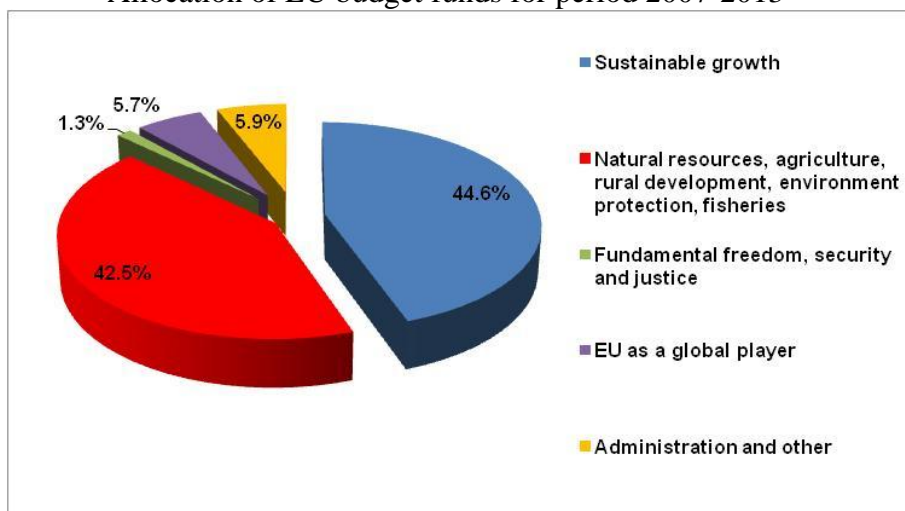
Within Pillar II of the CAP (Rural Development) has been introduced a lot of novelties. In 2005, after more than 40 years existing of the European Agricultural Guidance and Guarantee Fund (EAGGF), two components were separated and created two funds European Agricultural Fund for Rural Development (EAFRD) and European Agricultural Guarantee Fund (EAGF). Rural development policy is based on three directions:

- increasing competitiveness of agricultural and forestry sectors,
- environmental protection and land management, and
- quality of life and diversification of rural economy.

For the most part the goal of the current reforms were aimed at cheapening the CAP (reduction of the share for the CAP in total EU budget), improving the competitiveness of European agriculture in a global framework and adaptation of the world market conditions. Reducing the share of agriculture in the total EU budget below 50% is achievement having in mind that long time period the CAP budget was exceeding half the EU budget and covering even two-thirds of the total budget in previous years.

According to the 2007-2013 Financial Perspective, 42.5% of the total EU budget was allocated for preservation and management of natural resources and agriculture, rural development, environment and fisheries.

Allocation of EU budget funds for period 2007-2013¹⁹⁸



The budget of the CAP in the period 2007-2013 amounted to 362.85 billion Euros, of which 69.75 billion Euros will be earmarked for rural development and three times more or 293.10 billion Euros for direct payments and market support.

CAP Expenditure over the 2007 – 2013 Financial Perspective¹⁹⁹

- in billions of Euros -

	Total 2007-2013
Pillar I - Direct Payment and Market Support	293,105
Pillar II – Rural Development	69,750

In 2010, the EU budget amounts to 141.5 billion Euros, of which is provided 59.5 billion or 42% of the total budget for preserve and manage natural resources (costs related to market and direct payments + rural development, environment and fisheries). EU budget for 2011 amounts to 141.9 billion and it is increasing 0.3% compared to the previous year. Funds allocated for preservation and management of natural resources were reduced by 1% compared in 2010 and accounted for 58.7 billion Euros or 41% of the total EU budget.

¹⁹⁸ Source: www.ec.europa.eu

¹⁹⁹ Source: House of Lords, European Union Committee: The Future of the Common Agricultural Policy, 7th report of Session 2007-08, Published by the Authority of the House of Lords, London: The Stationery Office Limited, 2008

Montenegrin Agriculture

Agriculture has great economic importance in Montenegro since the share of agriculture in the total GDP is 11.3%. At the same time, the primary production considered together with the food processing sector shows that a 1/5 of the GDP is drawn from the food and drink production sector.

Agricultural area covers 38% (518,067 ha) of the total territory of Montenegro. Agricultural land, about 0.82 ha per capita, represent important resource since according to this indicator Montenegro is amongst the leading countries in Europe. However, the share of pastures and natural meadows (88%) in the structure of agricultural land is the largest, which are extensively used.

Covering a relatively small area, Montenegrin agriculture is quite diversified - from growing olive and citrus fruit in the coastal region through early vegetables and tobacco in the central part to the extensive livestock breeding in the north area. On the other side, commercial production of wheat, maize, sugar beet and oil crops is practically not existing, which essentially differentiates the Montenegrin agriculture even from countries in its closest surroundings.

The structural characteristics are rather unfavorable: small family holdings prevail, fragmented and plotted holdings with low productivity, which resulting in relatively low competitiveness of most agricultural products.

Montenegrin agriculture has its advantages, which are reflected in unexhausted land resources, low use of chemical agents - giving opportunity for organic production of the majority of products, specific and traditional products that may be marketed through consumption in tourism, and offer specific and recognizable Montenegrin products for market beyond its borders.

Intensive international integration processes in recent years, especially negotiations on the accession to the World Trade Organization, signing the Stabilization and Association Agreement for EU accession and the regional CEFTA 2006 Agreement, were marked the entire Montenegrin economy as well as agricultural sector.

The Stabilization and Association Agreement and Montenegrin Agriculture

Montenegro signed the Stabilization and Association Agreement with EU (SAA) in October 2007. In the period from January 2008 to May 2010 when the Stabilization and Association Agreement entered into force, the Interim Agreement on Trade and Trade Related Matters between Montenegro and the EU has been implemented.

Entry into force of the SAA means beginning of new phase of integration. The purpose of the SAA in terms of agriculture is creating free trade zone between the EU and Montenegro. This zone, almost completely free trade, will be created during five years of the transitional period from the date of entry into force of the SAA.

During implementation of the SAA, imports of agricultural products originating in the EU will be liberalized, and Montenegro will gradually abolish most of customs duties that applicable on imports from the EU. Using different models of liberalization for different groups of products, agricultural market will be liberalized with the largest trade partner (the EU absorbs around 40% of Montenegrin agricultural exports). Trade with non-sensitive products (products that are not produced in the country - tropical fruits, spices, tea...) is fully liberalized from the date of coming into force of the SAA. On certain agricultural products has been applied so-called gradually linear model of liberalization until completely abolishing customs duties in the last year of the SAA implementation (fruits, vegetables, tobacco ...). Certain level of tariff protection was maintained in the case sensitive products (meat and meat products, dairy products, honey, some vegetables and fruits ...).

On the other hand, implementation of the SAA includes the elimination of all quantitative restrictions and measures that are applied by the EU on imports of agricultural products originating in Montenegro, as well as elimination of customs and other duties except for cattle, beef, sugar and wine.

In the case of fruits and vegetables where are applied specific and ad valorem tariff only ad valorem part of duty is abolished. According to the SAA Agreement, the EU is committed that will apply 20% of ad valorem duty and 20% of the specific duty on imports of young beef ("baby beef") originating in Montenegro into the Community within the limits of annual tariff quota of 800 tons.

Harmonization of Legislation in the Field of Agriculture

The experience of other candidate countries has shown that the harmonization of legislative in the field of agriculture with the EU regulations is one of the most challenging tasks in preparation for EU accession, not only because of the large number of new regulations which should be adopted or changed, but also because specific role and sensitivity of the agricultural sector.

The field of agriculture represents broad area of European legislation which includes over 27,000 regulations with different levels of obligation (regulations, directives, decisions, recommendations and opinions). The regulations related to agriculture in the broad sense (including food safety policy, veterinary and phytosanitary policy) are divided into three chapters:

- *Chapter 11 Agriculture and Rural Development* - regulations which as a whole make up the Common Agricultural Policy. They can be divided into:
 - regulations related to horizontal issues (direct payments, establishing a system of integrated administration and control system, market regulation, the accounting system on the farms, regulations regarding to the promotion of agricultural product, quality policy, organic production, state aids and regulations relating to instruments for pre-accession assistance to agriculture - IPARD)
 - regulations governing the common market organization for agricultural products (grains, oilseeds, meat, milk, cotton, tobacco, sugar, wine, fruit and vegetables, bananas, cocoa, etc.), and
 - regulations related to rural development.
- *Chapter 12 Food Safety, Veterinary and Phytosanitary Policy* - this chapter consists of general rules, the veterinary regulations, market standards, food safety regulations, regulations related to feed and phytosanitary regulations.
- *Chapter 13 Fishing* - regulations relating to the EU Common Fisheries Policy, governing the preservation of aquatic resources, limiting negative impacts on the environment, conditions for use of water resources, structural policy and fleet management, aquaculture, etc.

For successfully harmonization of regulations related to agriculture it's necessary to undertake three types of activities:

- *Legislative Activity* - establishing organized system for harmonization of legislative with EU regulations
- *Institutional Building* - other side of medal of the harmonization process of national legislation with the EU regulations is building new institutions and strengthening existing institutions. In this area, it is necessary to establishing very complex coordination mechanism and implementation of new information technologies in order to meet very strict EU standards.

- *Personnel reorganization* - training and recruitment of personnel in order to establish good and sustainable coordination of the integration process.

For achieving this aim in June 2008, Montenegro has prepared and adopted the National Program for Integration of Montenegro into the EU 2008-2012 (NPI), which is the basis for harmonization of national legislation with the EU for the next five years.

In 2009 within implementation of the NPI the Law on Agriculture and Rural Development has adopted, which defines the legal framework in the field of market regulation, direct payments and other incentives according to the EU model. It's started with construction of new institutions that will accelerate the integration of Montenegrin agriculture in the EU's Common Agricultural Policy. According to the Law on Agriculture and Rural Development sets out the legal framework for the establishment of the Agency for Agricultural Payments that will be responsible for all payments in agriculture. Establishment of this Agency is one of conditions for using fifth component of IPA (IPARD) that related to rural development.

In part related to market regulation, it's necessary to complete the harmonization of regulations in the wine-growing sector, and fully harmonize system for collecting market information with the EU system and establish system for implementation of direct payments. In addition, until the date of accession it's necessary fully compliance of legislation with EU regulations in the area of horizontal measures, such as organic agriculture, quality policy and state aid.

Regarding to field of food safety, veterinary and phytosanitary policy, there is clear need for strengthening of the Veterinary Directorate by establishment of new units and strengthening the diagnostic capacity of the Veterinary Diagnostic Laboratory, as well as need for alignment and harmonization of legislation with *Acquis communautaire* in the field of veterinary policy, zootechnics and phytosanitary policy, including seeds, seeding materials and plant variety protection.

Conclusion

Monitoring and adaptation of agriculture to the EU policy has great importance. The EU is one of major world exporters / importers of agricultural products and there is no doubt that the policy that would be implemented by the EU in this area will have impact on global flows of goods, and thus inevitably on the Montenegrin market. On the other side, having in mind desire of Montenegro to become member of the EU, it is very important future direction that the EU will take, both during the preparation for membership, and also in time when achieve membership and become part of this

complex system. The main directions, that Montenegrin agriculture has to follow on the road of the EU integration, are:

- institutional development aimed on fulfillment of administration requirements of the CAP,
- improving the competitiveness - that will be achieved with more market-oriented agricultural policy,
- maximizing the direct benefits from the EU membership, and
- minimizing disturbances and economic costs of adaptation to the CAP.

In the EU accession process it's inevitable that the CAP will intensively paint Montenegrin agricultural policy with European colors and our task is to use opportunities which provides safer and more predictable business environment and the EU single market.

References

1. Verner Vajdenfeld, Wolfgang Vesels "Evropa od A do Š", Handbook of European integration, Beograd, 2003
2. Institute of Economic Sciences in cooperation with Friedrich Ebert Foundation "Bela knjiga", Beograd, 2001
3. Veselin Vukotić "Psihofilozofija biznisa", CID, Podgorica, 2003
4. The National Program for Integration of Montenegro into the EU for 2008-2012 (NPI), The Government of Montenegro, Podgorica, 2008
5. Law on Ratification of the Stabilisation and Association Agreement between the European Communities and Their Member States of the one part, and the Republic of Montenegro, of the other part, the Official Gazette of Montenegro no. 007/07-01, Podgorica, 2007
6. Milton and Rose Friedman, "Free to Choose", Global Book, 1998
7. Ludwig von Mises and Friedrich A. Hayek, "About Free Market", Mate, Zagreb, 1997
8. Adam Smith, "An Inquiry into the Nature and Causes of the Wealth of Nations", Global book, Novi Sad, 1998
9. E. C. Pasour, Jr. "Agriculture and the state", The independent Institute Oakland, California, 1990
10. Arie Oskam, Gerrit Meester and Huib Silvis: EU Policy for agriculture, food and rural areas, Wageningen Academic Publishers, 2010
11. European Commission Directorate-General for Budget: The European Union budget at a glance, Publications Office of the European Union, 2010
12. House of Lords, European Union Committee: The Future of the Common Agricultural Policy, 7th report of Session 2007-08, Published by the Authority of the House of Lords, London: The Stationery Office Limited, 2008

13. European Commission, Financial Programming and Budget, The current year: 2010 - investing to restore jobs and growth, Next Year: EU budget 2011
14. EU budget 2011, Publications Office of the European Union, 2010

Web sites:

www.ec.europa.eu

www.monstat.me

www.minpolj.gov.me

Ivana Vojinović, MSc*

Approximation of Environmental Acquis: challenges faced by Montenegro as ecological state

Abstract: *In December 2010 Montenegro was granted EU candidate status. One of the conditions for membership is that country harmonizes national legal system with the EU legislation and establishes system for its effective implementation. The Environment Chapter is one of the most difficult to complete among the 35 Chapters of the Acquis Communautaire. While the basic elements of legal framework are in place, Montenegro has to put efforts to implement and enforce the Environmental Acquis. In certain areas (e.g. horizontal legislation, industrial pollution and risk control, air quality, nature protection) high level of harmonization has been achieved, while others are lagging behind. Finally, compliance with Acquis requires huge investments in environmental infrastructure.*

Key words: *environment, environmental acquis, approximation of EU legislation*

1. Introduction

Montenegro has been one of the first countries that adopted the principle of environmental protection as integral part of its national concept. On September 20th 1991, at Žabljak, the Parliament, adopted *Declaration on Ecological State*, based on which it was decided for Montenegro to shape its identity as an ecological state, through balanced economic and social development. That was in line with the *I World Summit on Environment and Development* held one year later (1992) in Rio de Janeiro. The idea has been incorporated in Constitution which defines Montenegro as an ecological state (Article 1). Article 23 provides for a universal right to a sound environment for everyone and the right to timely and complete information about the environment and involvement in decision making process in this field, including legal protection of these rights. Finally, it is mandatory for everyone, especially the state, to preserve and improve the environment.

Montenegro declared its independence on June 3rd 2006, following a referendum held on May 21st 2006. In October 2007 a *Stabilization and Association Agreement (SAA)* between the European Communities and their Member States and Montenegro and an *Interim Agreement on Trade and Trade-related Matters (IA)* were signed. IA entered into force in January 2008 and the SAA in May 2010 after its ratification by the parties. Montenegro presented its application for membership in the EU on December 15th 2008 and in December 17th 2010 was granted candidate status. The

*Ministry of Sustainable Development and Tourism, Deputy Minister

key condition for membership is that the candidate country aligns national legal system with the EU legislation, the so called *Acquis Communautaire*, and establishes system for its effective implementation. This paper provides: (1) an overview of the extent to which Montenegro has so far transposed (and implemented) *Environmental Acquis* and (2) the summary of identified challenges in this field.

2. Harmonization with Environmental Acquis

The process of integrating the EU law in the national legal systems is called the **approximation process**. There are 3 key steps in this process:

- legal transposition of the EU legislation;
- practical implementation of the legislation; and
- enforcement (penalties).

The *Environment Chapter (Chapter 27)* and approximation with it is known to be one of the most difficult to complete among the 35 chapters of the *Acquis Communautaire*. Ensuring compliance with EU legislation requires significant investment in environmental infrastructure (e.g waste management facilities, water protection, air pollution, etc), but, on the other hand, brings significant benefits.

EU environmental policy aims to promote sustainable development and protect the environment for present and future generations. It is based on the integration of environmental protection in other policies, preventive action, the “*polluter pays*” principle, fighting environmental damage at source and shared responsibility. Since 70ies of XX century, *Environmental Acquis* has increased to over than 500 acts. In Montenegro, environment is covered by Chapter VIII - Cooperation Policy of SAA (article 111), and comprises the following segments: (1) **horizontal legislation**, (2) **air quality**, (3) **waste management**, (4) **water management**, (5) **nature protection**, (6) **industrial pollution control and risk management**, (7) **chemicals**, (8) **civil protection**, (9) **climate change** and (10) **noise**.²⁰⁰

²⁰⁰ **Waste Management** and **Water Management** have not been elaborated in this paper since they require in dept elaboration (which would inevitable go beyond the scope of this paper). At this point it is important to mention that *waste management* is huge challenge for Montenegro since, besides full alignment with legislation, it is of crucial importance to prepare necessary infrastructure which is very financially intensive. On the positive side, transposition of *Waste Framework Directive (2008/98/EC)* is advanced, in *Waste Management Law 80/05, 73/08*. The amendments to this Law will be adopted as of end of 3rd quarter of 2011. As far as *water management* is concerned, Montenegro is achieving certain progress in implementation of *Waste Water Directive*. In this field, medium-term priority is amendment to the *Water Law* and related by-laws in order to harmonize it with the *Water Framework Directive* and other relevant Directives. One of the problems in this area is overlapping of competencies between responsible authorities (see more under one of the concluding remarks). Similarly, **civil protection** (the main competence lays with Ministry of Interior), **forestry** (article 97 of SAA) and **nuclear safety** (article 110 of SAA) are not covered by this paper.

Montenegro has achieved high level of alignment in *horizontal legislation*. The basic legal framework is provided by: the *Law on Environment 48/08*²⁰¹, the *Law on Environmental Impact Assessment (EIA) 80/05* and the *Law on Strategic Environmental Impact Assessment (SEA) 80/05*. Total of 69 *Multilateral Agreement* in the environment area has been taken over by succession or ratification.

EIA Council Directive 85/337/EEC on the assessment of the effects of certain public and private projects on the environment is almost completely transposed through the *Law on EIA* and relevant bylaws. In practice, the public participate effectively in all phases of the EIA procedure (e.g. scoping, screening and decision-making). The only outstanding task to be addressed is the establishment of an information exchange system with neighboring countries potentially affected by developments requiring an EIA.²⁰² The *Environmental Protection Agency (EPA)* is responsible for obligations from the EIA Directive.

Transposition of the *SEA Directive 2001/42/EC on the assessment of the effects of certain plans and programs on the environment* by *Law on SEA* is nearing full completion. The full transposition will be completed by an amendment to this Law in 2011. The provision that has to be transposed is the one requiring SEA for plans and programs co-financed by the EU. The competent authority is responsible for the preparation of plans or programs at the national level and local authorities in case plans or programs are to be adopted at local level. EPA is responsible for granting or rejecting approval on SEA Report for plans or programs on national level.²⁰³

The main transposing instrument of the *Environmental Information Directive (2003/4/EC) on public access to environmental information* is the *Law on Free Access to Information 68/05*. Progress regarding harmonization was made with the *Law on Ratification of Aarhus Convention* which entered into force on February 2010.²⁰⁴ The Directive was also transposed by the Law on Environment introducing the definition of environmental information and public and it also provided for the

²⁰¹ This Law introduced the so called “*integrated approach to the management of the environment*” and goals and principles of the environment.

²⁰² Montenegro ratified the *Espoo Convention on EIA in Trans-boundary context*.

²⁰³ A procedure in the case of trans-boundary effects foreseen in the Law was implemented in the case of the Morača river (Notification to the Republic of Albania of a trans-boundary impact likely to be caused by construction of hydro power plants on the Morača, in line with the Draft Detailed Spatial Plan (DDSP) for an area of multipurpose accumulations on the Morača). Also, Montenegro notified Serbia, Croatia, Bosnia and Herzegovina and Albania in trans-boundary context for the DDSP for the corridor of 400 kW with an optical cable from the Montenegrin coast to Pljevlja and submarine cable of 500 kW with optical cable Italy - Montenegro and the draft SEA Report for the DDSP.

²⁰⁴ *Aarhus Centre* was opened on April 2011 as a part of EPA. Its mission is to implement *Aarhus Convention* by: assisting state bodies to fulfil duties stemming from Convention, promoting adoption of regulation that allow for access to information, public participation and access to justice in the area of environment, linking state bodies, civil society, and other stakeholders, awareness raising, etc.

obligation of dissemination of information. Transposition in this field will be finalized by the amendments to the Law on Environment in 2012.²⁰⁵

Transposition was completed for *Public Participation Directive (2003/35/EC)* in respect of drawing up certain plans and programs relating to the environment by the Law on SEA. The public concerned takes part in consultative process through submission of opinion and the participation in public debates.²⁰⁶ The transposition of *Environmental Liability Directive 2004/35/EC* with regard to the prevention and remedying of environmental damage is in an early stage. Namely, Law on Environment contains the entire Chapter VII titled *Environmental Damage Liability*.

In the area of air quality, Montenegro has achieved significant progress in transposition of the new *Ambient Air Quality and Cleaner Air for Europe Directive (CAFE Directive) 2008/50/EC* by adoption of the Law on Air Protection, which came into force in May 2010. The adoption of the Law was followed by Regulation on Establishment of Air Quality Monitoring Network 44/10 and Rulebook on methods and conditions for air quality monitoring 21/11. By the end of September 2011, adoption of the Rulebook on Reporting on Air Quality (in accordance with *Commission Decision 2004/461/EC laying down AQ questionnaire*) is expected. The Law prescribes the following measures for the improvement of air quality: limit values for the emission of pollutants from stationary and mobile sources of pollution, prescribes quantities of pollutants in certain goods²⁰⁷, reduction of GHG emission, gradual reduction of use of substances that deplete Ozone layer²⁰⁸, and the

²⁰⁵ Inter alia, the amendments shall contain a provision on application of the *Eco-Label Regulation (EC/66/10)* and *EMAS Regulation (EC/1221/09)* on the voluntary participation by organisations in a Community eco-management and audit scheme as of the entry into EU. Also, it will more closely regulate transposition and implementation of *SEVESO II Directive 96/82/EZ* on the control of major-accident hazards involving dangerous substances. So far, very limited progress was made in transposing this Directive by adoption of the Regulation on the list of dangerous goods type, method for determining quantity, permitted quantities and criteria of categorization and characterization of hazardous substances 5/11. Installations which may present a major accident hazard have not yet been identified, and a competent authority for this Directive is still to be designated.

²⁰⁶ The authorities responsible to prepare plans and programs inform public about the methods and deadlines for public insight into the content of the *SEA Report*, method of submission of opinions, and the time and venue of public debate. Depending on the field of work, the competent authorities are at national and local level (e.g. Secretariats). They are in charge of preparation of report on participation of authorities and organisations concerned and about public debate. The report contains the opinions submitted during the public insight and public debate on the SEA Report.

²⁰⁷ Regulation on Determination of Types of Pollutants, Limit Values and other Air Quality Standards 45/08, is fully aligned with *Directive on Arsenic, Cadmium, Mercury, Nickel and Polycyclic Aromatic Hydrocarbons in Ambient Air (2004/107/EC)* and *CAFE Directive 2008/50/EC*. *NEC Directive (2001/81/EC)* on National Emission Ceilings for Certain Atmospheric Pollutants has not been yet transposed. Certain definitions in the Law on Air Protection (and related secondary acts) provide a legal basis for Regulation on NEC whose adoption is expected by the end of 2011.

²⁰⁸ Provisions of the *Regulation on F-gases EC/842/06* on certain fluorinated GHGs are transposed in Regulation on ozone depleting substances and alternative substances (F-gases) 05/11. Importer/exporter is obliged to submit report to the EPA on quantity of imported/exported F gases.

other measures for prevention and reduction of pollution. Air quality zones have been designated, localities, number and allocation of measurement stations for air quality monitoring defined and an air quality monitoring network is going to be established in several phases.²⁰⁹ The EPA is in charge of its management, reporting and informing the public on air quality.

Harmonization of the national legislation with *Acquis* related to the fuel quality (*Directive relating to a reduction in the sulphur content of certain liquid fuels (1999/32/EC)* and *Fuel Quality Directive (98/70/EC)*), was made by adoption of the *Regulation on Limit Values of Pollutants in Liquid Fossil Fuels 43/10* which introduced the ban of leaded petrol in Montenegro as of January 1st 2011 and the limit values for sulphur content in diesel fuels, heavy fuel oil, gas oils and marine fuels. The *Program on Monitoring Fuel Quality* (in accordance with standard EN 14274) is ongoing since April 2011, marketing of leaded petrol is prohibited, marketing of unleaded petrol is based on Directive's requirements, system to collect national data is established and enforcement system is in place. Authorities responsible for fuel quality regulation are identified, assessment of national fuel consumption is ongoing and analytical methods for assessments of fuel quality are defined. In 2011, Parliament ratified 3 protocols related to the *UNECE Convention on Long Range Trans-boundary Air Pollution (CLRTAP): Protocol on Heavy Metals, Protocol on Persistent Organic Pollutants* and *Protocol to Abate Acidification, Eutrophication and Ground-Level Ozone*.

Montenegro is at an early stage regarding the transposition of *climate change Acquis*. The country ratified the *Kyoto Protocol* in 2007 and became its Non-Anex B country. Since it is non-Annex I Party to the *United Nations Framework Convention on Climate Change (UNFCCC)* it cannot participate in the global carbon market and has no greenhouse gas (GHG) emission limitation/reduction target. UNFCCC and Kyoto Protocol are implemented through the *Clean Development Mechanism (CDM)* in order to attract additional inflow of foreign direct investments related to the clean technologies and contribute to the sustainable development of the country. Implementation of *GHG Monitoring Mechanism Decision* is well progressed. The EPA maintains the GHG emission inventory developed according to the IPCC methodology and is responsible for monitoring GHG emissions. An inventory of GHG emissions for the years 1990 and 2003 is prepared. The national system for the development of a GHG inventory will be established in 2013 by the *Regulation on GHG inventory* and full implementation is expected after joining EU. Based on current inventory, the Government submitted to the UNFCCC the *1st National Communication for period 1990-2003*. Preparation of the *2nd National*

²⁰⁹ So far there are 4 automatic stations in urban zones, 2 of which shall be re-sited in order to attain full compliance with the *Directive 2008/50/EC* requirements. State network for air quality monitoring will be completed when EMEP station on Žabljak (included in the international network of stations for monitoring of trans-boundary emission of air pollutants) will be equipped and put in place.

Communication is ongoing. In 2011, *National Inventory of Emission in the Air for 2009* was submitted to CLTRAP Secretariat.

While in general, some climate legislation such as the *EU-ETS Directive (2003/87/EC) establishing a scheme for GHG emission allowance trading within the Community*²¹⁰, *Consumer Information Directive (1999/94/EC) relating to the availability of consumer information on fuel economy and CO₂ emissions in respect of the marketing of new passenger cars*²¹¹, are considered only mid-term priority, the Law on Air Protection sets legal basis for adoption of a *Rulebook on GHG gases monitoring* in accordance with Monitoring Mechanism Decision in 2013.

One of the most noteworthy progresses has been achieved in the field of ***nature protection***. Based on the *Law on Nature Protection 51/08*²¹², a series of by-laws have been adopted to further transpose the relevant Directives (*Wild Birds Directive (79/409/EEC)* and *Habitats Directive (92/43/EEC)*). There are still challenges in transposition of *CITES Regulation on Endangered Species Import and Export (338/97EEC)*. The separate *Law on National Parks 56/09* defines measures of protection and improvement of national parks. Currently 20,75% of the territory of Montenegro is reported as protected.²¹³ The *Strategy of Sustainable Development*, the *Spatial Plan of Montenegro until 2020* and the *Biodiversity Strategy 2010-2015* envisage for an increase of the protected areas.

The binding obligation for Montenegro, being EU candidate country, is establishment of *NATURA 2000*, an ecological network of protected sites. It is a system of mutually connected and spatially close areas of significance which, by balanced biographic allocation, significantly contribute to the conservation of natural balance and biodiversity. *NATURA 2000* is designed to protect the most seriously threatened habitats and species across Europe.²¹⁴ Base for *NATURA 2000* is *EMERALD* data base²¹⁵. Among other,

²¹⁰ The *Ministry of Sustainable Development and Tourism (MSDT)* plans to draft the *Law on Emission Trading* in 2014 in order to establish legal framework and institutional set-up for joining EU ETS system. The Law will regulate establishment and functioning of the national register for emissions trading and the legal set up for regulation of numerous issues and harmonization with growing number of EU regulation in this field.

²¹¹ There is no automotive industry in Montenegro. Official distributors are already providing some CO₂ information but it is a matter of good practice and not of a legal obligation.

²¹² The new *Law on Nature Protection* will be adopted until the end of 2011 and will address yet untransposed provisions and create conditions for establishment of the new system of protected areas.

²¹³ National parks are managed by Public Company "National Parks", while competencies regarding management of areas with lower level of protection lay with the local authorities.

²¹⁴ The *Habitats Directive* and *Birds Directive* form the regulatory basis for *NATURA 2000*. The *Birds Directive* requires the establishment of *Special Protection Areas (SPAs)* to help protect and manage areas which are important for rare and vulnerable birds. The *Habitats Directive* aims to establish *Special Areas of Conservation (SACs)* in order to provide rare and vulnerable animals, plants and habitats with increased protection and management.

²¹⁵ Within project "*Setting up of EMERALD network in Montenegro*" (2008) total of 32 *EMERALD* sites were identified based on criteria from Resolution 4 and 6 of *European Convention on Wild*

the inventory of red lists of endangered species will be prepared, habitat types identified and mapped and conditions and measures for nature protection will be incorporated in spatial plans and other planning documents.²¹⁶

In the area of ***industrial pollution control and risk management***, *IPPC Directive* has achieved nearly complete transposition in the *Law on IPPC 80/05* accompanied by the set of secondary legislation.²¹⁷ There is a complete administrative set-up in place needed for permitting procedures. The new permit system scheduled to be put in place in 2015 shall ensure that all of the relevant environmental issues for an installation are considered in an integrated way.²¹⁸

Implementing provisions of the *E-PRTR Regulation (EC/166/2006) concerning the establishment of a European Pollutant Release and Transfer Register* has been transposed into Montenegrin legislation through the *Rulebook on detailed content and method of keeping a register of polluters of the environment 43/10*. EPA is in charge of maintenance of this *Cadastre of Pollutants* at the state level. Cadastre of pollutants identifies the main polluters according to the type and intensity of pollution. Moreover, local registers shall be kept at the municipal level and shared with EPA on regular basis. However, implementation is in an early phase.

Transposition has not really started for any of the Directives in the ***chemicals*** sector (*Regulation on CLP (EC) 1272/08 on the classification, labeling and packaging of substances and mixtures*, *Regulation (EC) 1907/2006 concerning the Registration, Evaluation, Authorization and Restriction of Chemicals (REACH) and establishing a European Chemicals Agency and Biocides Directive (98/8/EC)*). The *Law on Chemicals* regulates the procedure for reporting and placing on the market new and existing chemicals, the procedure for assessing and evaluating the hazard arising from chemicals, the classification, packaging and labeling of chemicals, imports,

Flora and Fauna and their habitats (Bern Convention). Also, an assessment of the bird species listed in Resolution 6 of the Bern Convention was carried out and submitted to the Council of Europe.

²¹⁶ Montenegro implements project "*Montenegro and Natura 2000*," with the financial support of Norwegian Ministry of Foreign Affairs, while implementing agency is the World Wide Fund (WWF). So far, the desktop inventory was completed, the draft catalogue of Natura 2000 habitat types was prepared and the mapping methodology was tested.

²¹⁷ However, since in November 2010, the EU adopted new *Directive on Industrial Emissions - IED (2010/75/EU)*, recasting *IPPC Directive*, the *Large Combustion Plants Directive*, the *Waste Incineration Directive*, the *Solvents Emissions Directive* and 3 *Directives on Titanium Dioxide*, it is difficult to predict time for full implementation of IED although a number of provisions are already applied and part of the legal framework is in place. Limited progress has been achieved in transposing the latter 6 Directives by introduction of air emission limit values from stationary sources (*Regulation on the Emission Limit Values from Stationary Sources 10/11*).

²¹⁸ This includes the following: operators of installations shall take preventive measures against pollution, in particular through the application of the Best Available Techniques; no significant pollution (air, water, land, noise, odour etc.) is caused; waste that cannot be avoided is recovered or disposed safely; energy is used efficiently; accidents are prevented and their consequences are limited; the site is returned to a satisfactory state when the installation closes.

exports and other issues important for the protection of human health and the environment. Implementation is slow due to unclear and overlapping competences. Establishment, maintenance and enhancement of the unique system of chemicals management, preservation of high level of protection of health of people and environment, regulation of import and export of dangerous chemicals and alignment with the most important regulation in the chemicals field will be contained in the new *Law on Chemicals* which is to be adopted in 4th quarter of 2011. Also, Montenegro ratified *Rotterdam Convention on Prior Informed Consent (PIC) for certain dangerous chemicals and pesticides in international trade* and *Stockholm Convention on Persistent Organic Pollutants (POPs)*.²¹⁹

In the area of **noise**, the *Law on Protection from Environmental Noise 28/11*, which is aligned with *Directive on Assessment and Management of Environmental Noise (2002/49/EC)*, was adopted in June 2011. Further harmonization shall be achieved by adoption of the *Rulebook on noise indicators, limit values and acoustic zones* and the *Rulebook on methods of calculation and measurement of environmental noise*. The *Rulebook on making strategic noise maps* will follow in the first half of 2012.²²⁰

3. Conclusion

During the recent period, Montenegro put significant efforts in improvement of its environment all with the aim to practically accomplish strategic vision of ecological state. With the active participation of Montenegro, as independent state, in the process of European integration, these efforts have been intensified and that, eventually, have brought results. While the basic elements of legal framework are in place, Montenegro will have to make efforts to align with and especially to implement and enforce the *Environmental Acquis*. In certain areas (e.g. horizontal legislation, industrial pollution and risk control, air quality and nature protection) significant level of harmonization has been achieved, while others are still lagging behind. Montenegro, being the first constitutionally declared ecological country, is

²¹⁹ The *Law on Animal Welfare 14/08* modestly transposed the *Animal Experiments Directive (86/609/EEC) on the approximation of laws, regulations and administrative provisions of the Member States regarding protection of animals used for experimental and other scientific purposes*.

²²⁰ In line with the *Directive 2002/49/EC*, strategic mapping is necessary for one agglomeration (Capitol of Podgorica) and 2 regional roads. National railway and 2 airports have no traffic frequency requiring obligatory noise mapping. Beside legal framework, practical knowledge and technical infrastructure is necessary for local authorities and authorised/accredited legal entities, to implement all this. Competent authorities shall establish cooperation with the authorities of the neighbouring countries in case of noise issues in bordering areas. The preparation of action plans will start 2 years after adoption of relevant strategic noise maps. Action plans shall be revised every 5 years and can be revised earlier if significant changes in noise level occur. The Law foresees development of strategic noise maps by 2017 and consequent development of noise action plans by 2019.

faced with numerous challenges as regards harmonization of *Environmental Acquis*. They can be summarized as follows:

- Given its limited resources and the size of *Environmental Acquis*, Montenegro needs to better plan/prioritize activities for timely approximation of *Environmental Acquis* and to identify sustainable funding for its implementation. The need to develop a *National Strategy for Environmental Approximation (NSEA)* with clearly identified gaps, priorities and timelines for transposition and implementation, as a basic planning document presenting the optimal route for the approximation process of *Acquis Communautaire*, is essential. The *NSEA* is a comprehensive framework of actions with related costs needed to accomplish legal transposition and technical implementation of all environmental sectors.²²¹
- The *environmental administration* in all segments (legislation, implementation and inspection) and at all levels (national and local) needs to be significantly strengthened to implement *Environmental Acquis*. It will be particularly important to create conditions for building the necessary *technical and financial capacities* in this area within the next few years.
- Further efforts are needed in *consolidating fragmented responsibilities* and achieving precise division of responsibilities in environment sector.²²²
- Proper *horizontal and vertical coordination* has to be ensured with inspectorates and enforcement capacities strengthened and cooperation with the judicial system reinforced.

²²¹ Montenegro implements Twining Project with Italy: „*Support to Environmental Management*“, and its Component I is related to the analysis of the level of harmonization of Montenegrin legislation with the Acquis, identification of priority sub-areas of *Acquis* for which harmonization plans and »directive specific implementation plans« – DSIPs (for certain the so called “investment heavy directives”) will be prepared. It is expected that this will provide basis for *National Investment Strategy for Environment*. Also, *National Program for Environmental Protection*, supported by Action Plan, is to be prepared in 2013. It will be based on principles of sustainable development and the basic principles of the *Sixth Community Environment Action Program*.

²²² Area of water is the most challenging one. The *Ministry of Agriculture and Rural Development* is competent for water policy. *MSDT* has competencies over ecological aspects of this policy, *Ministry of Health* is in charge of health protection, especially regarding drinking water, *Ministry of Interior* is in charge of floods issues. *Water Council* is expert body of the Government. *Water Directorate* is competent for the unique water management. *Hydro-Meteorological Institute* is in charge of water monitoring, while *EPA* is authorised to collect and update data on the quality of all segments of the environment, including water. Remaining bodies that have some of competencies in this field are the following: *Institute for Public Health*, *Institute for Geology*, *Directorate for Sea Safety*, *Public Company for Coastal Zone Management*, *National Parks*, etc.).

- There is necessity to integrate environment principles and standards in other development policies as well as in the decision making process.
- Developed functional integral information system is essential for effective environmental policy implementation. The EPA regularly, once a year, prepares the Report on the State of the Environment. This is very difficult without quality and reliable data which could be retrieved from a unique information system. On the basis of the Law on Environment, the EPA is competent for establishing and operating the information system for storing, processing and analyzing data on all segments of environment. There is also a need for spatial representation of data concerning the environment, and particularly: protected sites, biodiversity, polluted areas, sites for measuring air quality, water quality, soil quality, which can be implemented by GIS technology. Single information system could enable more efficient reporting towards EIONET network.
- Although cooperation with NGOs and other stakeholders, has significantly improved over the recent period, it should continue with awareness raising campaigns and public participation promotion in environmental decision making.²²³
- Regarding horizontal legislation, further efforts are needed to more closely align legislation related to trans-boundary aspects of the EIA, including due consideration of viable alternatives which have to be properly carried out wherever legally required, proper coordination among different authorities and all stakeholders needs to be ensured²²⁴ and provisions related to the access to environmental information and access to justice implemented. Particular attention needs to be given to issues related to the *Environmental Liability Directive* (prevention and remediation of environmental damage) and *INSPIRE Directive* in the field of harmonization of infrastructure for spatial information.

²²³ Improvement has been achieved by adoption of Handbook on Criteria of Selection of Representatives of NGOs and civil society in working groups and other bodies established by the Ministry, in the process of Laws and other strategic documents drafting. In that way, progress has been achieved in public participation in the decision making process. Also, campaign „*Ecological Thread that Binds Us*“ aimed at environmental awareness raising, was organized in cooperation with NGO sector and in realisation of 160 activities, 21 NGOs participated.

²²⁴ The proposal regarding hydropower development on Morača is a test case. This means that genuine SEA on the DSP of the multipurpose development of the Morača, including all development alternatives, is carried out, with involvement of the civil society and other stakeholders. Any decisions have to be taken in line with the EU principles, after full assessment of potential environmental impacts and consideration of the necessary mitigating measures.

- Montenegro is progressing in its alignment with *air quality* legislation, but still needs to identify conurbations and zones, establish an air quality monitoring program, plans and databases and make data available to the public.²²⁵
- Despite adoption of strategic documents, there is no sufficient progress in area of *waste management* and construction of necessary infrastructure for a proper solution of this problem. It is important to adopt missing municipal waste management plans, have better cooperation between national and local authorities, capacity building and good dialogue with the civil society and stakeholders, increase efforts in developing many waste management capacities (recycling, incineration, composting); develop a plan to clean up illegal dumpsites, etc.²²⁶
- Montenegro has to speed up alignment in the area of *water*, in particular with regard to *Water Framework Directive* and *Drinking Water Directive*. There is a need to continue with preparation of the major infrastructure projects in the areas of water and waste, to be potential financed by IPA and other international donors.
- In the area of *nature protection*, there is need to introduce NATURA 2000. The goal of its establishment is better strategical planning, improvement of SEA and EIA (in the light of foreign investments inflow is important to have precise NATURA 2000 and EMERALD databases), better management of protected areas and development of National Monitoring Program of Biodiversity. On top of this, work of inspections on the field will be better, due to the accurate location of protected areas and protected or vulnerable species.
- Management of the protected areas needs to be significantly strengthened²²⁷, including: developing scientific data for designation of protected areas and future

²²⁵ Remaining challenges in transposition of the air quality directives are related to establishment of average exposure indicator, exposure concentration obligation, and national exposure reduction target for PM 2,5, for which only target value has been introduced so far. Full implementation is foreseen for 2014, after the revision of legislation following revision of air quality legislation in EU in 2013.

²²⁶ It is of importance to highlight the ongoing project with the World Bank titled: "*Montenegro Industrial Waste Management and Clean-up Project –IWMCP*" that includes potential recovery of the identified the so called "ecological hot spots": Aluminium Plant (two basins of red mug and landfill of industrial waste), Steel Company Nikšić (landfill of industrial waste), Shipyard Bijela (landfill of industrial waste-grit), Thermal-Power Pljevlja (landfill of ash and slug „Maljevac“) and Gradac Pljevlja („Addle Rock“).

²²⁷ The *Project of strengthening network of protected areas (PAS)* (2009-2012) aiming at strengthening current and establishing new protected areas in Montenegro and the *Project of Financial Sustainability of the network of protected areas in Montenegro (PAF)* (2010-2013) aiming at strengthening capacities in protected areas for sustainable financing, are financed by *Global Environment Fund (GEF)* and the implementing agency is *UNDP Office* in Podgorica. Project "*Dinaric Eco Region*" (2008-2011) is based on the *Convention on Biodiversity* and its goal is to strengthen capacities of the managers of protected areas of Dinaric Karsts. "*Integral Management in the Eco system of Skadar Lake*" (2005-2012) put as objective improvement of values of ecosystem of

NATURA 2000 sites, mapping of habitats and special protection areas, improving management of the protected areas, etc. Also, illegal hunting in the protected areas and unauthorized construction, particularly in the coastal area, have to be contained.

- Montenegro is striving for gradual harmonization and implementation of the *climate change Acquis* and will have to put a great deal of effort into implementing the climate and energy package setting a GHG emission reduction target for the EU. One of the priorities is to converge with the EU Monitoring Mechanism Decision, in addition to strengthening monitoring, reporting and verification mechanisms within the UNFCCC context. On the positive side, the implementation of the *Montreal Protocol on Substances that Deplete the Ozone Layer* is advanced.
- Introduction of integrated permits for big industrial installations (as of January 1st 2015) in line with the *Law on IPPC* will result in increased investments in equipment for prevention of pollution in order to meet high level of EU standards. In this way, pressure put on industries will be reduced. Alignment with the Directives on *industrial risks* (Seveso II) and large combustion plants has not been achieved and competent authorities for implementation have not been designated. Further progress is needed, also, in aligning with the *Waste Incineration and Solvents Emissions Directives*. In terms of the *COMAH Directive*, no implementation measures have been scheduled yet.
- Implementation in the area of *chemicals* is in an early stage. It is especially important to establish a sound chemicals management system in order to prepare Montenegro for the new *REACH Chemicals Management System*.
- As regards *noise*, the acoustic zoning, development of strategic noise maps and noise action plans on the basis of these maps are the biggest challenges.

4. Literature:

1. National Program for Integration of Montenegro into EU for the period 2011–2015, Government of Montenegro
2. Montenegro in XXI century – In the Era of Competitiveness, Subproject: Environment and Sustainable Development, Monteengrin Academy of Science and Arts

Skadar Lake and its natural resources via establishment and strengthening of institutional and strategic mechanisms for the trans-boundary cooperation. “*Establishment of the Pilot Sea Protected Area in Montenegro*” (2009-2013) aims at estimation of justification for the establishment of the pilot sea protected area and work on the Management Plan for the first sea protected area in Montenegro at locality Katiči, Municipality of Budva.

3. Commission staff working document: *Analytical report accompanying the Communication from the Commission to the European Parliament and the Council-Commission Opinion on Montenegro's application for membership of the European Union*, COM(2010) 670
4. Monitoring transposition and implementation of the EU environmental acquis, EUROPEAID/124644/D/SER/MultiService Contract No. ENV. E1/2010/22.02.07.01/557460, Draft Progress Report 6, Montenegro
5. www.vlada.me

Slavica Nikolic, MSc *

Joining the EU: Ecological Potential of (Un) Limited Growth

Abstract: *The European Union and joining the group of developed countries have become a strategic goal for the Western Balkans in the hope that the years of economic transition will become the past and that their economies will ultimately go towards the way of economic recovery and prosperity. The accession process has resulted in a number of challenges that should contribute to solving of many problems that will, in the end, result in the definition of long-term development directions. Simultaneously with the accession process it should be worked on dealing with "potential" problems that will arise from entering the EU. This primarily refers to the strict obeying of laws, rules and procedures in the field of environmental protection and limit harmful gas emissions that result from economic activity. Having regard to the fact that the Western Balkans are among the group of developing countries whose economies rely upon the dominant technologies that emit large amounts of carbon dioxide, environmental protection and efficient solutions to environmental problems will become significant factors for future economic growth. The question is whether and to what extent the new terms, »organic« or »green« economy experience will bring the change in economic strength and power of companies, states, regions in relation to the current balance of powers?*

Key words: *EU, climate change, economic growth, »green« economy*

Introduction

Global air temperature increase caused by increased emission of carbon dioxide and other greenhouse gases is one of the most critical problems the 21st Century society faces. The problem, which consequences can reduce or annul, reached level of social and economic development and efforts of underdeveloped countries to achieve the long-wanted progress.

Due to the seriousness of the issue and the consequences it carries, the climate change has become a critical topic on international, regional and national level. One group of authors considers that ignoring the climate change harms economic growth and, in the long run, even contributes to its decrease. On the other hand, tackling with the climate change, proper choice of strategies and actions will limit the

* Centar za preduzetništvo i ekonomski razvoj/Center for Entrepreneurship and Economic Development (CEED)

aspirations and wants of both developed and underdeveloped countries towards development. However, there is an agreement that costs and potential economic growth in the future will depend on the actions taken and decisions made in the present. Therefore, there is a tendency to find balance between increasing need for economic growth and decrease of greenhouse gas emissions, in other words, to find answer to the key question whether it is possible to »make peace« between these two seemingly irreconcilable demands: economic growth and decrease of greenhouse gas emissions caused by intensified economic activity.

Economic Aspects of the Climate Change Impact

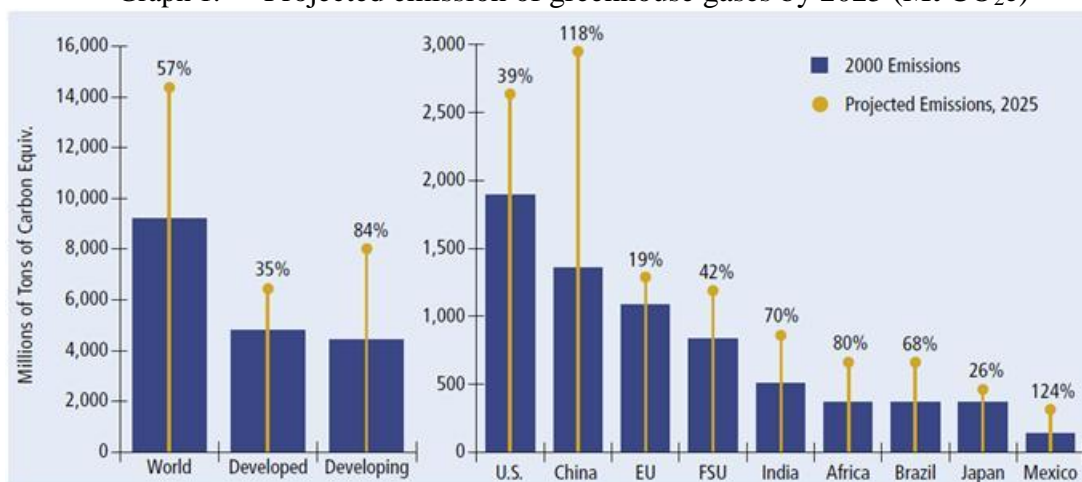
There are no more dilemmas whether climate change existed or not, but to what extent its effects »are felt«, with specific focus on their future impact assessment on aspects of economic, social and ecological systems. In order to minimize their influence it is necessary to define a threshold (limit) for dangerous climate change: the increase in average global air temperature to 2⁰C above pre-industrial level of 450ppm as the goal of stabilization of atmospheric concentrations of carbon dioxide. Achieving these goals will cost about 1.6% of average world GDP by 2030. The greatest challenge of international policy in facing climate change is to limit the greenhouse gases emission in the future. Developing countries strongly object to this, because due to the emissions that the most developed countries caused, they need to adjust their economy, which is mostly based on carbon intensive technologies. Furthermore, governments all over the world spend hundreds of billion dollars to subsidize fossil fuel industries, since almost 80% of the world's energy is generated from oil, carbon and gas, creating high level of dependence. According to some calculations, the last drop of oil will be spending on 27th October 2047. Until then, it is necessary to develop low-carbon technologies, whose implementation will enable achievement of economic-environmental efficiency. Thus, it seems reasonable view that the rapid development and application of these technologies is essential to mitigate the negative impacts of climate change.

The reorientation to renewable energy sources and application of so called »green« technologies require significant financial resources that may mitigate the chances for further growth and development. The latest analysis shows that the substitution of fuels that create greenhouse gases could cost 1% to 3% of world GDP, and the developing countries would be most affected since they are facing the choice between the need for faster economic growth and development and environmental sustainability in short term. According the UNDP, for introducing »green« technologies in these countries it takes between \$25 and \$50 billion on annual level.²²⁸

²²⁸ UNDP (2007), *HDR 2007/2008: Fighting climate change: Human solidarity in a divided world*, New York, NY, USA

Some calculations show that 25 countries with highest greenhouse gas emissions contribute to total emissions about 80% on average. Developed countries, which in 2005 accounted for 20% of the world population, emitted about 75% of total CO₂ emissions until 2000.²²⁹ Estimations made by the Energy Information Administration (EIA) point that the fastest growth of CO₂e will occur in developing countries, even for 84%, which will, until 2025, increase their contributions to global emissions on about 55%. The projected growth of CO₂e will to largest extent be caused by population increase, increased energy consumption, reduction of arable land and forest areas. Among developing countries, the highest growth was forecasted for Mexico (124%) and China (118%), which with those emissions will surpass USA, currently the world's largest greenhouse gas emitter.

Graph 1. Projected emission of greenhouse gases by 2025 (Mt CO₂e)



Source: WRI (2010), *Navigating the Numbers: Greenhouse Gas Data and International Climate Policy*, available at: http://pdf.wri.org/navigating_numbers_chapter3.pdf

Many studies show that the most sensitive to climate changes are underdeveloped and developing countries. They will bear the major part of negative consequences of these changes, while being the least responsible for their occurrence. UNDP Human Development Report 2007/2008 states that some 262 million people were affected by climate disasters annually from 2000 to 2004, over 98 percent of them in the developing world. In the Organisation for Economic Co-operation and Development (OECD) countries one in 1,500 people was affected by climate disaster.²³⁰

²²⁹ Egenhofer, C. i Georgiev, A. (2010), *the Treaty of Copenhagen - The first attempt to decipher the implications of the EU, Climate change: Studies and analysis*, European Movement in Serbia, Beograd

²³⁰ UNDP (2007), *HDR 2007/2008: Fighting climate change: Human solidarity in a divided world*, New York, NY, USA

Due to their low level of development and limited resources underdeveloped countries are not able to develop efficient strategies for climate risk management and to bring those risks to a minimum. Therefore that are the least capable to adapt to climate change. Naturally, climate changes will reduce their possibility and potential of economic growth and development and make gap between rich and poor even bigger.

The European Union and Facing the Climate Change

The EU is currently responsible for 17% of global emissions of carbon dioxide and 20% of greenhouse gas emissions of industrialized countries. The obligation taken by Kyoto protocol²³¹ is to reduce emissions in 8% in comparison to 1991 and it should be fulfilled in the period 2008-2012. The largest contribution to achievement of this 8% target gives former socialist countries. However, observing the level of new emissions from 2003-2007, the majority of them recorded growth trend caused by increased economic activity and growth. Luxemburg and Spain have achieved the largest exceeding of Kyoto target - 41.76% and 33.38%.

Table 1. EU member states (Mt CO₂e) and relation towards Kyoto targets

EU members	2003.	2004.	2005.	2006.	2007.	Kyoto target 2012.	Under Kyoto target
Latvia	10.7	10.7	10.9	11.7	12.1	23.3	48.07%
Estonia	21.2	21.2	20.7	19.2	22.0	40.0	45.00%
Lithuania	16.7	21.1	22.6	22.8	24.7	44.1	43.99%
Romania	ND ²³²	160.1	153.7	153.9	152.3	259.9	41.40%
Bulgaria	ND	68.9	69.8	71.5	75.7	127.3	40.53%
Hungary	83.3	795	80.5	78.8	75.9	114.9	33.94%
Slovakia	51.1	49.5	48.7	49.0	47.0	67.2	30.06%
Poland	382.5	396.7	399	399.3	398.9	551.7	27.70%
Czech Republic	147.5	147.1	145.6	149.1	150.8	180.6	16.50%
Sweden	70.9	69.7	67	66.9	65.4	75.2	13.03%
UK	658	660.4	657.4	647.9	636.7	678.3	6.13%
France	560.9	556.1	553.4	541.7	531.1	564.0	5.83%
Greece	137.2	137.6	139.2	128.1	131.9	139.6	5.52%
Belgium	147.6	147.6	143.8	136.6	131.3	135.9	3.38%
Germany	1024.4	1025	1001.5	980.0	956.1	972.9	1.73%
							Above Kyoto target
Netherlands	215.4	218.4	212.1	208.5	207.5	200.4	-3.54%

²³¹ The Conference of parties that adopted the Kyoto Protocol was held in Japanese city Kyoto on December 1997. The Kyoto Protocol is an international agreement that regulates greenhouse gas emissions and sectors that contribute the most to their emission. The major feature of the Kyoto protocol is that it sets binding targets for 39 industrialized countries and the European community for reducing greenhouse gas (GHG) emissions, in about an average of 5.2% against 1990 levels over the five-year period 2008-2012.

²³² No data

Portugal	83.7	84.6	85.5	84.7	81.8	77.4	-5.68%
Ireland	68.4	68.6	69.9	69.7	69.2	63.0	-9.84%
Finland	85.4	81.2	69.3	79.9	78.3	71.1	-10.13%
Slovenia	19.7	19.9	20.3	20.5	20.7	18.6	-11.29%
Italy	577.3	580.5	582.2	563.0	552.8	485.7	-13.82%
Denmark	73.6	68.2	63.9	71.0	66.6	54.8	-21.53%
Austria	92.5	91.2	93.3	91.6	88.0	68.7	-28.09%
Spain	407.4	425.2	440.6	433.0	442.3	331.6	-33.38%
Luxemburg	11.3	12.8	12.7	13.3	12.9	9.1	-41.76%
Malta	3.1	3.2	3.4	2.9	3.0	NT ²³³	
Cyprus	9.2	9.9	9.9	9.9	10.1	NT	

Source: Europe Energy Portal (2010), *CO₂ emissions in the European Union*, available on web page: <http://www.energy.eu/#CO2>

In an effort to solve the problem of global warming, the European Union took over the concrete commitment of climate regime after expiration of Kyoto protocol in 2010 and adopted Energy and Climate Strategy in 2007. The key missions of these policies are related to increasing energy efficiency in 20%, reducing greenhouse gas emissions in 20% and increase of the share of renewable energy sources in 20% and all to be achieved by 2020. »The set target of 20% is minimum level and it will be increased to 30% in international negotiations, since there is a concern that the European competitiveness could suffer serious consequences for the reduction of greenhouse gas emissions in case of reluctance of other large industrialized countries to commit themselves to achieving that objective.«²³⁴

The basic mechanism of climate change management on the level of the European Union and its members is the carbon-dioxide emissions trading.²³⁵ This system is based on the EU Directive 2003/87/EC and enables trading with the rights to greenhouse gas emissions between interested parties, most often commercial entities, in the European Union.²³⁶ The system operates in the way that EU members issue "quotas" of carbon-dioxide, in other words »right to emission«, where this »right to emission« is permit to emit one tone of CO₂e.²³⁷ The companies that do not use their surplus may sell it to other companies that exceed the allowed amounts. In this way, companies decide on their own whether they will reduce the level of

²³³ No target: there is no greenhouse gas emission target.

²³⁴ Dröge, S. (2010), *The EU Climate Strategy*, Climate Change: Studies and analysis, European movement in Serbia, Belgrade

²³⁵ In order to meet taken obligations, Kyoto protocol anticipates using two other market mechanisms: Clean Development Mechanism – CDM and Joint Implementation – JI.

²³⁶ This system has two periods of trading. The first period is from 01.01.2005. to 31.12.2007, which relates to preparing mechanism of international greenhouse gas emissions trading according to the Kyoto protocol. At the beginning of 2008, the so-called second period of trading started, which lasts five years and matches the first binding period of the Kyoto protocol. The third period of trading - period after 2012 is currently under discussion and it will cover the period 2013-2020.

²³⁷ <http://www.delhrv.ec.europa.eu/?lang=hr&content=980>

pollution or they will buy permits for pollution they emit, where the total level of pollution may not exceed the amount defined by total number of permits.

The aim of establishing this system is that EU member states limit the total of greenhouse gases emissions in a cost effective way in order to fulfill the commitments of the Kyoto Protocol. Application of this transferable permit system enables, by various market mechanisms, defining of the price for emission permit with pre-defined target emission reductions. The system encourages development of »green« technologies, in a way that companies that achieved surplus, may invest the funds obtained from their sale into development and application of less harmful technologies. Therefore the prevailing attitude is that reduction of CO₂e emissions by transferable permit system is achieved with minimal costs.

Practical application of this system showed its downsides. The governments of some countries set low quotas for certain sectors, and thus, the limitations of CO₂ emission were too low. This resulted in higher offer of the »rights to emission« and drop in price from €30 per tone of CO₂, first on 11€, while at the beginning of 2007 it amounted 7€. ²³⁸ However, according to the World Bank Report, the European Union Emissions Trading Scheme has still remained the main carbon market with 6 billion transactions of »emission rights«, ^{with total values of \$ 18 billion in 2009.} ²³⁹

Organization Sandbag²⁴⁰ in October published the Report which states that the EU Emissions Trading Scheme with CO₂ emission permits in the current five-year period is able to reduce the level of emissions in only 0.3%. According to them, one of the reasons for such low reduction lies in large offer of cheap international permits. The conducted analysis for the needs of preparation of the report shows that by 2012 the CO₂ reduction emission could be achieved in the amount of 32 million tons out of total annual emissions - 1.9 billion tons. according to them, better results could be achieved if the limitations to largest polluters are introduced, particularly to cement and steel industry. According to Sandbag estimations, 1.8 million permits will most probably be transferred to the period after 2012, which will negatively affect the investments into low CO₂ emission technologies. In order to avoid such situation, Sandbag suggests increasing CO₂ target emission reductions until 2020 from 20% to 30% and in accordance with that introduce more strict limitations. Otherwise, the main instrument of the European Union for CO₂ emission reduction

²³⁸ <http://www.suvremena.hr/3736.aspx>

²³⁹ http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:22594510~pagePK:34370~piPK:34424~theSitePK:4607,00.html?cid=ISG_E_WBWeeklyUpdate_NL

²⁴⁰ Sandbag is non-profitable group dedicated to the fight against climate change and promoting low-carbon emissions. For more details please visit: <http://www.sandbag.org.uk>

could lead to the increase in the future even up to 34% until 2016, instead of emission reduction.²⁴¹

Since 2008 the European Commission allows governments of the EU member states to offer on auction sale up to 10% of their permits issued during the second phase, in order to enable economic subjects to prepare for the third phase when there will be no free permit issuing. By the end of the last year, European Parliament Environment Committee adopted the list of industrial branches that will be entitled to free permits for carbon-dioxide emissions. »The list includes 164 sectors and sub-sectors, including chemical companies, steel plants, and plastic and aluminium producers. Other branches will buy part of permits on auctions, where in 2013 they will obtain 80% of permits for free, while in 2020 only 30%. From 2027 all permits for carbon-dioxide emissions will have to be bought on auctions.«²⁴² The first such auction was held in November 2008 in London where the government of Great Britain sold four million permits for greenhouse gas emissions. The permits were sold by the price of 16.15€ per tone, and the amount collected was €64.6 million.²⁴³

It can be said that climate change »created« new goods in the form of harmful gas emission reductions. Since the carbon dioxide is the major cause of greenhouse effect, the word is about Carbon Market – CM. The value of this market in 2006 amounted \$30 billion with the tendency of further growth. The latest World Bank Report shows that the value of carbon on global level in 2009 grew to \$144 billion, up 6% from 2008.²⁴⁴

In the long term, emissions trading can be a key tool in dealing with climate change at international level and reduce their negative impact, especially in less developed countries that will suffer the greatest consequences. The abovementioned will be possible to achieve if the rules of trading are defined in advance and should be binding and equally applied for all participants and if countries, both developed and undeveloped, accept the compulsory targets.

Western Balkan countries, if they want to become a full member of the EU, must harmonize their national legislation with the EU legislation in areas of environmental protection and harmful gas emissions. These countries during 2006 and 2007 ratified the most important documents related to greenhouse gas emissions and fight against climate change, Kyoto protocol and United Nations Framework

²⁴¹ Elsworth, R. i Worthington, B. (2010), *E R WHO? Joint Implementation and the EU Emissions Trading System*, Sandbag UK, dostupno na web stranici:

http://www.sandbag.org.uk/site_media/pdfs/reports/Sandbag_2010-10_ERWho.pdf

²⁴² <http://www.weekend.ba/novost/13225/besplatne-dozvole-za-emisiju-ugljen-dioksida>

²⁴³ <http://www.capital.ba/uk-prodala-cetiri-miliona-dozvola-za-emisiju-gasova/>

²⁴⁴ http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:22594510~pagePK:34370~piPK:34424~theSitePK:4607,00.html?cid=ISG_E_WBWeeklyUpdate_NL

Convention on Climate Change (UNFCCC). Given that the countries in the region are members of the Convention in Non-Annex 1, they are not obliged to reduce gas emissions. However, membership in the Convention imposes the obligation to periodically prepare greenhouse gas inventory as a part of the development of the National Report to UNFCCC, as well as the report on vulnerability of the natural resources and economy to climate change. By joining the European Union, implementation of these documents and commitment to reduce harmful gas emissions, gradual transition and application of »green« technologies will be based on the imperative, rather than voluntary basis.

Final Remarks

Predominantly caused by human activities, national by their origin, global by their consequences and effects, climate change is the key factor of future social and economic growth and development. There are evidences that their impact in the future will be even more intensive and stronger with very negative consequences. Consequently, in 21st Century the major threat to achieved level and future growth of society is the climate change. The application of proper measures both on individual and institutional level can create new opportunities for saving. On the level of overall economy, climate change policy can be the driving force of development, in a way that it will contribute to the replacement and closing of inefficient industrial systems both from environmental and economic aspect. On individual level, it is necessary to undertake suitable instruments that will result in reduced demand for atmosphere polluting products. This in the first line refers to raising the level of awareness and informing the public about how much our consumption choices influence the environment and contribute to climate change. In order to citizens be able to buy products and services from companies acting environmentally responsible, the European Union introduced Eco-Management and Audit Scheme – EMAS. Through ecological labels on products and services, consumers and all interested parties can check whether the manufacturer is involved in this program and in that way contribute to further promotion of environmentally responsible behavior.²⁴⁵

Anyway, many changes happened through history: political, social, cultural and economic and only those having the highest ability to adapt to altered conditions survived them. Observed in the context of climate change, it is about our commitment to adjust our own behavior and activities we undertake with the nature and its processes. How and in what way we will do it, it depends entirely on us. Will we turn off the lights in premises and places where not needed, set the optimal temperature on thermostat, take out cell phone battery charger from the plug box after using, take more walk, use public transport, avoid leaving computer and other electrical devices on »stand by« mode, etc? What consequences of our present decisions will bear those that will inherit us depends only on ourselves.

²⁴⁵ http://ec.europa.eu/environment/emas/index_en.htm

Bibliography

- [1] Cline, W.R. (1992), *The Economics of Global Warming*, Washington, DC: Institute for International Economics
- [2] Dröge, S. (2010), *Klimatska strategija EU*, Klimatske promene: Studije i analize, Evropski pokret u Srbiji, Beograd
- [3] Egenhofer, C. i Georgiev, A. (2010), *Sporazum iz Kopenhagena: Prvi pokušaj dešifrovanja implikacija na EU*, Klimatske promene: Studije i analize, Evropski pokret u Srbiji, Beograd
- [4] Elsworth, R. i Worthington, B. (2010), *E R WHO? Joint Implementation and the EU Emissions Trading System*, Sandbag UK, available on web page: http://www.sandbag.org.uk/site_media/pdfs/reports/Sandbag_2010-10_ERWho.pdf
- [5] Europe Energy Portal (2010), *CO₂ emisije u Evropskoj uniji*, available on web page: <http://www.energy.eu/#CO2>
- [6] Evropski pokret u Srbiju (2010), *Klimatske promene: Studije i analize*, Evropski pokret u Srbiji, Beograd
- [7] Goodstein, E.S. (2003), *Ekonomika i okoliš*, MATE, Zagreb
- [8] Harris, J. M. (2009), *Ekonomija životne sredine i prirodnih resursa: Savremeni pristup*, DATA STATUS, Beograd
- [9] Intergovernmental Panel on Climate Change – IPCC (2007), *Climate Change 2007: Synthesis Report. Contribution of Working Groups I, II and III to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change*, [Core Writing Team, Pachauri, R.K and Reisinger, A. (eds.)]. Cambridge University Press, Cambridge, United Kingdom and New York, NY, USA
- [10] Nikolić, S. (2010), *Uticaj klimatskih promjena na ekonomski rast i razvoj – uzroci i posljedice*, Magistarski rad, Ekonomski fakultet Podgorica
- [11] Stern, N. (2007), *The Economics of Climate Change: The Stern Review*, Cambridge University Press, Cambridge
- [12] United Nations Development Programme – UNDP (2007), *Human Development Report 2007/2008: Fighting climate change: Human solidarity in a divided world*, New York, NY, USA
- [13] World Resources Institute – WRI (2010), *Navigating the Numbers: Greenhouse Gas Data and International Climate Policy*, Washington, DC: World Resources Institute, available on web page: http://pdf.wri.org/navigating_numbers_chapter3.pdf
- [14] <http://www.ec.europa.eu>
- [15] <http://www.energy.eu>
- [16] <http://www.gov.me>
- [17] <http://www.ipcc.ch>
- [18] <http://www.oecd.org>
- [19] <http://www.undp.org>
- [20] <http://www.unfccc.int>

[21] <http://www.wri.org>

[22] <http://web.worldbank.org>

mr Jadranka Glomazić*

Harmonization of financial statements in the European Union – importance for the integration of the Balkan

Abstract

The paper is the result of research on the harmonization of financial reporting in the European Union and its significance in relation to financial reporting in the Balkans. This is because some of the Balkan country candidate for EU membership, and all the others are either on their way to be, or are serious in adopting policies that carry the euro integration

At the beginning, this paper presents the goals of the preparation of financial statements, and users whose needs meet the information presented in the financial statements of companies. After that, presented the importance and the goal of harmonization of financial statements, as a way to financial statements of all companies complies and prepared in accordance with the same rules. Harmonization of financial statements allows the information from which are included are of high quality to all companies operating under the same conditions and to increase the degree of comparability of their financial reports.

The second part of paper presents the instruments used in the harmonization of financial statements, and that financial statements are the subject of harmonization. The paper also introduces with elements of financial statements, how they recognize and measure.

Key words: Financial Statements, Harmonization, Comparability, Accounting Regulations, International Accounting Standards (IAS), European Union, Balkan.

1. Introduction

In recent decades in Europe initiated a process to craete a single European economic market. Infrastructure single economic market has been greatly influenced by accounting principles, accounting policies and valuation principles.

* University of Donja Gorica (UDG), Podgorica

In recent decades, in the Europe has initiated the process of creating a single European economic market. Accounting principles, accounting policies and valuation principles of the very influence to the infrastructure of the single economic market. Increasingly there is a need for comparing the company financial statements of some European countries. For this reason the EU has put emphasis on the harmonization of accounting regulations of the countries that are its members. On the other hand, the Balkan countries seek to harmonize their accounting rules with the European Union; because of their preparation for EU membership, and to facilitate cooperation and communication companies in these countries with companies in the European Union.

In this paper, the Balkan countries are all countries that, according to the political division, belong to the Western Balkans. Thus, we mean the Balkan countries that are not yet members of the European Union. According to this division of the Balkan countries are: Montenegro, Serbia, Croatia, Bosnia and Herzegovina, Kosovo, Macedonia and Albania.

2. Goals of financial reporting

Any change in the company for a certain period of time is recorded in financial statements of the company. These financial statements are the final picture of changes in that time period.

The main objective of financial statements is to provide information about business performance, yield and the company's financial position and about changes in these positions that are importante to a wide range of users for making economic decisions. Users of financial statements make decisions: when to buy, hold or sell shares of the company; estimated liability management; assess the company's ability to pay salaries to its employees; determine tax policy; determine by profits and dividends that are distributed or compile and use statistics of GDP.

Financial statements must be standardized in form and content in order to meet the needs of users. The fourth directive specifies formats for publication of financial statements, with which defines the content and order of presentation of individual items in the reports.

Users of financial statements are subject to the company or outside it who are in any way interested in its financial situation and success. For the business of the company are interested: investors (shareholders), managers, other employees, current and potential creditors, suppliers and other creditors, customers, government and its

agencies, the public. All users of financial statements can be grouped according to different criteria. The most common divisions are:

- internal and external users
- users with direct or indirect financial interest

2.1. Internal and external users

This division based on the fact what the position of users in company. According to this division, internal users are managers at all levels of responsibility and decision-making and company employees. On the other hand, those who are outside the company and who are interested for the business of the company are: current and potential investors and shareholders, current and potential creditors, suppliers and other creditors, customers, government institutions, such as tax administration, other government and non-governmental organizations, such as commissions for securities or central banks, financial advisors; auditors, trade unions and the general public.

In addition to the position in relation to the company, internal and external users are also differ in their objectives that seek to achieve by using financial statements. Therefore, all of these goals can be grouped into goals of internal and goals of external users.

2.1.1. Goals of internal users

Managers of the company are responsible for the preparation and presentation of financial statements of the company. On the other hand, they are interested for the information presented in financial statements, too. This information to assist them in planning, decision making and control in the company. The information contained in standardized financial statements are presented for the needs of most users and, as such, are not enough managers to make business decisions. For this reason, managers need additional accounting information. Managers determine the form and content of such additional information to meet their needs for them.

Employees are interested in information about the stability and efficiency of operations, as well as for the perspective of the company where they work. This information will allow employees to assess the company's ability to provide them with the payment of salaries, contributions on salaries and other rights. Thus, employees want to assess the safety of their jobs.

2.1.2. Goals of external users

Capital owners are in need of information that will assist them in making decisions about whether to buy, hold or sell shares of the company. They are interested in information that will help them to assess the company's ability to pay dividends, too.

Investors are directed to the risks related to investments in the company and the return of these investments.

Creditors, present or potential, are interested in such information from financial statements that will help them determine whether their loans and the interest accrued will be returned on time.

Business partners are the suppliers, customers and competitive company. Suppliers need information from financial statements that will allow them to assess credit worthiness of the company. Customers are interested in the information with which to consider the possibility of continuing the company's business, and therefore the possibility of their further cooperation. Competitors use information from financial statements in order to assess the competitive advantage.

Government and its agencies need information about operations in companies for determine tax policies and the basis for calculating a country's national income and similar statistics. For this reason, the government and its agencies use financial statements in order to obtain the necessary information.

Auditors give an opinion about the reality and objectivity of financial statements in accordance with the framework of financial reporting. They represent a link between managers in the company, who are responsible for the preparation and presentation of financial statements, and all users of the information contained in financial statements.

The financial statements of companies can be made available to the general public and are of great importance. Companies influence the public in various ways. First of all, can contribute to the local economy by hiring more people and supplies from local suppliers.

Thus, the financial statements of companies help the public to assess trends and changes in a given company, and the range of its activities.

2.2. Distribution of users according to financial interests

As noted above, depending on the financial interests of users of financial statements, all users can be divided into those who have a direct financial interest and those who have an indirect financial interest in the use of data from financial statements. Thus,

users with a direct financial interest are: managers, current and potential shareholders, current and potential creditors and employees. On the other hand, users with indirect financial interest are: tax administrations and other government institutions, the commission on securities and stock exchanges, central banks, unions, financial advisers and analysts, auditors and general public.

Due to financial conflict of interest, users of financial statements and have different needs for information. For this reason, conflict can arise goals of some users of financial statements. Thus, managers of the company directly to determine the accounting policies, and thus directly affect the achievement of its objectives. On the basis of the stated objectives, conflict management and shareholders appearing in the profit sharing. A goal of shareholders is to maximize dividend, a goal of managers is to maximize the retained earnings. Regardless of the conflicts of goals, managers and shareholders are required almost the same accounting information.

Based on this, we can conclude that the users of financial statements with a direct financial interest in the information needs of a greater degree of homogeneity. On the other hand, when a user with direct reports, and the other with indirect financial interest, then the heterogeneous information needs. For example, the needs are heterogeneous in the relation between managers and shareholders on the one hand, and tax administration on the other. Managers and shareholders for the realization their goals using information from the detailed financial statements, tax administration used the information contained, primarily, in the income statement.

Thus, the existence of conflicts between users of financial statements with a direct financial interest and those with indirect interest, the need for information from financial statements can be homogeneous and heterogeneous.

3. The importance of harmonization of financial statements

According of the meaning of words „the harmonization“, harmonization of financial statements is their harmonization for all companies, or their preparation in accordance with identical rules. The consequence of the harmonization that reports of all company resemble one another and thus are easier to use. All this is aimed at achieving a satisfactory degree of comparability of financial statements.

Reasons for the harmonization of financial reporting are to protect the interests of investors and creditors, as well as creating conditions for fair competition in the financial markets of the European Union and the Balkan countries.

The European Union has begun the process of harmonization of accounting by introducing the Fourth and Seventh EU Directives. Directives have made important progress in the harmonization of the financial statements of EU member states, so they set up a uniform system of accounting principles and have prescribed a standardized layout of financial statements. However, these directives have not reached the expected level of comparability and transparency of financial statements. For this reason, the European Union introduced the obligation of using International Financial Reporting Standards (IFRS) by Regulation of the European Parliament of 19 July 2002.¹ These standards issued by the International Accounting Standards Board for all companies that prepare consolidated financial statements and listed on stock exchanges regulated financial markets. This requirement came into force on 1st January 2005. and applies to all EU Member States.

The process of harmonization of financial statements is of utmost importance for companies that prepare consolidated financial statements. The preparation of these reports would be simpler if the reports of all companies in the world compiled on the same basis.

Harmonization of accounting include harmonization of accounting standards governing the measurement and publication of financial reports published by companies and harmonization of auditing standards and reports. In addition, harmonization need to be implemented in many other areas, such as training of auditors, public disclosure, and so on. However, the most important process of harmonization is the harmonization of accounting standards because these standards include the very important areas such as measurement and disclosure of financial statements.

The process of harmonization of the financial statements of the European Union takes place in two parallel processes:

1. The harmonization of national standards with IFRS;
2. The process of harmonization with U.S. GAAP.²

Bearing this in mind, cooperation The European International Accounting Standards Board (IASB) with The U.S. Financial Accounting Standards Board(FASB) is very intense and focused on the harmonization of national standards.

4. The goals of harmonization of accounting regulations

¹ <http://eur-lex.europa.eu>, Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19. July, 2002. on the application of international accounting standards

² GAAP – Generally Accepted Accounting Principles

For EU Member States the harmonization of accounting regulations is only part of the development EU into a single economic market. In this regard, it is necessary to distinguish the two objectives of harmonization of accounting regulations: the creation of a single competitive market and creating an efficient, integrated capital markets for the European Union.

To achieve the goal of creating a single competitive market, it is necessary that all companies operating in the EU under the same conditions. Applying this principle to the financial reporting need to harmonize the financial statements.

As for achieving the goal of creating an efficient, integrated capital markets, quality data are essential in the financial statements of companies that are trying to enter a market capital. Here is a very important role of financial reporting, which consists in reducing asymmetric information that could prevent some companies to enter the market. If the financial statements contain better quality information, it is easier to remove some asymmetry and thus increase market efficiency.

What does mean the integration of capital markets in the European Union? This integration enables a Member State A to Member State B and C lend capital, but also to borrow from them.

The process of harmonization of the financial statements of EU companies was influenced by factors outside the EU, first of all factors of the United States and other countries with English-speaking world. This resulted from the increasing degree of internationalization of capital markets and the needs of European companies that, in addition to Europe, enter in the international capital market.

All this called for harmonization of accounting at the international level. No longer a question of whether the need of international harmonization of accounting, but on the way to achieve this harmonization. In this regard, there are many discussions: whether the financial statements uniform or only harmonize; whether all companies, regardless of size or industry, should follow the same accounting standards; whether less developed countries should apply the same accounting standards as well as highly developed countries and many other discussions.

5. The reasons for the harmonization of financial statements in the European Union

All those who advocate the need for harmonization of financial statements believe that harmonization has many advantages, as the major reasons for its application. The most significant advantage, which stands out the most, is that the costs of

preparing financial statements according to one set of accounting standards are much lower than when they are prepared using multiple sets of standards. In addition to these benefits, emphasize and the following advantages:

- network externalities – arise when are widespread implementation of common standards;
- comparability of financial statements of different companies.

These two advantages are coming to the fore at a time when many users use the same accounting standards.

5.1. Network externalities

These externalities in applying accounting standards have led to the individual benefits from the application of these standards increase with the number of users of the same accounting standards. As a result, when a large number of users using the same standards, the aggregate benefit of all users will exceed the sum total of individual users. Such positive externalities resulting from a widespread use of broad groups of the same accounting standards, allowing users of financial information that saves time spent on exploring the application of another set of standards.

This network externality exists when using phone. In this case, when a person buys a phone, an indirect benefit from the purchase will be observed in other phone users. As with using the phone, the higher the number of users who apply the same accounting standards, the benefits for each individual user are higher. Thus, if two users apply these standards, comparison of the financial statements of a company will mean only a comparison with reports of other company that apply the same standards.

Applying the same accounting standards in economies of around the world would lead to connecting users of financial statements over the world and all those who prepare financial statements in one global network. In this case, the comparison of financial statements quickly and efficiently, because all users of the same standards familiar with their contents.

5.2. Comparability of Financial Statements

Another very important advantage of the harmonization of financial statements and application of the same accounting standards is the comparability of financial statements between companies. Applying the same standards helps managers and investors in making decisions on capital market. In addition, investors and financial analysts need reliable and comparable financial statements to understand the

financial statements of companies whose shares buy. Accountants who prepare consolidated financial statements, it would be easier to prepare such reports if they are all over the world prepared in the same way. Also, multinational companies would be easier to switch from one accounting staff to another country.

However, preparation of financial statements by applying the same system of accounting standards is not the only condition of comparability of financial statements. Thus, the financial statements that are prepared using the same accounting standards does not mean that they are comparable. This is because accounting principles are clear and objective. In practice, accounting is more a kind of art, because many items in financial reports based on subjective assessment of those who prepare financial statements.

6. The instruments of harmonization of financial statements

The instruments of harmonization of financial reports are the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS). These standards are the rules that apply to accounting, to be in a simple way to meet the goals of financial reporting. Thus, international accounting standards means the same as the rules of the game in basketball game. They provide that the financial statements are prepared under the same rules, which allows users to read them on the easier way, no matter what country they are located. These standards are laid down at a general level, and in different countries can be accepted at any of the following:

- as national standards;
- as national standards, but adapted to local requirements;
- national standards can be set independently, but in compliance with international accounting standards.

Each company is obliged to respect only those international accounting standards that are ratified and adopted. Some standards will be adopted and approved if the following conditions are met:

- standard must not be contrary to the principles of true and fair opinion as required under the Fourth and Seventh EU Directive;
- standard must be conducive to overall good;
- standard must meet the criteria of understandability, relevance, reliability and comparability.

In countries that have adopted IAS as a national problem there is on the what basis to prepare reports for companies which not listed on the stock exchange. Possible solutions to this problem are:

- to develop standards for small and medium enterprises by the International Federation of Accountants (IFAC) or
- that national standards or principles laid down bring on the same basis as međunarodniaccounting standards.

Therefore, international accounting standards are the application of the principle of balancing the specific business events. Although IAS apply the principles of balancing, they do not contain these rules. Thus, all the goals, assumptions and principles that are built IAS are presented in the conceptual framework of international accounting standards.

It is necessary to understand that the conceptual framework is not standard, and therefore does not set standards for any area of assessment or publication. The conceptual framework is a framework on which are built IAS's. So, if there is a conflict between a conceptual framework and accounting standards, then the requirements of this standard take precedence over the requirements of the framework. The conceptual framework is concerned with: the objectives of financial reporting; qualitative characteristics of the elements that make up the financial statements; determining, assessing and evaluating the elements that make up the financial statements; the concepts of capital and preserve capital.

The framework applies to financial statements of individual companies, as well as on reports a group of companies, which are compiled semi-annually (interim reports) and annual (annual reports). These financial statements include the following elements:

- Income Statement;
- Balance Sheet;
- Statement of Cash Flows;
- Statement of Changes in Capital;
- Notes to the Financial Statements.

7. Elements of Financial Statements

Elements of financial statements are the results of financial transactions and other events, which are grouped in an appropriate statement in accordance with the economic characteristics. Components of the balance sheet and income statement are

analyzed and classified according to the needs of their users. Always choose the way that best provides the information needed for decision making.

7.1. Elements of the Balance Sheet

Elements of the balance sheet that are in direct relation with the measurement of financial and property status of the company are: the property (assets), liabilities and equity.

Assets represent a resource that controls the company as a result of some past events. Since assets are expected flow of future economic benefits to the company. Past events that lead to a given company's assets include: purchase, construction, manufacturing, gift, etc. Control of assets is when a company claims all benefits from the asset and bear the risks arising in connection with a given asset. The future economic benefits embodied in an asset may flow to the company in many ways: the use for new products or new services, which will be given to companies that sell, exchange for other assets; use to settle the obligation; use for distribution to owners of the company, etc.

Liabilities are present obligations of the company arising from past events. Upon payment of obligations is expected outflow of resources from the companies that create economic benefits. The present liabilities represents a duty or responsibility to act or perform something in a certain way. Obligations may arise by law, contract or common business practices. It is important to distinguish between present and future liabilities. Thus, the decision of the management company to procure assets in the future does not mean that the present obligation is arose. The obligation usually arises when the asset is delivered or when a company concludes an agreement for the acquisition assets.

Equity is the company's remaining assets after deducting all of its obligations ($E = A - L$)³. Equity consists of share capital, reserves from profit and undistributed profits. This division of capital may be important for users of financial statements in making economic decisions, when the point to the limitations on the ability of companies to distribute or otherwise use its capital.

7.2. Elements of Income Statement

Elements of income statement are in direct relation with the measurement of performance and forming the yield position of the company. These elements are: income, costs and operating result (profit / loss).

³ A – Assets; L – Liabilities; E – Equity.

Incomes are all increases in economic benefits during the accounting period in the form of inflows, enhancements of assets or decrease in liabilities.

Costs are all reducing the economic benefits of the company during the accounting period in the form of outflows, reductions assets or create liability. Costs reduces the capital of the company.

Operating result is the income minus the costs of company. The result can be positive in the form of profit or negative in the form loss.

8. The recognition of elements of financial statements

The recognition of elements of financial statements is a process involving positions that meet the definition of an element in the Balance Sheet or the Income Statement. In other words, this means deciding whether the consequences of a transaction should be recorded on the Balance Sheet or Income Statement. This includes a description of individual items and their amount. Flaws that are made in recognition can not be corrected so that will be disclosed in the notes to the financial statements or disclosure of accounting policies used. Some element, as a result of the transaction should be recognized if:

- it is likely that any future economic benefit associated with that element to flow to the company or bulge out of it,
- the element can be reliably measured.

In recognition of the individual elements of financial statements, should bear in mind the interconnectedness of elements. Thus, if an element has the conditions to be recognized as an asset, then its recognition withdrawn at the same time recognizing or obligation or income. Also, if an element is eligible to be recognized as a liability, it is necessary to immediately recognize an asset or a costs.

8.1. Recognition of assets

The asset on the balance sheet is recognized when it is probable that future economic benefits will flow to the company and when the value of the asset can be reliably measured.

When there is an expenditure which is not likely to cause a flow of economic benefits to the company, after the expiration of the current accounting period, such an asset can not be recognized on the Balance Sheet. The result of this transaction is the recognition of costs in the Income Statement.

8.2. Recognition of liabilities

Liabilities in the balance sheet are recognized when it is probable that an outflow of economic benefits will result from the settlement current liabilities and when the amount of liabilities to be settled can be reliably measured.

In the event that an obligation will not result in outflow of economic benefits from the company, then it is recognized in the income statement as income.

8.3. Recognition of income

The basic condition for the recognition of income in the income statement is that the income is actually made and that the same value can be reliably measured.

In other words, income can be recognized in the income statement when an increase in future economic benefits associated with an increase in assets or decrease liabilities, which may be measured. This means that the recognition of income occurs simultaneously with increased recognition of assets or reduce liabilities. For example: when the increase the net value of the assets of a company, at the same time in the Income Statement recognizes the value of income.

8.4. Recognition of costs

An income is recognized in the income statement when a decrease in future economic benefits arising from the reduction in assets or increases liabilities can be reliably measured. So, this means that recognition of costs in the Income Statement occurs simultaneously with the recognition an increase of liabilities or decrease of assets in the Balance Sheet. For example in case of depreciation of equipment (decrease assets) or liabilities incurred to employees (increase of liabilities) in the company.

9. Harmonization of financial statements in the Balkan countries

As noted above, the Balkan countries have a need to harmonize the financial statements in the way to EU integration. For this reason, each country needs to align its legislation with EU regulations. First of all, it refers to the harmonization of the Law of accounting with the Fourth and Seventh EU Directives and the application of International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS).

Iz tog razloga, Balkan countries have adopted new laws on accounting, which stipulates the obligation application of IAS and IFRS. In this regard, the Balkan states

align their financial statements with accounting requirements present in the EU. Thus it is possible to compare the financial statements of companies of one country with reports from companies other Balkan countries, but also with the financial statements of EU companies. All this leads to faster integration of the Balkans in the EU and easier "arrival" of European capital in the Balkan countries.

10. Conclusion

The general globalization of the world resulted that companies are increasingly looking for financing in international capital markets. Users of financial statements need information about the company that are understandable, reliable and comparable. For this reason, the process of harmonization of financial statements is inevitable. The instruments of harmonization are IAS and IFRS, prescribed by the International Accounting Standards Board (IASB). The European Union has a major role in the process of harmonization. EU seeks to adapt the IAS and IFRS to requirements of member countries. The EU's goal is to harmonize a financial reporting within the EU, but and internationally. Thus, the EU adjusted its accounting standards with U.S. generally accepted accounting standards (U.S. GAAP), too.

The Balkan countries should, through the application of IAS and IFRS, adopt EU rules. In other words, to harmonize their financial statements using these standards and thus achieve their comparability with the financial statements of the EU, but also around the world. Therefore, the harmonization of financial statements in the Balkans is one of the conditions of their readiness for the match with the EU, and thus with the whole world.

Literature

1. Association of Accountants and Auditors of Serbia (2007): „*Međunarodni standardi finansijskog izvještavanja – I i II knjig*), Računovodstvo d.o.o, Beograd
2. Berman Karen, Knight Joe (2007): „*Finansijska inteligencija*”, ASEE, Novi Sad
3. Choi F.D.S; Meek G.K. (2005): „*International Accounting*“, fifth edition, Pearson Prentice Hall
4. Glomazić Jadranka (2010): „*Analiza finansijskih izvještaja u funkciji korporativnog upravljanja*“, master thesis, Faculty of Economics, Podgorica
5. I. Pervan (2004.): *Usklađenost okvira finansijskog izvješćivanja u Hrvatskoj, Bugarskoj i Rumunjskoj sa zahtjevima Europske unije*, Financial theory and practice 28 (4) str. 469-485

6. James C. Van Horne (1997): „*Finansijsko upravljanje i politika*“, MATE, Zagreb
7. Klikovac Ana (2009): „*Finansijsko izvještavanje u Evropskoj uniji*“, MATE, Zagreb
8. Law on Amendments to the Law on Accounting and Auditing, Službeni list Crne Gore No: 80/08, iz 2008.
9. Meigs F. Robert, Meigs B. Walter (1999): „*Računovodstvo: temelj poslovnog odlučivanja*“, Mate, Zagreb
10. Nobes C, Parker R. (2004): „*Comparative International Accounting*“, eighth edition, Prentice Hall
11. Pyle, White, Zin (1976): „*Fundamental accounting principles*“, Irwin – Dorsey Limited, Georgetown, Ontario, Canada
12. Research CEED Consulting (2009): „*Unapređenje korporativnog upravljanja u Crnoj Gori*“, Securities Commission of the Montenegro, Podgorica
13. Straub T. Joseph (1997): „*Understanding Financial Statements*“, Velocity Business Publishing, Inc, Bristol
14. The Law on Accounting and Auditing, Službene glasnik Republike Srbije No: 46/006 i 111/09
15. The Law on Accounting and Auditing, Službene novine Federacije BiH
16. The Law on Accounting and Auditing, Službeni glasnik Republike Srpske
17. The Law on Accounting, Narodne novine Republike Hrvatske
18. Vukajlija Milan (2002): „*Leksikon stranih reči i izraza*“, Prosveta, Beograd
19. www.ec.europa.eu
20. www.eur-lex.europa.eu
21. www.europa.eu.int
22. www.fbihvlada.gov.ba
23. www.gov.me
24. www.keshilliministrave.al
25. www.ks-gov.net
26. www.srbija.gov.rs
27. www.vlada.hr
28. www.vlada.mk
29. www.vladars.net

mr Milica Daković-Tadić

The auditing profession, ethics and standards in the function of global development

Abstract: Information from financial statements are public and have an important role in reducing the information asymmetry in capital markets and contribute to efficient allocation of capital. The application of information technology to support business activities and performance for auditors means coping with the new elements of risk that legal entity should overcome, and the auditor to consider in the planning stages and performance audit of financial statements. It is up to computer auditors to tend to increasingly develop and apply advanced technology in the audit, which has great impact on accounting and auditing profession. In order to provide quality and efficient performing audit procedures, certified public accountants institutions in developed countries have built up codes of professional ethics. In order for society to function properly, among other things, the ethical conduct of its members is necessary.

Key words: audit, information, users, ethics.

Introduction

System of financial reporting presents a quantitative system that within information and financial reports about performances of companies and its managers are prepared in the specific operating period. Secure covering of company's business transactions in the form of financial reports present unavoidable informational support for all investors, business partners, competitors, managements, regulatory bodies, employees, government agencies and others. Information from financial statements are public and have an important role in reducing the information asymmetry in capital markets and contribute to efficient allocation of capital. As key qualities of accounting information, relevance and reliability are accentuated while high level of legal and other professional regulation and generally high level of information comparison on international level, as the most important qualities of financial reporting, made that financial reports use variety of informational requirements of different interest groups.

Application of information technologies for support and performance of business activities for auditors means facing new elements of risk that legal entity needs to overcome and an auditor should reconsider in the phase of planning and performing financial reports of revision. In order to understand electronic conducting of business, new skills and practices are required and their level depends on the complexity of electronic business activities. Auditors are required to understand well enough the events, transactions and practices that have or might have certain

substitution influence on financial and auditing report. Auditor considers the specificities of electronic trade changes in business environment of legal entity that can relate to electronic trade and business risks of electronic trade all because of its influence on financial reports.

The computer auditors are expected to have a tendency to develop and apply advanced technologies in revision which has great influence on accounting and auditing profession. Computerized accounting systems and controls within, from the aspect of assets preservation, organizations are becoming more significant and presenting the greater and greater challenge for auditors. Using of various methods and patterns in auditing aims to improve revision according to the development of information technologies. Modern models and patterns in the process of audit performing do not substitute auditor's professional opinion. They should provide adequate support and additional value in auditor's coming to the conclusion no matter if it is external or internal revision.

In order to secure quality and efficiency of performing auditor proceedings, institutions of authorized public auditors in developed countries have made professional ethics codex. These accounting and auditing institutes have also regulated proper mechanisms for conducting rules and principles defined by codex by all members i.e. members of official accounting profession. By the codex of ethical conduct in auditing, professional and other capabilities and characteristics are defined that authorized public accountants should possess. Ideal conduct should be expected and not just regulated in every profession because every professional should be competent, experienced, creative, honest, aware and very cautious. When it comes to the accounting profession it can be accomplished in the way that its practicerer are obliged to create public image to 1. Have independence, integrity and wanted level of objectivity, 2. Have a technical competence and experience, 3. Perform their professional obligations with attentiveness and extreme responsibility toward public, 4. Develop special relations with colleges.

2. Revision & IT

The task of auditing is to additionally empower and improve credibility of information created in accounting. Auditing does that by expressing and exposing of competent opinion about reliability of information contained in those reports to all interested parties. It would be a wrong conclusion that revision provides complete security that those financial reports do not contain materially wrong and unreliable data. That could be result of either a mistake in the processing of accounting information or a result of wrong evaluation in choice and application of accounting principles-which could not be discovered even in case when auditing is done in agreement with generally accepted revision standards. This especially applies in a case when accuracy of certain balance positions in a great extent depends on

occurrence of independent events chain.²⁴⁶ Electronic trade is typical to take place in electronic markets that are actually electronic systems that support at least one of the classic market's functions.²⁴⁷ In digital economic environment, question of security is of great importance. Information presents business resource so it is necessary to pay attention on safety of information as much as on material, human, energetic and other company's business resources. Constant development of IT along with providing new technical solutions in business information flow introduces new terms which enables precise identification of certain technological solutions and procedures.

IT environment has growing influence on use of procedure for testing functioning of data validity control. In System characteristics which can be result of way of processing itself, lack of entry data is included. That means that data can be entered directly into computer without supporting documentation. In some of online transaction systems written records about individual authorizations for data entry (for example, approval for order entry) could be substituted by other procedures such as control of allowing amortization which are part of accounting programs(such as credit limit approval). Certain data could be maintained only in computer database. In literature it is recognized as lack of visible trace of transaction. In manual systems it is usually possible to trace transaction through system by checking original documentation, logs, registers and reports. However, in IT environment transaction trace could be partially or completely in computer reading form, and further on it could be present only in time limited period. Certain transactions or analysis results do not have to be printed so in that case there is a lack of visible outcome because in manual or some other IT systems it is usually possible to visually check analyses results. In other IT systems analyses results do not have to be printed or only summary data could be printed. Therefore lack of visible outcome could result with need to access data located in databases that only computer can read. Intensified application of IT leads to easy access to data and computer programs. Data and computer programs can be accessed and then changed in computer itself or by using computer equipment from distant locations. Therefore in lack of appropriate controls, possibility of unauthorized access and change of data and programs by individual from outside or inside the company is increased.²⁴⁸

²⁴⁶ It is similar in case when accounting principles alone offer more options for evaluation of certain business transaction or events. For instance, there are several permitted ways of logging and presenting of stock as well as of evaluating of some other balance items. Neither available accounting literature nor a (simple) logic do not prefer one comparing to another. Mentioned flexibility in application of generally acceptable accounting principles enables companies maneuvering space to conduct balance policy in agreement with its needs and priorities. Besides that, disagreement between standpoints, interpretation and direct application of accounting principles between management and auditors are very common. These are the factors that must be taken into consideration when it comes to level of reliability of information from financial reports which previously had been the subject of revision.

²⁴⁷ There are numerous of electronic markets and the most famous are: electronics store, electronic supplies enter, electronic sale center, electronic fare, electronic auction, electronic business etc.

²⁴⁸ in writing this segment of the paper, I used the following resources: Chris Davis, Mike Schiller, Kevin Wheeler, 2008, Revizija informacionih tehnologija: korišćenje kontrola radi zaštite informacione imovine, Savez

Electronic trade is based on high technological infrastructure. Policies, procedures and records of servicing organization can be significant for financial reports revision of legal entity. An auditor considers agreements and other relevant documentation in order to determine the way legal entity responds to the risks that come from activities transferred to specialize servicing organizations. Guide about risk evaluation that servicing legal entity has on the control risk auditor exerts from ISA 401 "revision consideration regarding clients that use servicing organization."

In high risk business environment, legal entity reaction is directed on conducting appropriate safety infrastructure and appropriate controls consisted of precautions for: confirmation of buyers and suppliers' identity, insuring integrity of transactions, reaching agreement on conditions of trade, collection from clients but also crediting buyers and establishing protection protocols for privacy and information. Insight in legal entity's business, auditor further uses for establishing events, transaction or practice which relates on business risks and which according to the auditor's evaluation may result in material mistake in financial reports i.e. may significantly influence on auditing procedures or auditing reports.

By implementation and functioning of internal controls many risks may be reduced regarding e-trade activities. Depending on the extent of importance for statements in financial reports, auditor considers control environment and control procedures that legal entity has applied on its electronic trade activities. If the systems of e-trade are complex with great number of business changes and high level of risk regarding losing auditing trace, auditor can reach for auditing techniques using computer(IAPS²⁴⁹ 1009"auditing techniques using computer). The following aspects of internal control are especially significant in conditions when the activities of e-trading are emphasized: preserving integrity of control procedures in dynamic environment of electronic trade and enabling access to records in purpose of auditing. When legal entity has an internet support in e-trade activities and when external entities may access informational systems, safety infrastructure and legal entity control is of the utmost importance. In order to achieve adequate security it is necessary to fulfill the requirements for authorization, authenticity, confidentiality and availability. Security infrastructure and controls encompass information safety policy, information safety risk evaluation and standards, measures, practices and procedures on which introduction and maintaining of individual systems are based. The auditor should consider issues such as use of safeguard measures and antivirus programs, effective use of coding, development control and carrying out of systems used for e-trade activities support and etc.

Electronic records of e-trade can be more easily destroyed or changed than paper records. Restoration of e-trade activity is characterized by lack of paper evidence, so

računovodnja i Revizora Srbije, Beograd; Cvjetinovic Dr Milivoje "Revizija kompjuterskih aplikacija u računovodstvenim informacionim sistemima", Ekonomski fakultet, Beograd, 2000; Ljutić Branko Ž., Polić Stanislav R., 2002, "Revizija Informacionih tehnologija", MBA Press, Beograd; Polić Stanislav R., 2001, "Revizija u uslovima elektronskog poslovanja", Revizor br.14, Beograd;

²⁴⁹ IAPS – International Auditing Practice Statement 1009 "Computer- assisted Audit Techniques"

it is necessary that auditor check whether the safety policy and safety controls can correspond to request for suppression of unauthorized changes in accounting system. It is common that auditor tests automatized controls such as checking of records integrity, digital signatures and stamps and etc., during examination of electronic evidence. Depending on evaluation of those controls, auditor considers need for conducting additional procedures such as transaction details confirmation or account balance by third party.²⁵⁰

3. Revision as a profession

Financial reports revision has a professional status and as such altogether with other professions is in service of public interest. Revision is primarily focused on entities with interests in a certain company. Public trust is key item of revision survival and its development. If revision is to lose public trust by a chance, its survival, namely its purpose of existence would be made absurd. Aware of that, auditors in the world have begun to find professional organizations that will take account of protection of profession and its further development. For that reason, auditing organizations, besides insisting on high expertise and competence of its members, have increasingly started to insist on moral qualities of individual that perform financial report revisions; with the intention of avoiding, meaning repeating situations when certain auditing companies with its own involvement (Enron case) have almost brought to disaster entire auditing profession in the world. Insisting on moral qualities of representatives of auditing profession is crowned with ethics codex for professional accountants brought by International Federation of Accountants, and is adopted in our country as well. This codex, insisting on moral qualities of revision profession bearer, has an aim to keep independence and objectivity of individuals conducting revision. Only in those cases, when auditor is independent, objective, competent and skilled person, we can rely on his opinion. It should be mentioned that liability for formulating and exposing financial reports is on company's management, while auditors are liable for opinion expressed regarding those reports. Recognized supervisory authorities within professional organizations or on a higher level are obliged to establish rules which secure auditors to be: 1) competent and responsible individuals; 2) independent and honorable; 3) during conduction of revision, they must comply to certain technical standards; 4) must maintain their professional qualification; 5) must be able to cover costs that may arise from their declining to conduct revision (for example, insurance from professional risk with insurance company). Besides establishing these rules, recognized supervisory authorities must supervise whether members comply, and these institutions also obligatory administer professional register of auditors. Various professional entities cooperate among themselves, share information and often do some business

²⁵⁰ ISA 505 – "Eksterne potvrde"

together. Every certified accountant (auditor) is professionally answerable to the recognized supervisory authority that belongs to.

4. Ethics and standards in revision

Revision as a profession, similar to some others (medicine, education, advocacy, architecture and etc.), respects the need for introducing certain conduct rules in work of its members whose job is of common social, i.e. public interest and importance. Primary goals of formulating those conduct rules is to provide members cursor for behaving and executing obligations of the one part, and at the same time to function as standards for measuring performing professional duties adequately, of the other part. Set of these conduct rules is defined by professional ethics codex which represents normative frame for its members` conduct. All problems cannot be solved with ethical codex in studying and evaluation of moral values, because it is hard and almost impossible to stay "ethically clean" in unethical environment. That is why professional associations regulate moral conduct principles of its members based on basic categories of social values. As a set of certain rules and principles, every ethical codex gives directions for maintaining professional standpoint and conduct in accordance with accepted professional ethic towards preservation and development of profession.²⁵¹

The most important common characteristics of all recognized professions that enable its preservation and development are as follows: 1) common public interest practice that contributes elevating motivation and labor quality and preservation of competence (public interest in revision are represented by all internal and external users of verified reports); 2) complex professional knowledge, experience and efficiency (due dynamic changes of environment in revision, adaptation of practice by frequent legal regulations and concept of accounting is necessary); 3) rigorous rules to access profession (every auditor must accomplish strictly defined standards of expert education and practical experience); 4) public trust (public trust has special significance for revision as profession as without it, goal of auditing activity could not be accomplished and auditing report would be of any use to anyone).

Public accounting companies have aimed its effort towards two main areas: 1) establishing professional ethics codex; 2) establishing and updating revision standards. Authoritative institutions which issued standards are American Institute of Certified Public Accountants (AICPA²⁵²) and The International Federation of

²⁵¹ Campbell Tom, Houghton Keith, 2005, "Ethics and Auditing" Published by ANU E Press The Australian National University Canberra ACT 0200, Australia

²⁵² AICPA – American Institute of Certified Public Account

Accountants (IFAC²⁵³), which issued Professional Ethics Codex and International Auditing Practice Committee (IAPC²⁵⁴), which as regular committee of IFAC is in charge of development and issuing standards and information about revision and services similar to it.

Revision standards are basic principles which determine nature and extent of necessary researches in every examination and which auditors, as members of professional entities, are obliged to apply in the process of revision. They represent elaboration of auditing principles. Imperative character of auditing standards is conditioned by its goal. They determine frame of auditor`s conduct, help him with the choice of auditing procedures that ensure high quality of performance and contribute to providing enough evidence for stating independent opinion about accuracy of financial reports.

Publication of standards, guides and auditing rules by professional entities effects on: 1) Quality of audit performing (performance is eased and audit procedures are equalized between different companies); 2) relation between client and auditor (principles cannot accuse auditor for inadequacy duration of auditing or to depose him because everybody complies with the same rules); 3) public opinion on audit role (gap between real and expected output is reduced because readers of the report can refer to standards) and 4) profession image (issuing standards indicates profession aspiration that its members provide good public service and government need to regulate auditing domain is diminished).²⁵⁵

Auditing practice is regulated by auditing standards which every auditor must esteem. They are applied always during performing audit. Standards do not substitute auditor`s judgment. They provide help to the auditor with the choice of necessary extent and depth of auditing judgment, as well as with the choice of expedient methodology. On the other part, standards determine criteria that help determine quality of audit results. Therefore, auditing standards are authoritative rules which measure performance quality of independent auditors. They are disclosed in purpose of lessening area of difference and variety of common auditing procedures and establishing of authoritative auditing practice that must be obliged in every situation. There are international and national auditing standards. National professional accounting entities, which are members of IFAC, incorporate international auditing standards in its national standards.

²⁵³ IFAC - The International Federation of Accountants

²⁵⁴ IAPS – International Auditing Practice Committee

²⁵⁵ Auditing standards have become from published opinions and interpretations of certain terms and procedures by professional institutions, in purpose of easing work to auditors, as well as issued guides which specify technical procedure of audit, which later on altogether assisted establish, i.e. formulate standards. Complying with professional standards is mandatory as well as exposing from its evasion, because they have legal acknowledgement, i.e. legal power. General public is given insight in standards` drafts, contemplated with comments and by necessity their draft is altered, and by Professional Institution Committee approval is published.

IFAC significantly contributes to the harmonization of auditing standards and practice.²⁵⁶ Issuing of international auditing standards has goal to elevate on higher level uniformity of auditing practice over the world. Even if IFAC is not able to harmonize auditing standards and practice, global market of capital will, because large corporations seek for the capital on global market and their audit must performed by one of the global auditing companies. These companies improve level of auditing standards in practices all around the world through its correspondents and capital relations. These same practices find their way in individual national practices of certain countries also.

Basic benefits from internationally acceptable standards development are as follows: 1) readers of auditing reports in other countries gives confidence in auditor's opinion, i.e. gives credibility to foreign auditor's work, which enables that auditor to give credibility to financial reports; 2) increase already existing benefits from international accounting standards, providing more security to readers that accounting standards are complied with; 3) help readers in creating international financial corporations; 4) provide further stimulation for improvement and enlargement of international accounting standards set; 5) facilitate and dictate the course of investing capital; 6) make easier for developing countries to form domestic national auditing standards and 7) increase efficiency and credibility of financial reporting everywhere where management (that prepares financial reports) separated from persons who use those financial reports, and need and necessity for audit is even bigger in cases where management is separated from users by bigger difference in cultural ,political and economic systems, geographical borders and etc.

Process of standardization in auditing for a goal has to secure enviable level of quality while conducting this very important function of public interest. In fact, it is about the function which contributes to efficient functioning of market capital in modern business environment.

Conclusion

In a modern, globalized and mostly based on IT business environment, financial reports (balances) are prepared and presented in accordance to the set of "basic rules" known as "Generally acceptable accounting principles(GAAP²⁵⁷) and International financial reporting standards(IFRS²⁵⁸). Its aim is to present useful and

²⁵⁶ IFAC has evolved from International Coordination Committee for the Accounting Profession (ICAAP – International Coordination Committee for the Accounting Profession) founded in 1927 in International Congress of Accountants in Sidney in order to work on more formal organizing to achieve harmonization between accounting and auditing profession. That is why in 1973, International Accounting Standards Committee is founded (IASC- International Accounting Standards Committee). International Federation of Accountants (IFAC) is founded on International Congress in 1977 in Munich as non-profitable, nongovernmental and nonpolitical organization of accounting bodies. General goal of IFAC is development and expansion of coordinated accounting profession on world level with harmonized standards.

²⁵⁷ GAAP - Generally Accepted Accounting Principles

²⁵⁸ IFRS – International Financial Reporting Standards

relevant information for the users of financial reports so they could make their business decisions. However, in order to eliminate, i.e. reduce so called informational risk of many financial reports users, in a modern environment there is an independent expert testing of those reports. In other words, security of information reliability is the task of independent auditing of financial reports.

The nature and way of transactions analyzing occurred by electronic trade activities responds to the nature and range of risks which are in connection with transactions evidence and processing. Procedures made by auditor and related to the information integrity in accounting system are mostly related to the estimation of system reliability used for gathering and analyzing of information. Regular controls of transactions integrity are mostly related to the input confirmation, prevention from double input i.e. prevention of transactions omission, security of various conditions related to orders and deliveries etc. There are several of other controls that enable all steps of transaction to be performed and that secure records to be on a proper way kept, copied and protected.

This is related to the way different systems are connected and integrated and thus make integral information system. The way of transactions transmitting, resulted by activities of electronic trading, to the accounting of a legal entity can influence on the issues such as: competition and accuracy of processing, recognition of income and recognition and recording of disputable transactions. Depending on significance of claims in financial reports, auditor considers controls in reference to connections of transactions of electronic trade with internal systems. Every auditor is obliged to work in a way that serves public interest i.e. all internal and external users of balance information. Acquiring membership in a professional institution, every auditor is obliged to respect public confidence and its continuous maintenance.

This is related to the way different systems are connected and integrated and thus make integral information system. The way of transactions transmitting, resulted by activities of electronic trading, to the accounting of a legal entity can influence on the issues such as: competition and accuracy of processing, recognition of income and recognition and recording of disputable transactions. Depending on significance of claims in financial reports, auditor considers controls in reference to connections of transactions of electronic trade with internal systems. Every auditor is obliged to work in a way that serves public interest i.e. all internal and external users of balance information. Acquiring membership in a professional institution, every auditor is obliged to respect public confidence and its continuous maintenance.

5. Literature

- 1) Campbell Tom, Houghton Keith, 2005, "Ethics and Auditing" Published by ANU E Press The Australian National University Canberra ACT 0200, Australia

- 2) Chambers Andrew D., 1995, "Computer Auditing", Pitman Publishing, London;
- 3) Chambers Andrew D., 1995, "Auditing in the IT environment", Pitman Publishing, London;
- 4) Cvjetinovic Dr Milivoje, 2000, "Revizija kompjuterskih aplikacija u računovodstvenim informacionim sistemima", Ekonomski fakultet, Beograd;
- 5) Davis Chris, Schiller Mike, Wheeler Kevin, 2008, "Revizija informacionih tehnologija: korišćenje kontrola radi zaštite nformacione imovine", Savez računovođa i Revizora Srbije, Beograd;
- 6) Hayes Rick, Schilder Arnold with Dassen Roger, Wallage Phlip, 1999, "Principles of Auditing-An International Perspectives" McGraw-Hill
- 7) Ljutić Branko Ž., Polić Stanislav R., 2002, "Revizija Informacionih tehnologija", MBA Press, Beograd;
- 8) Polić Stanislav R., 2001, "Revizija u uslovima elektronskog poslovanja", Revizor br.14, Beograd;

Sandra Tinaj, Msc *

Human Resource Management, Models and Processes

Abstract: *Human resource management (HRM) is a very large field of practice and relatively young academic discipline. Human resources are an important segment at the level of the individual, company and at the level of the entire society. It is most important that companies develop and promote human resource management to deal with people who are specialized in this field. Human resource management is contributing to the development of individuals, competitiveness and productivity of the company, as well as to improving human capital of the entire society.*

The aim of this paper is to, through a qualitative normative analyses, point out the essence and importance of the human resource management as a factor of increase of competitiveness advantage and to point out some of the basic models and process of human resource management and complexity of this field. Through the analysis it will be presented the situation in Europe and Montenegro.

Key words: *human resource, human capital development, management, processes*

Introduction

Human resource development (HRD) is the process of increasing the knowledge, the skills and the capacities in the society²⁵⁹. HRD is, also, any process or activity that, either initially or over the long term, has the potential to develop adults` work-based knowledge, expertise, productivity, and satisfaction, whether for personal or group/team gain, or for the benefit of an organization, community, nation, or ultimately, the whole of humanity²⁶⁰. Human resource is directly oriented towards human capital both on the level of company and society.

Human capital is recognized internationally as a key factor for the economic development of countries and the improvement of their relative position in the global knowledge-based economy. There is a great deal of research and evidence that testify that investment in human capital is linked to GDP growth as it has a positive impact on the competitiveness of the economies and innovation. A highly educated and skilled labour force is more productive, it can promote and absorb new

* University of Donja Gorica

²⁵⁹ Harbison, C. D & Myers, C.A. „Education, Manpower and Economic Resource Development: Strategies of Human Resource Development“, 1964, page 2.

²⁶⁰ McLean, G.N., & McLean, L.D „If we can not define HRD in one country, how we can define it in an international context? Human Resource Development International, 2001. Page 313.

technologies and it is more adaptable to economic structural change. Within the European context, the Lisbon strategy gives primary importance to human capital for economic development, and sets the improvement of education and the enhancement of the skills of the European populations as primary objectives in the effort to make Europe a competitive and dynamic economy²⁶¹.

Human resource management (HRM) is a very large field of practice and relatively young academic discipline. Human resources are an important segment to the level of the individual (personal and professional development), company (basic precondition for development and growth of the company) and at the level of the entire society (the generator of social and economic development).

Human resource management is one of elements of improving human capital in one society. Investment in education, training, adequate health and safety on work, in company, is improving the human capital at the level of society.

1. Overriding Points of Human Resource Management

Human Resources can include a broad spectrum of specialties within organizations. Some examples of specialties include recruiting, payroll, policy, safety, training and development, and performance management. In smaller organizations, the HR professional may handle all of those specialties, while in larger organizations, each specialty is most likely functioning as a separate department. The roles within HR can vary greatly as well as with many departments from the purely administrative to the executive. HR's primary purpose is to ensure that the right people are working in the right places to accomplish the organization's goal. Human resource management activities reflect a greater emphasis on individual rather than collective employee relations, increase in the complexity of the employment process and the growth of an important strategic dimension based on the notion of 'human capital.

HRM is evolving discipline that is oriented on²⁶²:

1. Belief in Human Capital – pragmatically, not ideologically HRD professional advocate for human capital, human development opportunities, and fairness.
2. Goal of Improvement - The HR profession focuses on making things better and creating and improved future state. Examples include everything from helping individuals learn new content to helping organizational systems determine their strategy direction.

²⁶¹ Labour Markets in the Western Balkans, Challenges for the future, The European Training Foundation.

²⁶² Swanson R., Holton E., „Foundation of Human Resource Development“, 2009. page 16 -18.

3. Problem-Solving Orientation – HR is oriented to solution – problem solving. Problem can be thought of as question, matter, situation, or person that is perplexing or difficult.
4. System thinking – is basic to HRD theory and practice. System thinking is described as a conceptual framework, a body of knowledge and tools that have been developed over the past fifty years, to make full patterns clearer, and to help us see how to change them effectively”.

Different authors agreed that human resource development is complex process that covers different phases. Managing of human resource requested knowledge about phase process. Based on statement of authors Swanson and Holton, human resource development is a five-phase process. They said: „We have defined HRD as a five-phase process that is essentially a problem defining and problem-solving method. HRD and its two primary components training and development (T&D) and organization development (OD)-are each five-phase processes. Variations in the wording for the HRD, T&D, and OD process phases have a common thread with varying terminology. Here are all three variations:

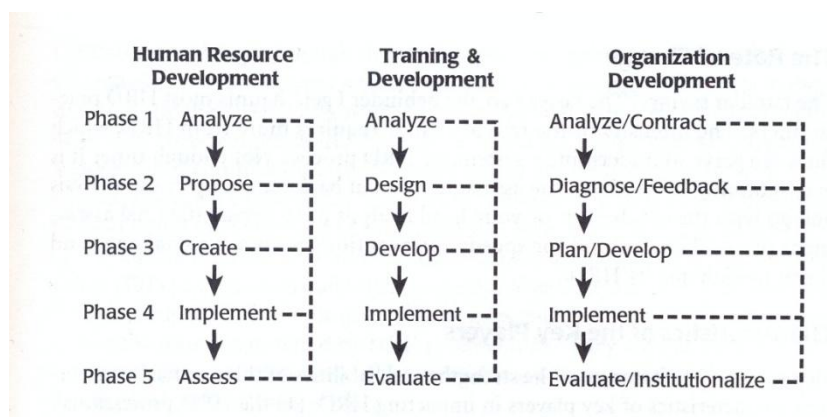


Figure 1. Five-phase processes²⁶³

2. Practical side of human resource management

Authority for human resource management in some company should be separately department with strong and close cooperation with other department. This department should have specialist in area of economy, law, psychology and expert from the business of company. Best practices show, that this department should be under top management with strong advisory role. Sector size for the development of human resource depends on the size of the company ie. number of employees, plans

²⁶³ Swanson R., Holton E., „Foundation of Human Resource Development“, 2009. page 24.

for the future development and how management actually recognizes importance of human resource management. Why do we need knowledge of economics, psychology, law and administration for human resource management? Because the core HR activities are payroll, time and labor management, benefit, motivation, administration and HR management. These activities correlate with the HR objectives which are largely the responsibility of Human Resources. Aim of mentioned department is efficient and effective human resource management. Efficient and effective Human Resource management is a challenge to all HR professionals. Staffing, training and helping to manage people so that the organization is likely to increase the performance level is imperative to work in a productive manner. Normally, human resource functions are tracking data points on each employee. These might include experiences, capabilities, skills, data, personal histories and payroll records. In the most general sense businesses carry out different activities dealing with managing their approaches to employee benefits and compensation, as well as employee records and personnel policies.

Human resource management determines business efficiency and long-term stability of human resource; it is very important for contemporary turbulent economy. Knowledge of Human Resource Management as a function is not only important for the human resource department, it is important for all managers of the global operational management. Managers at all levels need to know to manage people, motivate people, to take measures to stop leaving job, to reward people, to teach people to work more efficiency and responsibly²⁶⁴.

3. Modern trends in human resource development

The focus of HR strategy over the last decade has been to find an ever-widening range of methods to cut costs and improve operational performance. Some elements, tendency and trends are evidenced in modern process of human resource management that is required by modern business and without them human resource management cannot be considered as successful, are as follows:

1. Cost saving;
2. Operational flexibility;
3. Human capital;
4. Performance effectiveness.

²⁶⁴ Ristić Ž., „Menadžment ljudskih resursa“, Ekonomski fakultet, Beograd, 1998. Page 366

All of these elements cover next measures/activities²⁶⁵:

1. Cost saving

- Reduction of operational costs: redundancy - pay cuts and freezes - increasing variable pay as percentage of total pay - recruitment freezes - outsourcing - removing 'deputy' posts - gain sharing - rationalising company car policies - maximising grants or subsidies.
- Control of overheads: relocation to lower-cost centres - use of teleworkers - cutting benefits - rationalising back-office functions - expense account audits - trimming expense budgets - extending the working day.
- Limitation of future liabilities: changing from defined benefit to defined contribution pension schemes - removing incremental pay scales - curtailing 'grade creep'.
- Pain sharing: board pay cuts - HQ downsizing - single status facilities - limiting top management severance packages - outplacement counselling.

2. Operational flexibility

- Job flexibility: job design - flexible working hours - annual hours contracts - time off in lieu (TOIL) - time banking - part-time working - fixed-term contracts - multi-skilled work teams.
- Pay and benefit flexibility: profit sharing - employee share ownership - share options - self-service benefits.
- Operational flexibility: time management - improving managerial leverage - the 24/7 workplace - use of freelance and temporary staff - suggestion schemes.

3. Human capital

- Encouragement of lifelong learning: individual learning accounts - action learning - e-learning - mentoring.
- Retention of know-how: strategy for older workers - staged retirement - removing age barriers - knowledge management - developing knowledge banks.
- Promotion of equal opportunities: removing glass ceiling - equality training - equal opportunities monitoring - diversity policies - positive action.
- Promotion of health and fitness: in-house fitness centres - discounts on external facilities - stress counselling - company sports teams - regular medicals.

4. Performance effectiveness

- Use of performance management methods: benchmarking - process reengineering - management by objective - employee appraisal - upward feedback (360 degree feedback) - decentralization - empowerment - delegation - quality circles - open door policies - performance incentives - supply chain management - HR systems integration - data mining and warehousing.

²⁶⁵Federation of European Employers; <http://www.fedee.com/hrtrends.html>, 25.08.2011

- Improvement of recruitment process: student sponsorship - on-line recruitment - automated cv scanning - background checks - positive vetting - verification of cv data - University ratings - personality/literacy testing - assessment centres - head-hunting - succession planning.
- Reduction of absenteeism: attendance bonuses - wellness programmes - surveillance of those on long-term absence - motivational programmes.
- Prevention of fraud and theft: expense claim audits - whistleblowing schemes - amnesties - forensic audits.

Analyzing the attitude of companies toward the human resource, treatment of employees and their motivation, it is important to make difference between Eastern and Western approaches. By most estimates, the Japanese management system stands out as a far more advanced, better and more efficient than the Western. What distinguishes it is a completely different approach to man, which is thought to originate from the Eastern cultures. That is why it is very difficult to implement in the European and American companies. The basis of the Japanese approach is the vision of community-employee company founded on complimentary their interests. It does not encourage mutual competitiveness of employees, nor the need for a new profile, achieved through the employment of new staff, but the current continuously, during his working life making - additional education and retraining. The main motto is to feel protected and the worker accepts the objectives of the company as his personal, as the company responds in the same way.

4. Treatment of human resource management, EU and Montenegro

In European Union countries, especially in EU 15, human resource management is mandatory part of organization structure in successful company. But also, in these countries recognize space for improving human resource management function. Although there are specialized departments for human resource development and more experts for this field in EU than in Western Balkans, therefore in Montenegro, and ratio of management to other employees, ratio of professional HR staff to employees differs between countries.

In Europe, there has long been a considerable gap between the Anglo-Saxon and continental approaches to the way enterprises are organized and operated. Companies in the UK and Ireland have a significantly higher proportion of managers relative to other employees than companies in countries such as Germany, and particularly Italy²⁶⁶.

²⁶⁶ http://www.fedee.com/kb_contents.shtml, 20.08.2011

Table 1. Ratio of management to other employees²⁶⁷

UK & Ireland	Netherlands, Belgium & Greece	Other established EU states	Estonia & Latvia	Other new EU states
1:5	1:8	1:15	1:8	1:16

If analyze the proportion of professionally qualified human resource (HR) staff compared to other employees in medium-large companies across Europe, we find the UK has a ratio of just 1:127, while other (EU15) states (except for Ireland and Sweden) have an average ratio of 1:2,790. Although not all members and affiliates of professional personnel/HR bodies will be in management positions, the larger the HR department and the more sophisticated its staff, the more HRM jobs can be expected to exist.

Table 2. Ratio of professional HR staff to other employees HR/E (medium-large companies only)²⁶⁸

UK	Ireland	Sweden	Poland (Kopec)	Other EU15 states	New EU states
1:127	1:189	1:402	1:166	1:2,790	1:5,105

Statistics about HR staff and their number ration with other employees, in Montenegrin company do not exist. Human resource department, in most of company does not exist. Human resource department exist, only, in company who has international character but in most of them, mentioned department have dominated administrative function. In Montenegro, still prevalent, traditional under which managers operate on the established rules, that is characterized for the industrial economy, when people views as interchangeable parts. According to this model, the managers are undisputed boss who gives orders from the top and success measured by quantitative indicators. Qualitative indicators that are reflected in employee's satisfaction process efficiency improvements and opportunities for them are not priority. This type of human capital increases social tensions, there are

²⁶⁷ Sources: UNECE, ILO. Took over from the site Federation of European Employers, http://www.fedee.com/kb_contents.shtml, 20.08.2011

²⁶⁸ Sources: Eurostat, EAPM, 2001 study by Dr J Kopec (Cracov University of Economics)

* Companies employing 50+ employees. EU15 states are the 15 member states of the European Union prior to accession on May 1 2004. Took over from the site Federation of European Employers, http://www.fedee.com/kb_contents.shtml, 20.08.2011

transferred to the state, and production efficiency and with it competitiveness are reduced²⁶⁹.

If we analyze complete situation in Montenegro, on the private and public sector we can conclude that recognition of importance of human resource management, implementation of this function and development of human resource is not on the satisfactory level²⁷⁰. At the level of private sector, we can conclude that in banking and telecommunication sectors, companies have human resource department. In field of tourism, energy, agriculture, food industry, companies in Montenegro, in most cases, do not have specialized staff that deals with human resource. Fund that invests in employee education and training are very small. Companies do not motivate, and even in the case of employee motivation do not give scholarships to support their education. Companies do not put attention on informal education of employee such as training/workshop/e-learning. Montenegro is, based on the Competitiveness index report related to employee training, on the 69 place. At the level of public administration, has formed the Human Resource Management which deals recruitment and staff development. Also, there are one good example among public institution, Parliament of Montenegro has done and start with implementation of Human Resource Development Strategy 2011-2014.

Conclusion

It is most important that companies develop and promote human resource management to deal with people who are specialized in this field. Human resource management is contributing to the development of individuals, competitiveness and productivity of the company, as well as to improving human capital on the level of society.

Through the analyses of the situation in Europe and Montenegro, Montenegro needs to improve treatment of human resource both on the public and private level.

This article will be finished with the statement of Nobel laureate Gary Becker. Becker in his article, *The Age of Human Capital* (1990) defines human capital as knowledge, information ideas, skills and health of individuals which is why“ ... the economic success of individuals, but also the entire economy depends on the extent

²⁶⁹Glisevic N., „Ljudski kapital i konkurentnost Crne Gore“, Crna Gora u XXI vijeku – era kompetitivnosti, Crnogorska akademija nauka i umjetnosti, Podgorica 2010.

²⁷⁰We can point out that human resource management (HRM) is a fairly new concept, first given general currency by the Harvard Business School in the early 1980s. Fifty years ago companies were still debating whether the term 'personnel department' should replace 'employment department' and in the 1920's even the largest companies commonly operated with simply a 'time office' and a separate 'welfare department';

and efficiency of investment in people themselves, „continues“technology is perhaps the locomotive of modern economy, especially in high tech sector, but human capital is the fuel“.

Literature

1. Analoui, F., (2007), *Strategic Human Resource Management*, Thomson Learning, London.
2. Becker, G.,(1975), *Human Capital*, National Bureau of Economic Research New York
3. Gary S. Becker *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education..* Chicago, University of Chicago Press (1964, 1993, 3rd ed.).
4. Glisevic N., „Ljudski kapital i konkurentnost Crne Gore“, Crna Gora u XXI vijeku – era kompetitivnosti, Crnogorska akademija nauka i umjetnosti, Podgorica 2010.
5. Harbison, C. D & Mayers, C.A. „Education, Manpower and Economic Resource Development: Strategies of Human Resource Development“, 1964,
6. McLean, G.N., & McLean, L.D „If we can not define HRD in one country, how we can define it in an international context? Human Resource Development International, 2001.
7. Swanson R., Holton E., „Foundation of Human Resource Development“, 2009.
8. Ristić Ž., „Menadžment ljudskih resursa“, Ekonomski fakultet, Beograd, 1998.
9. Labour Markets in the Western Balkans, Challenges for the future, The European Training Foundation.
10. Lisbon strategy 2000.
11. Federation of European Employers, http://www.fedee.com/kb_contents.shtml

Andrej Bracanović*

CULTURAL AND RELIGIOUS PATTERNS OF INTEGRATION TO „THE PROMISED LAND“

Abstract: *The main course traced, nowadays, for all countries in Balkans, excluding those that are already member states of EU is European integrations. The big majority of political actions are taken according to that course. This paper, on the other side, discusses the main characteristics of European model, which provides peaceful and productive, in an intellectual sense of that word, cohabitation between various religious denominations, communities, cultural and subcultural specificities.*

Author gives a brief background of Balkans being fascinated with phenomena of the Promised Land, forming all its expectations to that main, public discourse frame. The main achievement should be identifying with one, joint, European identity, formulated as „unity in its diversity“. The concept of universal state as shown here, regarding to work of Arnold Toynbee, is familiar to twenty centuries lasting history of Balkans, emanating, from Antiquity to the early Modern Age, through the Roman Empire, Ottoman and finally Austro-Hungarian Empire.

Key words: *Europe, European Union, Balkans, European identity, religion, cultural model, universal state, secularization.*

I A VINDICATION OF THE TITLE

It is needless to admonish hodiernal man of Balkans that course of European integrations represents his way to future and prosperity, whether he marches on a wide city boulevard or a tight path of some Balkan mountain. We consider superfluous every comments on how much, the presence of European Union, is important in our everyday life, and even more on our future, final and permanent presence in European Union, within the membership. Though, virtually, particular questions are, how do we find ourselves so fascinated with European Union and what kind of knowledges do people from Balkans have, considering multiculturalism and multiconfessionality (whereby we do not contemplate only variety of Christian denominations), and finally, which spiritual value will Balkan contribute to universal altar of European civilisation. Proposed text aspires to be an attempt to fathom possible answers to these questions.

* University of Donja Gorica – Faculty of Law

In a several succeeding chapters are engaged with issues of a great importance for cultural and religious identity of Europe and Balkans, over historical background of their internal relations, ranged from conflict to permeation, to examining terms on a level of their incidence. Those chapters encompass joint, ultimate and civilizational dilemmas Balkans having toward Europe.

It is, however, indisputable that forthcoming reforms expected from Balkan states, are going to be conducted, sooner or later, largely with success, considering the fact that reforms, as every other social and bureaucratic change, are installed in a highly controlled conditions, and carefully set regulations. Hence, stands the question, is it possible to join with reforms spiritual and universal cultural values and traditions of Balkans, which besides that are not of a recent date, neither are deprived of aretological significance for European men.

Which course is to be set in motion, and by which pattern is possible to transpose religiousness of Balkans into European cultural matrix; how to bring European model of coexistence of two and more different confessions to our, Balkan verity of frequent bigotry... Such are the questions rarely having someone dealing with them, least of all those who lead states to European Union.

II PHENOMENOLOGY OF „THE PROMISED LAND“

*„And I am come down to deliver them out of the hand of the Egyptians,
and to bring them up out of that land
unto a good land and a large,
unto a land flowing with milk and honey...“
Exodus III, 8.*

Probably one of a man's deepest needs is to be protected; to be sure that he would be confident in acquiring not only everyday requisites but developing his thoughts and ideas. That has been witnessed with above verses of hope of a Jewish people working during oppressive sun of Northern Africa, and expecting Promised Land, in which is said „flowing with milk and honey“. Clearly, where milk and honey flows, there is no place to struggle for your existence. Endeavor is fixed towards prosperity of spiritual, cultural and philosophical ideas of both individual and social upturn. Based on a fundament of the Promised Land, „**welfare state**“ concept, of which every modern society thunders, seeking it as an ultimate, has been built.

Obviously, European model of religious and cultural cohabitation, not only that supports that concept yet it thoughtfully builds it up. Side by side with that, Europeans, traditionally, have „**welfare**“ elements on the other level, entrusting it to sphere of

comprehension and self-knowledge, desiring to take mouthful more of protection, figured as a need, of which was written above. That is homologated by Grace Davie, telling us that considerable number Europeans confides various actions, which they are not capable to perform by they own, to their churches. „For example, the Church was asked, periodically, to penetrate sacral in life cycle of individuals and families, and sometimes even to articulate national crisis and celebrations.“²⁷¹ Such condition depicts a final point, both for those nations that stand at great European hall waiting room; for that reason Balkan fascination with European Union is more vivid. Balkans could oneself find tested model in Europe and delegate such actions to religious institutions and expect implementation, in which there was no success so far. Consequently, confirmed further by Davie, „Within Balkans, internal relations of religious identity and plenty of other factors have become even harder to be solved, opposed „memories“ came into conflict with issues of territory, sometimes having destructive consequences“.²⁷²

The other benefit of which Balkans desires, and which is shown to him through the show-window of Europe, is common identity that he would be enrobed to, changing the „bear jerkin“, intensively attributed to it since 19th century; thereby, Balkans would be released from the yoke of the civilization periphery. The issue of common European identity was found very disputable nowadays; for some it is even hard to discuss that very idea. Many will, apparently justified, object the standpoint of a unique identity, telling that there are a few, entirely different, even opposing peripheral civilizations in Europe (even if we consider by that only nations existing within European Union), every of each being additionally compounded with significant number of subcultures. In that sense, we might find it impossible to vesture the same coat of identity on Andalusian poet, professor from Freiburg and Corinthian shepherd.

In parallel to that, between many attempts, four peripheral civilization have been recognized, such as:

- 1) Greek civilization (as a successor of Antiquity and Byzantium);
- 2) South-Slavic;
- 3) Roman (represented by Romania nowadays); and
- 4) Islamic²⁷³

²⁷¹ Grace Davie – **EVROPA: IZUTETAK KOJI POTVRĐUJE PRAVILO**, u Peter L. Berger – **DESEKULARIZACIJA SVETA I SVETSKA POLITIKA**, MEDITERRAN Publishing, Novi Sad, 2008 p. 100, [Peter L. Berger – **THE DESECULARIZATION OF THE WORLD - RESURGENT RELIGION AND WORLD POLICY**, (editor, et al., 1999). Wm. B. Eerdmans Publishing]

²⁷² Ibidem, p. 100.

²⁷³ See: Mihailo Marković – **UZAJAMNI ODNOSI MEĐU RAZLIČITIM CIVILIZACIJAMA NA BALKANU**, u **SUSRET ILI SUKOB CIVILIZACIJA...**, p. 96 – 98.

Though, supporting the state that Husserl gives, it is quite possible to recognize one European, primarily spiritual, identity, which is *essentialia concordiae* of such diversity. Noetic pathos of European is aspiration of living freely, forming their way of existence from the idea of nous. „Spiritual telos of European men is exactly the idea of infinity; he himself is rooted in Greece of 7th and 8th century B.C.“²⁷⁴ Europe is a place of meeting with a different of your own, thou, meeting not of a tragic pigment, which Balkans is very used to. We read words of Nedeljković: „encounters of civilizations in Balkans are mostly with calamitous epilog“.²⁷⁵ In that sense of meaning, European identity is a tendency of Balkans, hoping to become its final point.

The other question is what are the constitutive elements of such an identity. (described by James O'Connell as „formative factors“) which is the task numerous authors have put to themselves. Inimitable Hellenic-Roman cultural frame. Greek-Roman-Germanic family of law or Christianity, are only some (perhaps the strongest of them) elements that were discussed. However, every each of those attempts had its exceptions, which could not be placed in joint matrix. The year of 2001 meant the turning point in determining final European identity. Namely, in the same year, by making decision on foundation of the Convent²⁷⁶, a need for adopting the Constitution of European Union was defined. The Constitution would, once and for all, put an end on issue of a very foundations of European unity. „Attention of European citizenry was, mainly, directed to even more important and intriguing dilemma: Does the draft text of European Constitution have any reference of religious heritage“²⁷⁷ within a process of European integrations and understanding European identity.²⁷⁸

The polemic was ended in a reconcilable formulation, which emphasised cultural, religious and humanistic heritage of Europe, wherewith Europe determined one less explicit concept, and decided to „omit nominating Christian heritage and Christian values in its own *constitutio*“.²⁷⁹ Nevertheless, out of that kind of commitment, undoubted recognition of religious foundation making the European identity **unique in its diversity**, how it was declared and celebrated, as a theoretical paradigm, nearly with conciliar lexicon.

²⁷⁴ Saša Hrnjez – *EVROPSKI IDENTITET*, Philosophy students club „Gerusija“ – Novi Sad <http://gerusija.wikispaces.com/Evropski+identitet>

²⁷⁵ Dragan Nedeljković – *PROROČANSKE SLUTNJE IVE ANDRIĆA ili ODRAMI CIVILIZACIJA NA BALKANU*, in *SUSRET ILI SUKOB CIVILIZACIJA NA BALKANU*, Conference recordings, Historical Institute of Serbian Academy of Arts and Sciences, Pravoslavna reč, Beograd, 1998. p. 399.

²⁷⁶ *Convent* was a body formed of 105 members, presided by former French president Valéry Marie René Giscard d'Estaing (president from 1974 until 1981) – *author's remark*

²⁷⁷ The public discourse of the period was, mostly, referring that it could be dominant Christian heritage. Not only the Pope John Paul II reacted, suggesting the recognition of a social status to religious communities. but Greek Orthodox Church, and not a small number of EU member states, such as Italy, Poland, Spain... – *author's remark*

²⁷⁸ Ma Vladimir Pavićević – *EVROPSKI IDENTITET I VJERSKE ZAJEDNICE*, p. 4.

²⁷⁹ *Ibidem*, p. 4.

Notedly, that is a background of a Social magisterium of Pope John Paul II, which especially declares „in principal, accepting of religious pluralism as a *sine qua non* of civil society“.²⁸⁰

This condition was anticipated by, already mentioned, O'Connel, who, among many other, determines three formative factors that cumulatively „partake in creating and transforming what we call Europe“.²⁸¹ In the mentioned essay he adduces that those three factors (topics) are judeo-christian monotheism, greek rationalism and roman organisation.

Mere that pattern, in wich we could find place for compound and diversified social frame of many disparities and specificities, truly is the pattern of an erratic Balkan societies aspire to one common identity; luckily for Balkans, the identity „unique in its diversities“.²⁸²

III THE BALKANS IN THE UNIVERSAL STATE

To comprehend aspires of Balkans to fit into unique european model, elementary historical knowledges are required. First of all, understanding the concept of universal state, wich is so immanent to Balkans, is appertain to this. Two are the segments that, in this respect, could be discussed. First one is balkan, entirely prosaic and vital, recognised in the fact that balkan nations joining European Union, should not mean nothing much that belonging to universal legal-political-cultural frame, to what Balkan is used since Antiquity. The second segment is european, and it denotes aspire of Europe that exactly it should become that „universal state“, wich menas „feature of similarity which will be accepted as a valid evidence“.²⁸³

Universal state uptook as one political community to wich whole society with common identity is inherited,²⁸⁴ is an entity whose appearance on the Balkans is identified in different periods of its history. The very first universal state for the Balkans was Roman Empire, by wich the unique pattern was made, very soon, not only in its planetary popular legal expression, wich to date remains unsurpassed (no less on the Balkans than in the rest of Europe) but in a cultural, and ,within removing secular obstacles wich „until then were

²⁸⁰ Milorad Ekmečić – *SUKOB CIVILIZACIJA ILI STVARANJE SVETSKOG SISTEMA RELIGIOZNOG PLURALIZMA*, in *SUSRET ILI SUKOB CIVILIZACIJA NA BALKANU*, p. 34.

²⁸¹ James O'Connel – *THE PAST AND THE FUTURE MAKING...* quoted in Peter L. Berger – *DESECULARIZATION OF THE WORLD...* p. 81-82.

²⁸² Ma Vladimir Pavićević – *op. cit.*

²⁸³ Arnold Toynbi – *PROUČAVANJE ISTORIJE, JP SLUŽBENI LIST SRJ - CID, Beograd – Podgorica, 2002. p. 18. [A Study of History: Abridgement of Vols I-VI, with a preface by Toynbee (Oxford University Press 1946)]*

²⁸⁴ Compare: *Ibidem*, p. 18-37.

decelerating spreading of Christianity“; ²⁸⁵ religious one. Some of the universal patterns founded in Rome are alive even today, also in the Balkans. ²⁸⁶

Hence, the Hellenistic world founded one more catalyst that have had far-reaching consequences in the world of Balkans, (though, not only in Balkans) which is a binary opposition in Balkan way of seeing Europe, on one side, and Europe's occasional rapacious observing the Balkans. Herodotus himself made a division of world, in geographical sense, to Europe and Asia, adding a satellite Africa to Asia, which, most pragmatically, represents division to Hellenic and Persian world. One similar division, geographically dislocated previous one, proclaimed in Mediana by Valentinian and Valens, which will, eventually, mean, delineation between Western and Eastern Roman Empire, ²⁸⁷ under which Balkans will continue to gravitate for almost a millennium, will provide a basis for Hegel to pronounce that on the East natural Sun is born, and on the West, the inner sun of *self-consciousness*. ²⁸⁸ Not that such a division have not had vanguards, because the Byzantines considered Latines barbarous and heretics, though the West named Byzantines unfaithful and schismatic Greeks. ²⁸⁹

Even today, there are some historians who accept idea of **fundamental dualism** in Europe. Katsaropoulou saith about that: „Moreover, they use to identify only one part, i.e. the occident, with Europe, and in their opinion only the Western civilisation is really European“ ²⁹⁰.

Despite such divisions, it is obvious that Roman Empire have succeeded to productively unite wide spectrum of the Mediterranean in a unique political and administrative system. ²⁹¹ The state of uniqueness was achieved, especially with two mechanisms, which are considered quite modern today; those are: mobility and universality of language and alphabet. Mobility, in the modern understanding of the word, is definitely a specificum of

²⁸⁵ Edvard Gibon – *OPADANJE I PROPAST RIMSKOG CARSTVA, NOLIT-DOSIJE*, Beograd, 2007. p. 251-252. [The Decline and Fall of the Roman Empire; with an Introduction by Hugh Trevor-Roper – *EVERYMAN'S LIBRARY*, New York – Toronto, 1995]

²⁸⁶ The significance of the Roman law, which is the basis of legal systems for Balkan states, unexceptionally, and nearly all of one in Europe, was already mentioned. On the other hand, papacy, which has jurisdiction over 800 million believers denomination, „of which many are not citizens of Europe“ observed by Henry Chadwick, is the one of those frames, which are still one of the pedestals of secular Europe. See: *OKSFORDSKA ISTORIJA RIMSKOG SVETA, CLIO*, Belgrade 1999. p. 423-432.

²⁸⁷ More about in Edward Gibbon – *op. cit.* p. 309-312.

²⁸⁸ See: Saša Hrnjez – *op. cit.*

²⁸⁹ Κωστας Ι. Γιαννακοπουλος – *BIZANTINH ANATOΛY KAI ΛATINIKH AYΣY*, Athina, 1966. p.

²⁹⁰ Melpomeni Katsaropoulou – **EUROPE – A DIVIDED CONTINENT – VISIBLE AND INVISIBLE BOUNDARY LINES THROUGH THE COURSE OF HISTORY**, in *SUSRET ILI SUKOB CIVILIZACIJA NA BALKANU*, p. 329.

²⁹¹ See: *OKSFORDSKA ISTORIJA RIMSKOG SVETA*, p. 370-377. [The Oxford History of the Roman World; Edited by John Boardman, Jasper Griffin and Oswyn Murray, Oxford University Press 2001]

European population, especially the youth, though in its historical perspective, it represents a transplant, for what purpose we could find many evidences, which this essay does not require.²⁹²

On the other hand, unified and strict system of public administration expressed in Latin language, overwhelmingly remind us of contemporary Europe, when being more and more aware of fact that English language have become not only the language of European administration, but, using quite depleted, though precise formulation, *lingua franca* of modern European society. Although not with the same cultural range, as it was with Latin in the course of Antiquity or even Middle Ages. It is well known that the famous jurist Ulpianus, at the beginning of 3rd century A. D. induced „Punic and Celtic language as one that could be used in judicature.“²⁹³ Nowadays, we can not anticipate or expect such a thing from European administration.

Existence of what Toynbee calls „thin glaze of Hellenic civilization through Latin medium“²⁹⁴ have pushed Balkans towards one more need for universal state, whose fulfillment was found in *Pax Ottomanica*, though western Balkan part in „Danubian Habsburg monarchy“.²⁹⁵ Consequently, it becomes utterly clear how Balkan consolidation to European institutional circle, represents absolutely natural aspire, by mechanism approved within a two thousand year continuance and Balkan vacillation between East and West.

IV CONCLUSION

At the very end, big question of the present, that has been addressed to the Balkans and/or from the Balkans is – How Balkans, for its own, could be incorporated to unique European identity? Multi-religiousness, multi-culturality and multi-ethnicity are new *fraternité, liberté, and égalité* of contemporary Europe and its society. Lesson, that is to be learnt from the Balkans, is how to put those three principles, which used to lead to value system distortion, as model of convivance, depicted with its tenet of **unity in its diversity**.

What has not been disavowed even by the authors of European Constitution is joint religious heritage that makes such an identity, not only for European Union, but for those nations that would, eventually, join the Union, where surely Balkans belongs. Even though European Union is a secular community, it does not mean secularization in its old misconception. Secularization seen as John O'Connell comprehended it has three forms of manifestation, as follows:

²⁹² About that see an interesting article about a pilgrim travelling from Bordeaux to the Holy Land in 333. A. D. *Ibidem*, p. 370-377

²⁹³ *Ibidem*, p. 372.

²⁹⁴ Arnold Toynbee – *op. cit.* p. 94

²⁹⁵ *Ibidem*, p. 355.

- o distinction between religious and legal/political institutions;
- o decreasing the number of religious individuals; and
- o marginalising religion to private spheres of individuals²⁹⁶

It appears that, more and more, principle of uttermost secularization has been abandoned and moved to what is secularization in the strict sense, manifested throughout the mentioned distinction – dissimilitude and seclusion of institution of religion and of those public one, in favor of what Peter Berger calls **desecularization of late modernity**.²⁹⁷

Finally, it turned out that balkan need to act in the frame of one „universal state,, such as European Union, superseded balkan affiliation to, historically different, universal empires it had belonged to, with hope that the future one could become a guarantee holder for prosperous coexistence of different spiritual and cultural values immanent to the Balkans. That „universal state“ would, respecting and supporting religious diversification of the Balkans, replicate approved model of convivance, that exists in Europe, ignoring the equation wich says that strengthening process of modernising, simultaneously means increasing secularization, wich was found inaccurate.

Let me conclude, repeating the words of Danièle Hervieu-Léger, one of the leading French sociologist of religion: „Whence the paradox of modernity, wich in its historical sense replaces the need for religion and significance of religion (amnesia) and in its utopian form, must preserve relations with forms of religion that are essential to keep its identity? It resembles me of a challenge...“²⁹⁸

REFERENCES

Books, studies and articles:

1. BERGER, Piter L. – **DESEKULARIZACIJA SVETA – PREPOROD RELIGIJE I SVETSKA POLITIKA**, MEDITERRAN Publishing, Novi Sad, 2008 - [Peter L. Berger – *THE DESECULARIZATION OF THE WORLD - RESURGENT RELIGION AND WORLD POLICY*, (editor, et al., 1999). Wm. B. Eerdmans Publishing]
2. GIBON, Edvard – **OPADANJE I PROPAST RIMSKOG CARSTVA, NOLIT - DOSIJE**, Beograd 2007- [THE DECLINE AND FALL OF THE ROMAN EMPIRE; with an Introduction by Hugh Trevor-Roper – *EVERYMAN'S LIBRARY*, New York – Toronto, 1995]

²⁹⁶ Grace Davie – *op. cit.* p. 94.

²⁹⁷ See: Peter L. Berger – **DESEKULARIZACIJA SVETA – OPŠTI PREGLED**, p. 11-30.

²⁹⁸ Grace Davie – *op. cit.* p. 98.

3. ΓΙΑΝΝΑΚΟΠΟΥΛΟΣ Ι. Κωστας – *BIZANTINH ANATOLY KAI LATINIKH AYSY*, Αθηνά, 1966
4. DERADO, Ivo – *CRKVA I DRŽAVA*, Hrvatsko kulturno vijeće, Zagreb 2009
5. LEAMAN, Oliver – *TAKING RELIGION SERIOUSLY*, *The Times*, London, 6th February 1989
6. *OKSFORDSKA ISTORIJA RIMSKOG SVETA*, Clio, Beograd, 1999 - [THE OXFORD HISTORY OF THE ROMAN WORLD; Edited by John Boardman, Jasper Griffin and Oswyn Murray, Oxford University Press 2001]
7. ROSEN William – *JUSTINIAN’S FLEA – PLAGUE, EMPIRE & THE BIRTH OF EUROPE*, PIMLICO, London, 2008
8. Smith, M. H. Julia – *EVROPA POSLE RIMA*, Clio, Beograd, 2006 - [THE EUROPE AFTER ROME; A New Cultural History Oxford University Press 2005]
9. *SUSRET ILI SUKOB CIVILIZACIJA NA BALKANU*, Istorijski institut SANU Beograd – Pravoslavna reč, Novi Sad, 1998
10. TOJNBI, Arnold – *PROUČAVANJE ISTORIJE*, JP SLUŽBENI LIST SRJ - CID, Beograd-Podgorica, 2002 - [A STUDY OF HISTORY: ABRIDGEMENT OF VOLS I-VI, with a preface by Toynbee (Oxford University Press 1946)]
11. CASANOVA, Jose – *PUBLIC RELIGIONS IN THE MODERN WORLD*, University of Chicago Press, Chicago, 1994

Web sites:

1. CONCORDATE WATCH - <http://www.concordatwatch.eu>
2. EUROPEAN COMMISSION – SPECIAL EUROBAROMETER - SOCIAL VALUES, SCIENCE AND TECHNOLOGY - http://ec.europa.eu/public_opinion/archives/ebs
3. PHILOSOPHY STUDENTS CLUB „GERUSIJA“ – NOVI SAD – <http://gerusija.wikispaces.com>

Marija Orlandić²⁹⁹

The natural resources of the Balkans in the light of EU integration

Abstract:

Balkan countries and neighboring countries in the European Union share the same air, the same river and the same sea. Respect the natural environment is a prerequisite for the health of all in the region. Prudently guided policy and practice of preservation and use of natural resources can provide a better life for future generations. Besides being the result of direct benefit to the region, such as reduce pollution, encourage sustainable development policies will help the Balkan countries to move through European integration. Improved environmental concerns in the system of transport, competition, consumer protection or regional development, the way that these countries have successfully used the standards of the European family to which they want to join. At the same time, the region represents a unique habitat with its sand dunes, estuaries, lagoons, marshes and forests, and the purpose of preserving these natural resources concerns not only the region but also the rest of Europe and the world at large.

Key words: natural resources, sustainable development, the Balkans, European integration, protection.

Introduction:

Sustainable Development Policy, which is the essence of the European Union, and the basis and balance of development throughout the world, can only be achieved if the appropriate approach to issues of preserving the natural environment. However, planning the protection of the environment has not been in the forefront of any policy of the Balkan countries. Neglect of environmental considerations has left many scars, seen and unseen: when the rate of pollution is high, it's not just the economic or aesthetic question, but also serious health threats.

For example, until the sheep graze poisonous grass in some abandoned industrial sites, there is a risk to anyone who feeds on their products. Illegal construction spread around the city because of a lack of effective planning of urbanization. Inefficiencies in the implementation of environmental policy lead to soil erosion and damage in agriculture.

You need to pay attention to the region of the country the issue of protecting the natural environment before the situation deteriorates. But they often lack the capacity, review the status, data collection and capacity to articulate and application

²⁹⁹ Faculty for International Economics, Finance and Business, Institute for Strategic Studies and Prognoses

of modern legislation. In this region, discipline procedures and responses that encourage the development of the natural environment are often new and unfamiliar concepts.

What are natural resources?

Natural resources are called everything that comes from the Earth - plants, animals, water, timber, oil and metals. Natural resources are used to generate electricity, the cultivation of crops and driving cars. In fact, everything that is eaten, used or purchased in stores is made from, or natural resource.

Natural resources are all around us, that people know very well, so use them. Many resources are depleted faster than they can be replaced with new ones. The world is increasingly concerned that some resources will be fully spent if it does not reduce their consumption. This is a serious problem because the entire living world depends on these resources.

Renewable resources can be replaced or re-created. One of the renewable resource is solar energy. Non-renewable resources can not be replaced, once spent, they spent forever.

Sustainable use of resources

To use natural resources to be sustainable, should be taken to the thought and how they are spent. we must consider the resources we use and how. Sustainable resource utilization way there when their utilization can last virtually forever, without utjicaja on the environment. Therefore, you should:

- use renewable resources like wind and solar energy instead of non-renewable such as fossil fuels.
- the use of these resources is a less environmentally friendly.
- reduce the use of natural resources, especially non-renewable, re-use and Shredder Residue Recycling.

People will always need natural resources for life and therefore in their consumption should think of future generations.

The importance of biodiversity

People have only a vague idea of how the environment is linked to their well-being. Few, however, understand the importance of these ties. Human health is linked to

the environment and has a profound impact on the ecological footprint left on the planet. The main threat to biodiversity is not only exploitation but also the kind of change and habitat destruction resulting from human population growth and human activities that damage the environment.

About 80% of the population in developing countries relies on traditional medicine, mostly to the one that arises from various plants. More than half of commonly used drugs in the developed world, such as aspirin, are obtained from natural sources. Human health often depends on the good functioning of ecosystems. Resources provided by nature makes it possible to breathe clean air and drink fresh water. Thanks to the natural resources there is fertile soil, the plants are pollinated, the waste is degraded, and are provided food and fuel.

Biodiversity in the Balkan Peninsula is in much better shape than in developed European countries. That is why to implement various activities aimed at biodiversity conservation in general. Given the wealth of flora, this area is one of the global centers of biodiversity. In the Balkan Peninsula have been recorded 2600 endemic plant species, according to recent research.

All threats to biodiversity are present, the most important relate to:

- The loss, fragmentation and degradation of habitats;
- Reducing the population of certain species;
- Pollution and contamination;
- Invasive and invasive alien species;
- Climate change.

Various actors have a lot in common and must be exercised together to common goals. Politicians and policy makers should devote more attention to the problems of nature protection. There are many links between welfare and the environment. Although these do stand out as the most powerful arguments for nature protection, it must do more to prove to decision makers and the public. Responsibility for the protection of biodiversity is common, with particular focus on dialogue between civil society, government institutions and the private sector. The expansion of urban areas, expansion of transport networks and clearing land to make way for agriculture, destroying natural habitats. Pollution from various sources undermines the functionality of ecosystems. The growing demand for goods and services provided by the threatening nature of the species. Import of foreign invasive plants and animals have devastating consequences for local species. There are also climate changes at WWF, which has warned for years and already affecting species and ecosystems. Their influence will continue in the coming decades, and their consequences are unpredictable and potentially dangerous.

Nature and people are inseparable, it is all connected. To save the species, they must protect their habitats, which are located in the wider environment. So to fight with climate change, pollution and impacts of human development. This means that the corporation had to be active partners in conservation.

The Balkan countries are at a turning point, have only begun to recognize the economic value of natural resources. TEEB a study prepared by a group of experts led by Sukhdev Pavano, explains the importance of evaluating and making the true cost of natural capital. Just so it's safe to say that investments are focused on maintaining and improving, not on the exploitation and destruction of natural capital.

In October in Nagoya during the 10th Conference of Parties to the Convention on Biological Diversity, adopted a new global strategic plan. It would be 2020. The biodiversity should be preserved and used sustainably, and profits arising from the use of genetic resources must be shared fairly and equitably.

At the regional level this means to take action to protect biodiversity. After the UN 2010th year, declared the International Year of Biodiversity in the EU are running many processes, especially the work on a new strategy and new targets for biodiversity conservation of the EU until 2020. It is necessary to conserve biodiversity and restore ecosystems to the greatest extent possible. Restoration of ecosystems, nature conservation and sustainable use biodiversity are a vital part of the EU biodiversity strategy to streamline its economy on the road as efficiently and above all sustainable use of natural resources.

The importance of energy for the EU

In recent years, energy has become one of the priority themes of the EU. Although it is still, primarily, issues and competence of Member States and their national policies,

The EU is increasingly working on creating a common European energy policy. For the EU as energy and combating climate change two sides of same coin. In addition, energy issues were among the first in a dialogue with partners within the EU's external relations. Energy is an integral part of the EU Security Strategy. As the competition for scarce resources increases, while sources of supply in a gradual decline, and the risk of conflict is of growing importance. Excessive dependence on fossil fuels, particularly natural gas and oil as energy sources, many states seem sensitive to even the least disruption in supply, whether arising from the terrorist attack, or as a result of political factors or international disputes. Although countries are trying to redirect the use of more renewable energy sources, dominated by the need for coordinated international efforts to find solution for new threats to energy security, particularly in terms of security of energy infrastructure, such as oil tankers and pipelines.

"Any energy policy, whether national or European, has to implement three principal objectives at the same time: security, combating climate change and economic growth. You can not choose between these three measures or in favor of one at the expense of others", wrote Claude Mandil (Claude Mandil) until recently president of the International Energy Agency in the recommendations of the French government before its EU presidency in the first half of 2008. Indeed what the Europeans were topical issues of energy security and its "twin"; in the form of climate security and the fight against climate change. In times of recession and a deep economic crisis, unprecedented in the history of the EU, this topic has only appeared in the background. After all, the gas dispute between Russia and Ukraine has resulted in suspensions of gas supplies in a number of EU member states, showing a measure of energy dependence and vulnerability of individual states, and the Union as a whole. On the other hand, forecasters and analysts suggest long-term energy trends with the energy of passion, whether it is by reducing supply of fossil fuel exhaustion or unavailability of resources, increasing demand in the "merging economies", geopolitical risks, and even conflicts for resources, including oil and gas. Because of that energy becomes an integral part of foreign and trade policy and EU policy making new safe policies.³⁰⁰ On the other hand, forecasters and analysts suggest long-term energy trends with the energy of passion, whether it is by reducing supply of fossil fuel exhaustion or unavailability of resources, increasing demand in the "merging economies", geopolitical risks, and even conflicts for resources, including oil and gas. Because of that energy becomes an integral part of foreign and trade policy and EU policy making new safe policies. At the same time, foreign and EU policy are key tools for policy-making to achieve the future security of supply. Otherwise, the EU energy sector accounts for over 10% of GDP.³⁰¹

Since the Green Paper to energy package

"The Green Book is a new beginning for energy policy in Europe", were the words with which the Commissioner for Energy Andris Piebalgs (Andris Piebalgs) announced the publication of this document, as a kind of manifesto for a common European energy policy. He added "that it means the right to change the direction and indicates the perception that energy is now truly a global issue and the challenges facing the world can be solved at the global and, therefore, for Europe at the EU level".³⁰² Balance the energy sector in the EU Green Paper presented to

³⁰⁰ Claude Mandil, Energy Security and the European Union, Proposal for the French Presidency, 21.04.2008. Internet, http://www.premier-ministre.gouv.fr/IMG/pdf/08-1005_Rapport_au_Premier_ministre_final_ENG.pdf, pristup_13.03.2009

³⁰¹ Study in Energy Supply and Geopolitics-Final Report, Clingendael International Energy Programme, Institute for International Relations Clingendael, the Hague, Netherlands, 2004, str.10-30

³⁰² Andris Pibalgs, „A Common Energy Policy for Europe“, speech at the conference „ EU Energy

confirm the justification, but also delays in the adoption of a common energy policy.³⁰³ Introductory assessment is that Europe has entered a "new energy period"; marked by a number of challenges, which, among other things, tells the following energy landscape: EU import dependence in the next 20 - 30 years will increase from current 50 to 70% and will depend and supplies from unstable regions. Half of the EU gas comes from only three countries (Russia, Norway, Algeria), according to current trends and gas import in the next 25 years will increase 80%. Prices of oil and gas reserves are in the last two years almost doubled. There is a growing trend of world demand for fossil fuels (oil, gas, coal), and the dispersion of demand, above all, the huge growth in China and India. Europe is facing a set of energy, a range of threats to security of supply and is already being hit hard by climate change. In relation to climate change, predicts, for example. That the absence of measures to reduce r by the end of this century to raise the average temperature in the range of 1.6 to 5.8 degrees Celsius, which can have very serious consequences for the economy and ecosystem. At the same time, Europe has not developed a rounded, competitive energy market, and only this allows security of supply and lower prices.

Green Paper pleads for sustainable, competitive and safe energy. It's proposed six key areas for action. The first is the development of competitiveness and the internal energy market.

Then, the diversification of energy sources with fewer adverse effects of climate.

Third, the solidarity approach to avoid such crises in supply. Furthermore, sustainable development implies a favorable balance of environmental protection, competitiveness and security of supply. Fifth, the development of new technologies is and in the end - foreign policy. The latter is necessary because the Union must speak with one voice to snabdijevačima and unique to the diversification of supply sources. This particularly highlights the need to develop "a new partnership with its neighbors, including Russia", and other major exporters and importers.

The objectives of the Commission in connection with a new energy policy are clearly set high. The aforementioned percentage of energy import dependency of 70% by 2030. in itself shows how the EU is vulnerable to this issue. Position of the EU is unique, first internally and then as externally, to strengthen its position by suppliers.

There are three basic pillars of the new energy policy. First of all, to the formation of an integrated internal market in the direction of strengthening, both in terms of competitiveness through further liberalization measures, and sustainability, and

Policy and Law “, Brisel, 9.mart.2006.

³⁰³ "Green paper"; Internet: http://ec.europa.eu/energy/green-paper-energy/doc/2006_03_08_gp_document_en.pdf, pristup 13.03.2009.

security of supply. Main place gets a clear division between the supply and production of energy from one and the transmission of the other. The second pillar is the energy transfer to the lower CO₂ emissions and a binding target of 20 per cent share of renewable energy sources (solar, biomass, wind, etc.) in the energy mix by 2020. Now the level is of 6.5% stake. To achieve this goal will require tremendous growth in three basic forms of renewable energy: power generation, biofuels and heating and cooling. This section is intended to transport the share of biofuels increased to 10% by 2020. Increasing energy efficiency, practically saving and rational use of energy, is the third pillar. If you achieve this goal the EU until 2020. used as much as 13% less energy than in 2006. Methods and means of achieving these savings are different: more economical internal combustion engines, more efficient household appliances, improving insulation of residential and commercial properties as well as greater efiksnost in transmission and distribution grid.

Western Balkans, the Energy Community-part pan-European energy market

Energy Community of South East Europe is the result of old EU efforts to create a Pan-European Energy Community. In early nineties the realization of Pan-European Union began with the Energy Charter and continued through the adoption of EU directives and regulations for the internal market in electricity and gas. The community is formed on the model of the European Coal and Steel Community, forerunner of the EU.³⁰⁴ The signing of the Energy Community between the EU and the countries in the region of Southeast Europe, 25 October 2005. in Athens, it was assessed as a "historic step towards full regional integration in the EU single energy market and the first example of sectoral integration". Special Coordinator of Stability Pact Erhard Busek (Erhard Busek) on this occasion said that "the implementation of the agreements have long-term political, economic and social consequences for all stakeholders, including the development of stability and efficient energy supply of South East Europe, the introduction of market-based regulatory system and the geopolitical importance of providing various directions of energy supply of Europe".³⁰⁵ The main objectives of the Energy Community: Creating an integrated energy market in Southeastern Europe which enables cross-border trade and connections with the Union's internal market, strengthening security of supply, attracting investments in power generation, reconstruction and construction of transmission network and improve the situation in the field of environmental protection. In fact, in this area would be able to talk about E-34. Because, in essence, a Member State are "sectoral" integrated into the EU committed

³⁰⁴European Commission, DG TREN, An integrated market for electricity and gas across 34 European countries, memo, Internet, [http:// europa.eu/rapid/pressReleasesAction.do?reference=MEMO/05/397](http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/05/397), pristup 20.03.2009.

³⁰⁵<http://www.stabilitypact.org/pages/speeches/detail.asp?=2005&p=207>

themselves to the application of rules and directives of the Union. In turn this attracts investment and strengthens the market position of the region and member states. Estimates suggest that in the next two decades, for providing a stable and reliable energy supply countries are gathered in the Community must be up to 20 billion euros. In addition, the development of cross-border networks for electricity and gas not only opens up the possibility of increased trade, but also solidarity with any problems or breakdowns in supply. To strengthen the energy security of the region, through the diversification options for their energy supply.

The Energy Community has three operational sections. First, the Agreement extending the application of the *acquis* in the field of energy, environment, renewable energy, the competition, which affects the creation of equal conditions for doing business in the territory of the Community and the EU. Second, establish a regional mechanism that enables a deeper integration of local energy markets. This will allow the adoption of legislation that allows the rapid development of infrastructure, especially pipelines. Third, it was agreed to work towards a common policy for foreign trade, mutual assistance and removing barriers to enternal energy market.³⁰⁶

Conclusion:

The growth in production of goods in the last hundred or two hundred years had resulted in the release of large amounts of thermal pollution, which are exposed to all the nations of the world regardless of how his contributions.

The basic sources of energy such as coal and oil can be renewed only during an entire geological period and are distributed unevenly. They have in the Balkans, but are insufficient or weak and mediocre.

In the meantime the world has become a closed system in economic and in environmental terms.

The issue of energy security and stability has become in recent years, the cardinal question of the entire world's economic, social and economic systems. EU as such, despite its high development and evolution of its relationship to the issue of energy security also faces the problem of reducing their "mark on the environment" and its role in reducing the human impact on climate. The connection of the energy sector to the competitiveness of European industry or any leads to willingness to facilitate the sake of economic "prosperity" run over the importance of fighting for the creation of legal, institutional, technical, economic and social conditions for a successful and sustainable combat climate change.

³⁰⁶ European Commission, DG TREN, An integrated market for electricity and gas across 34 European countries, Memo, Internet, <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/05/397>, pristup 20.03.2009.

In the energy sector the most important mechanisms to combat climate change are generally known, yet worth mentioning again, namely the introduction of energy efficiency and renewable energy production, transmission, distribution and consumption / meeting energy needs.

Unfortunately, the Western Balkan countries must be fully aware that neither the old nor the new members of the European Union, which had a far longer and far more favorable market and political conditions for the implementation of European legislation in the common market for renewable energy and energy efficiency, and improvements in kompetetivnosti, security of supply and level of environmental protection (in the energy sector), yet far from failed to fully implement European legislation in this sector.

Therefore it is necessary to believe that it is necessary to seriously consider their experiences and problems they had, and which are now in the energy field, the ways in which they wore with these problems.

Literature:

1. Andris Pībalgs, „A Common Energy Policy for Europe“, speech at the conference „EU Energy Policy and Law“, Brisel, 9.mart.2006.
2. Besim, Ćulahović, *Ekonomija svijeta – trendovi, rast i razvoj*, Ekonomski fakultet, Sarajevo, 2008
3. Claude Mandil, *Energy Security and the European Union, Proposal for the French Presidency*, 21.04.2008
4. Eban, Goodstein, *Ekonomika i okoliš*, Mate, Zagreb, 2003
5. “Green paper”, 13.03.2009.
6. Ilija Vujošević i saradnici, *Crna Gora u XXI stoljecu - u eri kompetitivnosti*, ENERGIJA, CANU, 73/6, 2010.
7. John M. Callaway, Slavica Kaščelan, Marina Markovic *Ekonomski uticaji klimatskih promjena u Crnoj Gori: prvi pogled*, Kancelarija UNDP, Crna Gora
8. Johnathan, M. Harris, *Ekonomija životne sredine i prirodnih resursa, savremeni pristup*, Data Status, Beograd, 2009.
9. Mihailo, Burić i saradnici, *Crna Gora u XXI stoljecu - u eri kompetitivnosti*, ŽIVOTNA SREDINA I ODRŽIVI RAZVOJ, CANU, 73/2, 2010.
10. Veselin Vukotić i saradnici, *Crna Gora u XXI stoljecu - u eri kompetitivnosti*, EKONOMSKI RAZVOJ, CANU, 73/3, 2010.
11. Veselin, Vukotić, *Makroekonomski računi i modeli*, CID, Podgorica, 2003.
12. Study in Energy Supply and Geopolitics-Final Report, Clingendael International Energy Programme, Institute for International Relations

Clingendael, the Hague, Netherlands, 2004, str.10-30

Web sites:

<http://www.consilium.europa.eu/showPage.aspx?id=266&lang=EN>,

<http://www.premier-ministre.gouv.fr/IMG/pdf>

http://ec.europa.eu/energy/green-paper-energy/doc/2006_03_08_gp_document_en.pdf,

<http://www.teebweb.org>

<http://www.ncsonline.org>

<http://www.worldwach.org>

<http://www.emagazine.com>

Milika Mirkovic*

The Effects of CEFTA Agreement on the Montenegrin economy

Abstract: This analysis is focused on the CEFTA Agreement and its impact on economy of Montenegro. The aim of analysis is presenting the essence of the CEFTA Agreement, with accent to the overall significance of the Agreement in the context of trade liberalization on the path to integration of Montenegro into the EU. CEFTA agreement is very useful for Montenegro, because regional market has become more open. In the first part of the article is given theoretic view of CEFTA Agreement, as well as its importance for the state party. The second section explains the current effects of CEFTA agreement on the economy of Montenegro.

Key words: *CEFTA, free trade, competition, investments, growth*

Introduction

In international trade literature, there is a common feature that the abolishment of barriers to trade leads to the expansion of trade flows. Most of the empirical studies aiming at simulation of welfare effects of trade liberalization.

CEFTA agreement is based on the concept of free-market economy. Through usage of this agreement and regional cooperation, the Montenegrin companies are faced with a market that operates according to standards that are condition for Euro-Atlantic integration. Neighbourhood space, without language barriers and long-term knowledge of the common market is additional recommendation that the promotion of mutual trade relations very important part of economic policy of signatories countries.

CEFTA agreement provides for transparency and standardization in business environment, the greater impact on trade and investments, strengthening regional cooperation, which is the path to EU integration, capacity building for better enforcement of regulations. CEFTA agreement has not a customs union³⁰⁷, but it is a

* Institute for Strategic Studies and Prognoses; Faculty for International Economics, Finance and Business

³⁰⁷ Free trade zone, such as CEFTA, is a form of economic integration between countries where the members according to the agreement ensure the free trade of goods between them. All barriers to free trade within the zone are eliminated, while each member country retains its own barriers to foreign trade and with external partners and non-member countries. On the other hand, the customs union has all characteristics of the free trade zone, but the member countries have correlated tariff and foreign trade policy towards non-member countries and external partners. Free trade zone is weaker form of economic integration than custom union.

multilateral free trade agreement where each party is obliged to apply own legislation. The principles on which it was based preparation of the Agreement are: build upon existing bilateral free trade agreements, basing on the current CEFTA agreement (with additional new areas - services, intellectual property, public procurement and investment); compatibility with WTO rules and procedures; compatibility with the Memorandum to liberalize and facilitate trade; harmonization of the matter of bilateral agreements to increase transparency and predictability; providing a suitable institutional framework for the managing of contract, control effectiveness and implementation of the Agreement.

The final results of the signing of this agreement are increasing the volume of trade within the zone through elimination of customs duties, quantitative restrictions and the harmonization of regulations. On the one hand, consumers have a better product offerings and lower prices due to competition, while the other side of the producers was facilitated access to foreign markets. Also, the CEFTA agreement contributes attraction of direct foreign (especially Greenfield) investments as result of a uniform policy regulation, sending signals about stability, as well as access to much larger market than it is on the individual country markets. This is especially important to small countries like Montenegro.

1. General characteristics and importance of CEFTA Agreement

The eight countries, Albania, Bosnia and Herzegovina, Croatia, Macedonia, Moldova, Montenegro, Serbia and Kosovo³⁰⁸ signed an Agreement to amend and enlarge the Central European Free Trade – CEFTA 2006³⁰⁹ on 19th December 2006 opening the door to 30 million consumers in South Eastern Europe. CEFTA 2006 entered into force on 26th July 2007 for five signatories (Albania, Macedonia, Moldova, Montenegro and UNMIK/Kosovo), for Croatia on 22nd August 2007, Serbia on 24th October 2007 and for Bosnia and Herzegovina on 22nd November 2007.

CEFTA agreement defines the general conditions relating to trade. The general rule is that it will abolish quantitative restrictions, customs duties and other levies on

³⁰⁸ The United Nations Interim Administration Mission in Kosovo (UNMIK) on behalf of Kosovo in accordance with United Nations Security Council Resolution 1244 signed an Agreement

³⁰⁹ Original CEFTA agreement was signed by Visegrád Group countries, that is by Poland, Hungary and Czech and Slovak republics (at the time parts of the Czech and Slovak Federative Republic) in 1992. It entered into force since July 1994. Slovenia joined CEFTA in 1996, Romania in 1997, Bulgaria in 1999, Croatia in 2003 and Macedonia in 2006. All of the parties of the original agreement had now joined the EU and thus left CEFTA. Therefore it was decided to extend CEFTA to cover the rest of the Balkan states, which already had completed a matrix of bilateral free trade agreements in the framework of the Stability Pact for South Eastern Europe.

exports and imports of goods in trade between countries in the region. The main objectives of CEFTA Agreement are: expansion of trade in goods and services and promote investment through fair, stable and predictable rules, removing barriers to trade among the parties, providing adequate protection of intellectual property rights in accordance with international standards and harmonization of the provisions of modern trade policy issues such as rules of competition and state aid. Additionally, it is provided clear and effective procedures for resolving disputes, and gradually creating a zone of diagonal cumulation of origin between the EU and Western Balkan countries.

CEFTA agreement respects the rules of the WTO, as well as support for the WTO accession for those countries not yet members. CEFTA imply a system of political and legal regulation of trade disputes (Joint Committee, mediation, arbitration) and includes rules relating to respect for the protection of industrial property, competition, liberalization of services (long term), public procurement.

The main advantage of CEFTA Agreement in comparison with bilateral agreements is consisted in possibility of usage of diagonal cumulation of origin of goods³¹⁰, which leads to maximizing production and export capacity. It's present the cohesive factor of regional cooperation which will contribute to creating favourable conditions for placement on the market of the European Union; the involvement of gradual liberalization of trade in services, equalizing conditions for investment by applying the WTO rules and ensuring equal treatment of domestic investors in the Region;

Gradual opening of public procurement markets and equal treatment of domestic and suppliers from countries in the region, providing the protection of intellectual property rights in accordance with international standards, an improved mechanism for resolving disputes that can happen during the implementation of the Agreement, the obligation to respect WTO rules.

As a modern and liberal Free Trade Agreement, which covers more than 90% of mutual trade in the region, the CEFTA agreement encourages further growth of trade and competitiveness of the product (allows for economies of scale, reduce production costs, increase efficiency, productivity and specialization of production).

³¹⁰ As with the bilateral agreement, liberal, or duty-free trade with CEFTA, is possible only for goods having the status of domestic origin. Unlike the bilateral agreements, where applicable only bilateral cumulation of origin of goods, which means that imported raw materials, such as Croatian and incorporated into a final product made in Montenegro, it can be exported duty-free only in Croatia but not in other countries in the region. CEFTA allows diagonal cumulation or accumulation (addition) of origin of goods and more countries in the region that will have the status of domestic origin. Diagonal cumulation of origin involves the participation of at least 3 parties (countries), i.e. the use of raw materials, semi finished and finished products from different countries, where these materials are treated as a domestic component. For example, the status of the domestic origin can has one product if it is finalized in Montenegro, but one part is imported from Serbia and another one is imported from Macedonia. Thus, Montenegro could such a product, duty-free, launch to the all CEFTA countries.

Additionally, CEFTA includes measures in order to provide better trade and elimination of non-tariff barriers (co-operation in matters of technical barriers to trade, standards, sanitary and phytosanitary measures, customs cooperation and other border authorities in order to facilitate administrative procedures).

CEFTA agreement represents a positive signal and an improved framework for mutual investment and foreign investment (FDI). The agreement provides an opportunity for easier access to markets of around 30 million consumers. A special part of the Agreement regulates foreign investments (the best guarantee of treatment), as well as the liberalization of public procurement. Increased inflow of investments provides higher modernization of production, usage of new technologies, knowledge, modern marketing and management, increasing product quality and service, and thus exports to the region.

Multilateral CEFTA agreement enables cross-border joint production, thanks to the implementation of the protocol of origin or the "cumulation of origin" of goods that are common in many countries of CEFTA. This enables lighter duty-free treatment of products in exports in EU and region counties.

CEFTA agreement creates the conditions for balanced development of region, strengthening solidarity, harmonization of development policies, improving infrastructure, creating a favourable image.

Free trade zone in Southeast Europe has a political importance. The EU has supported and highlighted as one of the priorities of its regional policy in the Western Balkans, the ratifying of the CEFTA agreement. More parts CEFTA Agreement are directly related to the usage of EU rules, especially in terms of competition law, government subsidies, etc. CEFTA agreement represents a bridge between the EU and South-Eastern markets.

Stronger economic integration and competitiveness, is one of the preconditions, which the Western Balkan countries need to fulfil in the Euro-integration path. An important aspect in this way is communication, because the national economic growth and prosperity can be encouraged by good relationship with neighbours. This provides larger and more accessible market for local firms, both in terms of exports and imports, so as to attract foreign investment.

The future of EU integration will depend on raising efficiency and international competitiveness of European economies, the political unity between countries, and harmonizing of conflicting interests.

The beginning of implementation of CEFTA agreement does not mean that Montenegro completed its work on creating a better business environment in the region, rather it means the beginning of the fulfilment of the objectives of the Agreement. This is related to further trade liberalization and elimination of technical barriers.

Entering to the EU contributes to overcoming the political and economic barriers in communications in the Western Balkans, which tries to solve the CEFTA agreement. Besides increasing and improving trade of goods, agricultural products and services

in this agreement have already been incorporated much more ambitious. The accent is on encouraging investment by creating stable, predictable and fair rules, protecting intellectual property rights, the harmonization of rules of protection of competition, state aid, as well as the liberalization of public procurement. Under this agreement the institutional basis for resolving any disputes that may arise in the trading among its members.

2. Effects of CEFTA Agreement on economy

The empirical experience of many countries indicates that the result of positive developments in the region that enables the CEFTA agreement lies in the increased competitiveness of products and services, export growth, and employment and economic growth in the country and region as well. Trade is the greatest factor that leads to economic growth. When the trade occurs as a result of true demand and supply, the economic growth that occurs also truly reflects the increase in economic welfare. Thus, free trade brings about increased economic growth, which means better and more jobs; better standards of living; etc.

CEFTA agreement opens the door to free trade with the market exceeding 30 million consumers. The agreement represents a potential for growth of the Montenegrin economy and for all economies in the region. Through regional connectivity, a unified and open market of the Western Balkans is created. The merged countries have bigger chance to increase trade exchange and attract foreign investors, because the only stable region provides a good basis for developing and encouraging investment. Better connection through the implementation of infrastructure projects contributes additional stability and economic prosperity of the region.

Orientation of economic policy in the direction of regional connectivity, Montenegro and the whole CEFTA Region has the opportunity to use potentials of the multilateral trading system and thus provide a positive impact on sustainable development.

Regional economic integration is especially good choice for a country such as Montenegro, which is highly dependent on international trade. The biggest benefits from duty-free space will have companies with a relatively high-quality supply, which will easier reach new consumers, while the main losers will be companies that have survived thanks to the difficulty in performance of competitors from the environment in the domestic market.

Faster EU integration requires regional economic cooperation and market reforms. Long, complicated and no transparent procedures at border crossings, expensive and extensive testing and control and the lack of accredited laboratories for the control of goods crossing the border, are the biggest non-tariff barriers which hinder trade cooperation in the region.

With the countries signatories of this agreement, Montenegro has certain concessions and no tariff barriers to trade. With the Croatian for some products instead of very high tariff rate, Montenegro has contracted zero tariff rates. Full trade liberalization has led to Montenegro can place their products on CEFTA markets. On the other hand, Montenegro has a zero tariff rates on certain products with Albania, too. In this way, the Montenegrin market is more available to countries in the region, and vice versa.

By signing the CEFTA agreement Montenegro has increased the volume of trade with all the signatories to this Agreement. Total share volume of trade with this group of countries in total imports and exports of Montenegro has increased rapidly since 2007 i.e. since the signing of this Agreement. The share of exports to CEFTA countries in total exports of Montenegro in 2007 amounted 28.9%, while the same indicator in 2008 was increased to 35.42%. In 2009 export decreased, but share of export to CEFTA countries in total export of Montenegro increased to 46.19%. In 2010, the share of export to the CEFTA countries in total export of Montenegro was about 40%. On another side, import from CEFTA countries is also increased since signing CEFTA agreement. The share of import from CEFTA countries to the total import in Montenegro increased from 33.58% in 2007 to the 40.42% in 2010. Also, in the first six months of 2011 trade activity with CEFTA countries increased in comparison with same period of 2010. From the market of CEFTA countries, Montenegro imports mineral fuels and oils, machinery and appliances, plastic products, products of iron and steel, beverages, milk and dairy products, etc. The exports are mostly iron and steel, beverages, aluminium, wood and wood products. The new production capacities in the field of agriculture, food production, finalization of production in the metalworking industry based on steel and aluminium are the chances for improving market performance.

Montenegro has deficit of trade balance with all CEFTA countries, except Albania and Kosovo. From this we can see that there is a huge potential for Montenegro in increasing production and competitiveness of products and at the end increase export to the CEFTA countries.

The problems that exist in the implementation of CEFTA agreement constitute non-tariff barriers. The most common non-tariff barriers are complicated procedures at border crossings - extensive administration work and inconsistency of customs and inspection services, insufficient number of internationally recognized laboratory accreditation and certification bodies, and authorized laboratories and institutions; non-recognition of certificates of quality, problem of non-compatibility of domestic standards and technical regulations with international standards, lack of adequate transport and other infrastructure; complicated visa regime, corruption and smuggling.

Analysis of external trade of Montenegro with CEFTA countries shows positive effects of signing CEFTA agreement. Increasing volume of trade activity cause increasing activity in other sectors of economy.

Regional market has become more open, and through non-tariff barriers, market expansion and strengthening competitiveness, leads to the greater efficiency of the overall functioning of the economy. Using raw materials which are not in Montenegro, enable higher usage of own capacity and create new products, which can be exported without customs restrictions.

Besides the impact on foreign trade and on trade balance, the signing of the CEFTA agreement has an impact on budget revenues, particularly revenues from value added taxes and revenues from taxes on international trade and transactions.

Revenues from value added tax are the most important category of budget revenues. During the period from 2003 to 2009 revenues from value added tax have steadily increased. By signing the agreement on CEFTA, revenues from VAT were growing, but at a lesser rate than in the period before 2008. In 2008 VAT revenues amounted €439.81 million or 11.86% more in comparison with previous year. However, in structure of total budget revenues the bigger share has revenues of import VAT. So, lesser rates of growth of this category of budget revenues are relevant for VAT that comes from the import channel. Share of value added tax in total revenue was shrinking during the period to 2009. These revenues were in 2007 accounted for half of total revenues, but this proportion decreased in later years.

Additionally, revenues from taxes on international trade and transactions in the period since 2003 were increased, but signing CEFTA agreement it reduced. Until 2006 the growth rate of revenue from taxes on international trade and transactions have been increasing, and after a growth of 38.15% in 2006 it grew by 20.67% in 2007. A smaller increase in revenues from taxes on international trade and transactions is a direct consequence of the signing of the CEFTA agreement, and abolition of trade barriers. Lower growth rate of revenues from taxes on international trade and transactions was in 2008 when this category of budget revenues increased by 6.47% over the previous year. In 2009 and 2010 taxes on international trade and transactions were at approximately the same level, but at a considerably lower level compared to 2008.

Also, very important effects of CEFTA agreement are attracting FDI. Creating business area without barriers has very significant positive impact to the economy. FDI represents a very efficient instrument of development whole economy. It brings capital and benefits in terms of imports of new production technologies that allow better utilization of all advantages of the economy, such as high-quality workforce and low production costs. Above mentioned the system of diagonal cumulation of origin of products, makes CEFTA countries, therefore Montenegro very attractive for foreign investors.

Besides the positive impact of CEFTA agreement on the economy of the country, there are also several possible negative effects of this agreement. The sharp increase in imports can have negatively impact on no-competitive products. This can have a major impact on trade of the country, as well as the worsening balance of payments. Also, it may happen that, market liberalization by competition destroy domestic

production that was not ready for open competition. To avoid the negative effects of excessive application of the agreement, signatory countries can use certain measures to protect the domestic economy, which is implemented in accordance with the WTO and measures of the foreign trade business.

Conclusion

There is no doubt that the CEFTA agreement to its members brought multiple benefits, both in production and trade, as well as to harmonize the regulations and institutions, the principles of free market operations. CEFTA Agreement is very useful for Montenegro. Regional market has become more open. The diagonal cumulation of origin, or the use of raw materials and intermediate goods that are not in our market, it allows for greater usage of own capacity and creating products that are also free of customs burdens be sold in the CEFTA signatory countries and the EU. Elimination of tariff barriers, Montenegro has increased trade with the region. As a result is the growth of exports and imports to CEFTA countries. During the implementation of bilateral agreements with Montenegro CEFTA signatories, as well as from the entry of this multilateral agreement into force, export-import ratio is favourable. This clearly indicates the need for increased efforts to creating competitive products and removing non-tariff barriers.

This is a good signal for foreign investors, because they eliminate the barriers. Any further liberalization of markets and the economy in general, carries with it certain risks or dangers, but the benefits are much greater.

The main expected impact of implementation of free trade is the acquisition of price competitiveness of countries which allows duty-free access to their own markets. Indirect, positive effect of tariff liberalization is the enlargement of markets and manufacturers locating in the area of customs union in order to supplied common market from a favourable location. So, the expected increase in inflows of foreign direct investment and the growth of competition would lead to lower prices and benefits of consumers through lower prices.

Literature

1. Babic Mate - Makroekonomija, MATE, Zagreb, 2000
2. Begg D, Fischer S, Dornbursch R – Economics, 8th edition, Mc Grew Hill Education, UK, 2005
3. Dangerfield Martin - Sub regional economic cooperation in central and Eastern Europe: the Political Economy of CEFTA, Edward Elgar Publishing, UK, 2001

4. Franičević V, Jurčić Lj - Croatia's potential trading partners: EU, CEFTA, the Balkans, University of Zagreb, Faculty of Economics, 2001
5. Jože Pavlič Damijan - Efficiency of free trade agreements: Did the reduction of trade barriers have any effect on increasing trade between Slovenia and the CEFTA countries?, working paper, 1999
6. Nikolic Goran - Uticaj spoljne trgovine na ekonomski rast, Economic Annals No. 165, April 2005 - June 2005
7. Rakita Branko – Medjunarodni biznis i menadzment, Centar za izdavacku delatnost Ekonomskog fakulteta Beograd, 2006
8. Vukotić Veselin - Makroekonomski računi i modeli, CID, Podgorica, 2001
9. www.cbcg.org
10. www.mif.gov.me
11. www.monstat.org

Vojin Golubović*

The impact of age structure of population on the pension system in Montenegro

Abstract: *This paper analyze the impact of age structure of population on the pension system in Montenegro. The data from last Census³¹¹ showed that negative demographic trends continued and their impact on the pension system could be even worse than it was expected. This particularly refers to the considerable decrease of young population and enormous increase of the share of elderly in total population. The impact of these trends on the pension system is assessed. The effects of the change in age structure will put public finances in very unfavourable position since the deficit of pension system will increase as percentage of GDP.. It seems that system will become very unsustainable in the long-run if the radical reform of pension system does not happen.*

Key words: *aging, demographic structure, pensions, sustainability, transfers, deficit*

Introduction

The United Nations forecasts show that one quarter of the world's population will be older than 65 years by 2050³¹². Due to these negative demographic trends, as well as, the nature of the so-called “pay-as-you-go” (PAYG) pension system, the governments of many countries are faced with financial difficulties. Similar situation is in Montenegro. Since the beginning of the transition period, the PAYG system in Montenegro is continuously faced with such problem due to the high rates of unemployment and unregistered labour force, and slow economic growth. However, the main reasons for the unsustainable pension system in the long-run are negative demographic trends such as declining fertility rates and aging population. These are reasons that encourage the reform of the pension system and its implementation.

The age structure of population in Montenegro

The aging population is problem that Montenegro faced during previous decades. The share of elderly in total population was significantly increased during observed period. The number of people who are 65 or older, amounted 50603 in 1991 while it increased to 85535 in 2011 with average annual growth rate of 2,66%. On the other

* Institute for Strategic Studies and Prognoses

³¹¹ Census 2011, MONSTAT

³¹² World Population Aging 1950-2050, United Nations, Department of Economic and Social Affairs, Population Division, 2002

side, the share of young population (age group 0-14) registered average annual decrease of 1,53% (from 155458 in 1991 to 116453 in 2011), which is consequence of low fertility rates. The working age population (15-64) registered slight increase, but the expectation is that the number of people who belong to this age group will also reduce in the future due to the low current fertility rates.

Table1: The age structure of population in Montenegro

Census year	1953	1961	1971	1981	1991	2003	2011
Age group	Number of citizens						
Total	419873	471894	529604	584310	615035	633985	620029
0-14	149144	171658	169139	160546	155458	131883	116453
15-64	239781	266514	317417	373406	402754	421256	422041
65+	30930	33440	40417	48020	50603	75156	81535
80+	5972	7088	8322	9366	11215	10087	15530
Age group	Share in total population (in %)						
0-14	35.5	36.4	32.1	27.6	25.5	21.0	18.78
15-64	57.1	56.5	60.2	64.2	66.2	67.0	68.07
65+	7.4	7.1	7.7	8.3	8.3	12.0	13.15
80+	1.4	1.5	1.6	1.6	1.8	1.6	2.50
Census year	1953	1961	1971	1981	1991	2003	2011
Average age	27.4	27.5	28.9	30.7	32.7	35.8	37.5
Ageing index ³¹³	21	19	24	30	33	57	70

Source: Census 1953, 1961, 1971, 1981, 1991, 2003, 2011, MONSTAT

The increase of population in Montenegro between 1991 and 2011 was slight with average annual population growth rate of 0,04%³¹⁴ If such low growth rate remains the same, the population of Montenegro will slightly increase by 2050.³¹⁵ However,

³¹³ The ageing index is calculated as the number of persons 65 years old or over per hundred persons under age 15.

³¹⁴ The Censuses from 1991 and 2011 are observed, since demographic structure from Census 2003 still "suffered" from the migrations after wars in the region. The assumption is that situation in 2011 is more stable, i.e. migration rates are expected.

³¹⁵ This increase will be caused mainly by the expected increase of life expectancy, since the fertility rates register decrease.

the age structure will be radically changed in the future. According to MONSTAT's demographic projections the share of the people 65 year old or above in total population will increase by 2050 and it will amount from 19.6% to 25.2% depending on the scenario.³¹⁶ However, the results of the Census 2011 show that the most probable is the scenario of low fertility rates, with expected migration and mortality rates and this scenario is used for the projections of pension system indicators.

Table 2: The age structure of population in Montenegro until 2050

Age group	2020	2030	2040	2050
0-14	107687	98047	86885	80103
15-64	450209	452199	452681	430681
65+	101036	124612	140079	166009
80+	22840	26571	39531	47611
Total	658932	674858	679645	676793
Share in total population				
0-14	16,34	14,53	12,78	11,84
15-64	68,32	67,01	66,61	63,64
65+	15,33	18,46	20,61	24,53
80+	3,47	3,94	5,82	7,03

Source: MONSTAT, author's calculations

The number of persons who are old 65 years or above would be more than doubled in Montenegro by 2050, and it will increase from 81535 in 2011 to 166000 in 2050, which represents an average annual increase of around 2 000 person per year for this age group. This means that at the end of projection period, almost every fourth resident of Montenegro (24.5%) will belong to the age group 65+, while today every eighth resident of Montenegro belongs to this age group. In the same period, the number of elderly, who are old 80 years or above would increase by over 4 times, which means that in 2050 every fourteenth citizen of Montenegro will be older than 80 years. At the same time, low fertility would lead to very intense reduction in the number of persons younger than 15 years, from 116453 in 2005. to only 80103 thousand in 2050, which is the average decrease of more than 1000 persons per year. Their share in total population would be reduced from 18,78% in 2011 to 11.84% in 2050. As a result of these changes in age structure, the multiple would be an increased value of the aging index will increase from 70 to 207.

Projections of main pension system indicators

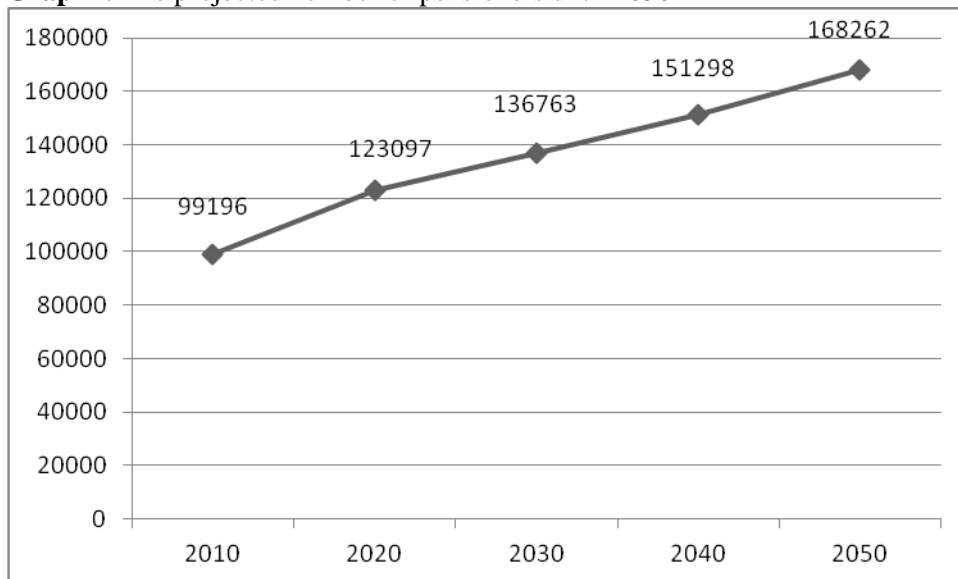
Projections of pension system indicators represent necessary inputs for development of scenario and analysis of financial sustainability of PIO Fund in the period 2011-

³¹⁶ Demografski trendovi u Crnoj Gori od sredine 20 vijeka i perspektive do 2050. godine, MONSTAT, 2008

2050. This part of analysis includes projections of indicators according their dynamics in previous period such as: the number of pensioners, the number of insurers, system dependency ratio, expenditures of PIO Fund(expenditures on gross pensions and total expenditures) and revenues of PIO Fund(revenues based on contributions and total revenues).

In order to project *number of pensioners* (age, survivor, and disability pensioners) in Montenegro during observing period (2011-2050), the share of these pensioners in certain age and gender groups of population is calculated.³¹⁷ The use of share of number of pensioners in different groups of population on projected structure of population³¹⁸ gives a projected number of pensioners in Montenegro as well as their age and gender structure for period 2010-2050. The projected number of pensioners shows the increasing trend during entire observed period.

Graph1: The projected number of pensioners until 2050



Source: MONSTAT, PIO Fund, author's calculations

According to the PIO Fund data, the number of pensioners (old-age, disability and survivor) amounted 99,196 or 16% of total population. According to the projections for the period until 2050, the number of pensioners in 2050 will reach 168,262, or almost 25% of total projected population which is direct consequence of aging population in Montenegro. During period 2010-2050, number of pensioners will increase for 69,066. The average annual growth rates of the number of pensioners will be high during observed period and it will amount 1.33%.

³¹⁷ Based on PIO Fund data on age and gender structure of pensioners for 2010

³¹⁸ Variant of low fertility, expected mortality, and expected migrations

Table 3: The share of pensioners in total population until 2050

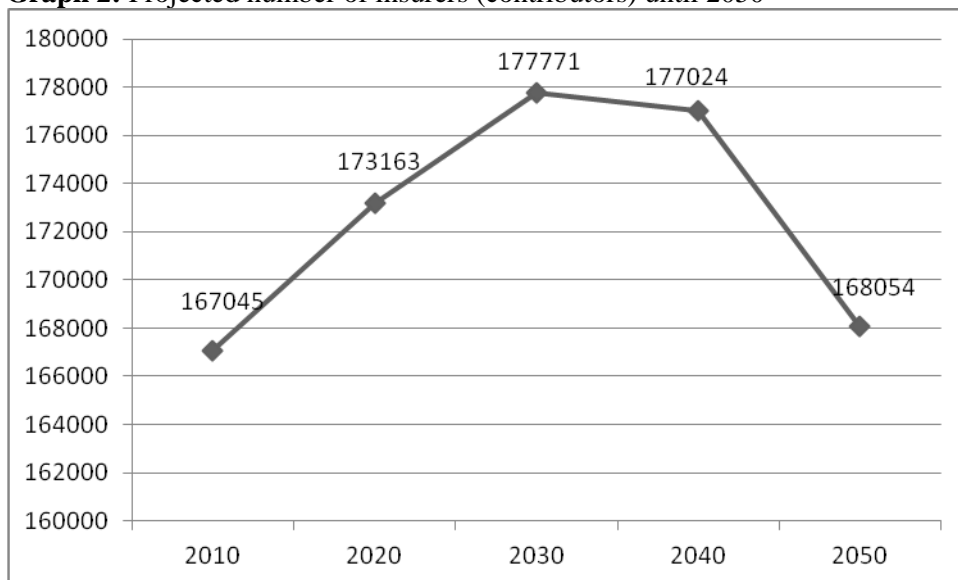
Year	2010	2020	2030	2040	2050
Population ³¹⁹	620,029	658,932	674,858	679,645	676,793
Number of pensioners	99,196	123,097	136,763	151,298	168,262
The share of pensioners in population	16.0%	18.7%	20.3%	22.3%	24.9%

Source: MONSTAT, PIO Fund, author's calculations

Projections of *insurers (contributors)* are needed in order to analyze future revenues of state pension fund, as well as to project system dependency ratio. Projections of insurers are based on projections of age and gender structure of population until 2050. In order to project number of insurers in Montenegro during observing period, the share of insurers in certain age groups is calculated.³²⁰ Based on PIO Fund data on age and gender structure of current insures, it is calculated share of insurers in certain age and gender groups of population. Appliance of this share on projected structure of population gives a projected number of insurers in Montenegro.³²¹

The number of insurers in 2010 amounted 167,045 or 27% of total population. According to the projections, the number of insurers will have increasing trend till 2030, when it will reach the level of 177,771. After that, the number of insurers will decline, and in 2050 it will amount 168,054 or around 24.8% of total projected population. This will be direct consequence of decrease of working age population.

Graph 2: Projected number of insurers (contributors) until 2050



³¹⁹ Projections of population are based on MONSTAT's demographic projections.

³²⁰ Based on existing data on insurers.

³²¹ Since this research is focused on the impact of age structure on pension system, the assumption is that other relevant indicators, such as labour market indicators will be constant.

Source: MONSTAT, PIO Fund, author's calculations

A rising *old age dependency ratio*³²² is a big concern for Montenegrin government, due to negative demographic trends. It will be very difficult for pension and social security systems to provide adequate security for old-age and non-working population. Old age dependency ratio will be almost doubled during the period 2010-2050, since it will increase from 19.3% in 2010 to 38.55% in 2050.

Table 4: Old age dependency ratio until 2050

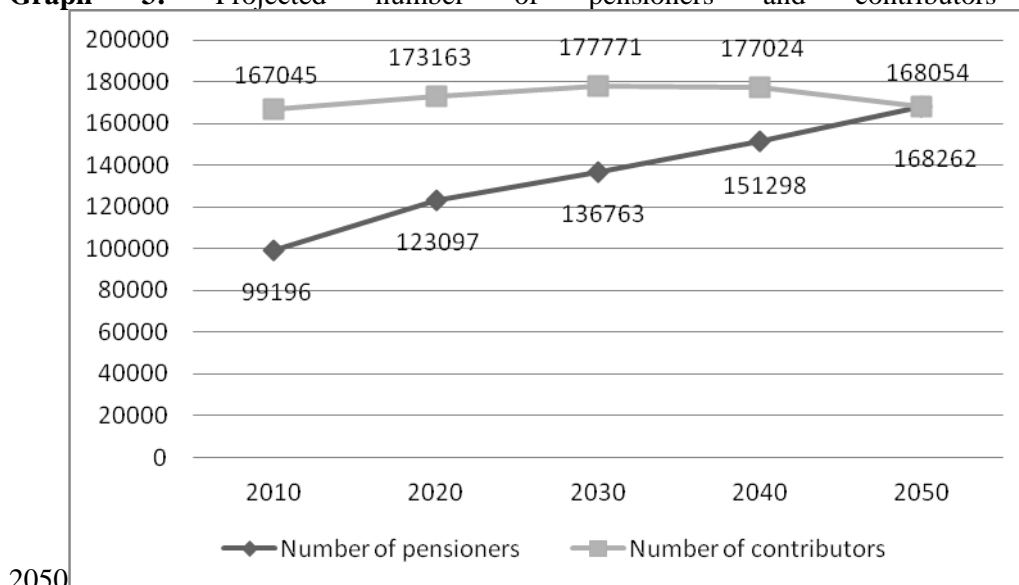
Year	Age groups	Population	Dependency ratio
2010	15-64	422,041	19.3%
	65+	81,535	
2020	15-64	450,209	22.44%
	65+	101,036	
2030	15-64	452,199	27.55%
	65+	124,612	
2040	15-64	452,681	30.94%
	65+	140,079	
2050	15-64	430,681	38.55%
	65+	166,045	

Source: MONSTAT, author's calculations

Ratio between contributors and pensioners is going to be unfavourable during observed period. This ratio between the number of active payers who are contributing to the PIO Fund and the number of pension right bearers is going to be inadequate. According projections, the number of pensioners and the number of insurers (contributors) will be equalized in 2050.

³²² Old age dependency ratio is equal to the number of individuals aged above 65, divided by the number of individuals aged 15 to 65, expressed as a percentage.

Graph 3: Projected number of pensioners and contributors until



Source: MONSTAT, PIO Fund, author's calculations

The ratio between contributors and pensioners amounted 1.68 in 2010. However, this ratio will decrease and it will amount 1.4 in 2020, 1.3 in 2030, 1.17 in 2040, while it will amount exactly 1 in 2050.

Projections of *pension expenditures and revenues* are very important part of pension system analysis, since this system faces financial challenges. The State Pension Fund deficit is a simple problem of proportion since the number of employees who pay contributions register lower growth rates than the number of pensioners. Additionally, the problem is that the state turned out to be a bad investor (especially in the ex-socialist economies). Namely, during the years when the state pension funds ran huge surpluses, states did not hesitate to spend money without adequate planning. These two arguments are equally applied in the case of Montenegro. The share of pension expenditures in the GDP of Montenegro is around 11%. Pension contributions are insufficient and can pay only about 72% of the total pension expenditures. The Ministry of Finance makes significant transfers from state budget to fill the gap in the PIO Fund. Having in mind the state's liabilities in the future, related to the settlement of external debt, transfers will represent an even greater burden on the budget.

The number of projected pensioners is used as a basis for the projections of *expenditures* of pension system, i.e. the expenditures on net pensins. To date reform of the pension system included reform of mandatory pension insurance, i.e. reform of PAYG system in 2004 through drafting the new Law on Pension and Disability

Insurance³²³, which is changed in 2010 again. One of the main reform measures in 2010 was change of pension adjustment. The pensions are adjusted according "Swiss formula", in which the pensions are adjusted annually by combining 25% of the average wage growth rate and 75% of the consumer inflation increase. This formula is used with projected growth rates of wages and projected CPI, and average pension in Montenegro is calculated during period 2010-2050. The assumption is that wages and inflation will grow during observed period by 3%. However, these rates are modified for the nearest period due to the different expectations. The same growth rate is predicted for the GDP, with exception of 2011 and 2012 where the expected GDP growth rate is 2,5%, based on the expectations of the Ministry of Finance. Projections of average pensions during 2011-2050 are based on projected pension growth rate and average pension from the previous year. Some part of pension expenditures is related to other special categories. These expenditures include contributions for pensioners' health insurance, body injury compensations, etc. These expenditures amounted approximately 5% of expenditures on net pensions during previous years. Adding of these expenditures to expenditures on net pensions provides data related to *expenditures on gross pensions*.

Table 5: Projections of pension system expenditures³²⁴ during 2010-2050 (in € million).

Year	Expenditures on gross pensions	Total expenditures of pension system	GDP	Expenditures on gross pensions as % of GDP	Total expenditures as % of GDP
2010	330	365	3003	11%	12.15%
2020	593.48	623.16	3996.7	14.85%	15.59%
2030	889.37	933.84	5371.2	16.56%	17.39%
2040	1322.27	1388.38	7218.4	18.32%	19.23%
2050	1976.27	2075.08	9701.02	20.37%	21.39%

Source: MONSTAT, Ministry of Finance, PIO Fund, author's calculations

According to the projections of pension system expenditures, it is obvious that these expenditures will grow as percentage of GDP. The main reason for that situation will be the increase of the number of pensioners. The expenditures on gross pensions will increase from 11% of GDP in 2010 to 20.37% of GDP in 2050, while total

³²³ The Law on Pension and Disability Insurance, Official Gazette of Montenegro, 54/03 and 78/10

³²⁴ Average monthly expenditures on net pensions are calculated by multiplying projected number of pensioners by projected average pension. Annual expenditures on net pensions are calculated by multiplying this amount by 12 (12 months).

expenditures³²⁵ of pension system will be higher than 21% of GDP at the same time. It would not be a problem if the revenues of PIO Fund are sufficient for the covering those expenditures. However, during previous decades the PIO Fund registered increasing deficit, which became the inherited responsibility of state budget. Transfers from the state budget to PIO Fund are at the high level, and these transfers will increase in the future.

Total *revenues* of PIO Fund are projected to be equal to the total expenditures of this fund. Total revenues present a sum of revenues that are based on contribution payments and other revenues of PIO Fund. Contribution revenues during period 2010-2050 are based on contribution rate for pension insurance, projected average wages and projected number of contributors. Since 2008 the Law on mandatory social security contributions³²⁶ is in force and according to this law, social contributions on pensions, health insurance and unemployment are gradually decreasing. In 2010 the contribution rate for pension insurance amounted 20.5% of gross wage. The rate of 20% is used in these projections for the entire period. A sum of average wages is calculated by multiplying of number of projected formally employed persons (contributors) by projected average wage in the country during observed period.

Table 6: Projections of PIO Fund revenues from contributions until 2050

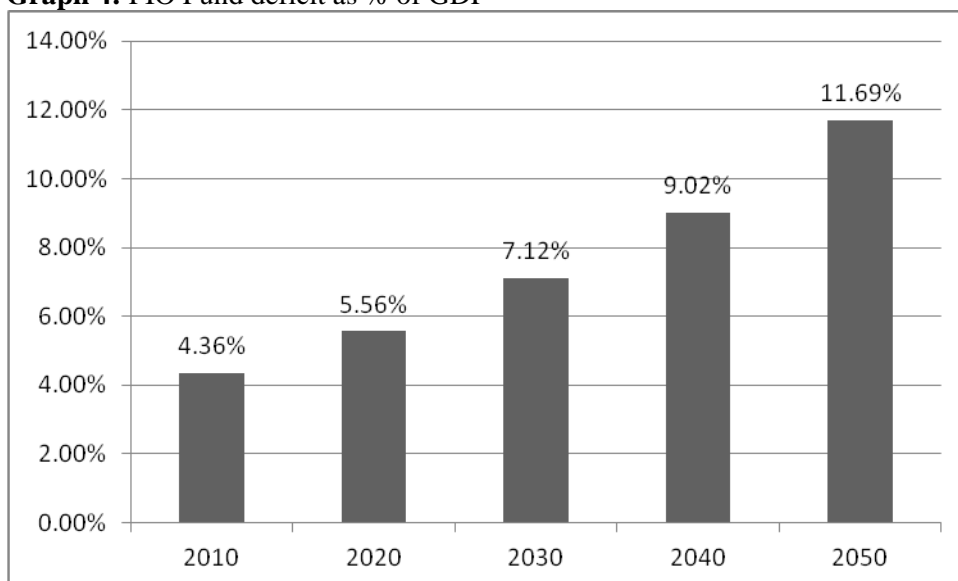
Year	Revenues from contributions (in million €)	As % of gross pension expenditures	As % of total pension expenditures	PIO Fund deficit (in million €)
2010	234	70.9	64.10	131
2020	399.34	67.29	64.08	223.81
2030	550.93	61.95	58.99	382.91
2040	737.34	55.76	53.10	651.04
2050	940.68	47.60	45.33	1134.40

Source: Ministry of Finance, MONSTAT, PIO Fund, author's calculations

The revenues from contributions will not be sufficient source for the pension system expenditures in the future. The situation will be worsened since these revenues will decrease their share in total revenues (which are equal to total expenditures) of PIO Fund from more than 70% in 2010 to less than 50% in 2050. This means that PIO Fund deficit will increase during observed period and it will amount 1.13 billion € in 2050, or more than 11% of GDP.

³²⁵ Total expenditures include also other expenditures which are estimated on 5% of expenditures on gross pensions. The other expenditures are related to the costs of pension payments, costs for specific assignments, administrative costs, material costs, investments, etc.

³²⁶ Law on mandatory social security contributions – Official Gazette of Montenegro, 13/07

Graph 4: PIO Fund deficit as % of GDP

Source: Ministry of Finance, PIO Fund, MONSTAT, author's calculations

The PIO Fund deficit will increase in the period 2010-2050 from 4,36% of GDP in 2010 to 11,69% of GDP in 2050 which suggests that increased number of pensioners and aging population will deteriorate the sustainability of pension system in Montenegro and at the same time increase the transfers from the state budget.

The solution must be find in more radical reform measures that are related to the introduction of so-called "second pillar" of pension insurance, i.e. the mandatory capitalized saving and establishment of private pension funds. The advantages of capitalized saving system could be visible not only through enhanced sustainability, but also through the improvement of capital market and increased economic growth rates³²⁷

Conclusion

The main problems of the current pension system in Montenegro revolve around negative demographic trends, i.e. falling fertility rates and an aging population. According MONSTAT's projections of population based on low fertility rates, expected mortality rate and expected migrations, Montenegro will be faced with a negative population growth rate and low total fertility rate. This will result in the aging of Montenegrin population. The number of elderly who are 65 years old or above will increase, and their share in the total population will register growth in the future. At the same time, the working age population will fall and its share in the

³²⁷ Vukotić, V. (2004), Penzijske reforme kao novi potencijal ekonomskog rasta, ISSP, Podgorica, 2004

total population will decline. As a consequence, the old-age dependency ratio will increase and it will be doubled in 2050 in comparison with 2010. The number of pensioners will increase which will affect negatively the sustainability of pension system. Deficit of PIO Fund will be higher than 11% of GDP in 2050. This will present a huge burden for the state budget.

The conducted reform of existing PAYG system in Montenegro will not solve the problem of deficit in the long-run. The enhancement of financial sustainability of pension system is possible through the introduction of mandatory capitalized saving since this kind of pension insurance have many advantages in comparison to the existing one. This introduction of capitalized saving could enable to workers to own the capital. "The world would be a better place if every worker were also an owner of capital. Workers would benefit from the appreciation of assets in the long term and feel more connected to the overall performance of the economy. The interests of the workers would be more in line with the interests of those who manage and control those assets, there would be less inequality of wealth, and workers would place a higher value on strong property rights and the rule of law. Above all, workers would find a new dimension of freedom and dignity in their lives."³²⁸

References:

1. Bačović, M. (2006). Demografske promjene i ekonomski razvoj – analiza investicija u humani kapital, ISSP, Ideja, Podgorica, 2006
2. Bejaković, P.(2000). Dosadašnja kretanja broja umirovljenika i mirovina u Hrvatskoj - demografske odrednice budućih kretanja, Institut za javne financije, Zagreb, 2000.
3. Cerda, R. (2004). On social security financial crisis, Journal of Population Economics, Volume 18(3), 509-517
4. Davis E P. (2006). How will ageing affect the structure of financial markets, Brunel University Economics and Finance, working paper 07/10
5. Feldstein, M. (1996). Social security and saving: new time series evidence, National Tax Journal, 49(2), 151-164
6. Holzmann, R. and Hinz R. (2005). Old Age Income Support in the 21st Century, World Bank, Washington DC, 2005.
7. Holzmann, R and Palmer, E. (2006) Pension Reform, The World Bank, Washington DC, 2006
8. Penev, G. (2008), Demografski trendovi u Crnoj Gori od sredine 20 vijeka i perspektive do 2050. godine, MONSTAT, Podgorica, 2008
9. Pinera, J. (2001), Toward a World of Worker-Capitalists, The Boston Conversazioni, Boston University, 2001
10. Vukotić, V. (2002), Penzijske reforme i tržište kapitala u Crnoj Gori, ISSP, Podgorica, 2002.

³²⁸ Pinera, J.: Toward a World of Worker-Capitalists, The Boston Conversazioni, Boston University, 2001

11. Vukotić, V. (2004), Penzijske reforme kao novi potencijal ekonomskog rasta, ISSP, Podgorica, 2004
12. www.monstat.org
13. www.pensionreform.com
14. www.vlada.me

Reviews

Prof. dr Petar Ivanović*

**Anniversary celebrating 210 years
since the birth of Frederic Bastiat**

Abstract: *Bastiat is one of the first apostles of the economic freedom, free trade and individual rights and freedom. Millions of people today desire that these important principles be allowed to flourish, and still they are impeded by few. His work and messages, and brilliant and provocative essays, are as actual today as they were 150 years ago. Indeed, has the essence of the economy been changed meanwhile? Or we only believe that economic essence is changing as a result of human development. Such believes may influence on what we can see and understand, and prevent us from grasping all of the consequences. It seems that today, perhaps even more than ever, when we discuss economic development and growth we are witnessing a battle, which finds its historical beginnings between those that took opposite sides throughout the past 150 years. Reading Bastiat may help better understanding the steps that must be taken to create a system that will enable us as a society to reach our full potentials.*

Key words: *private property, free exchange, protectionism, economic freedoms, market, law, visible vs.invisible*

* * Montenegrin Investment Promotion Agency (MIPA) and UDG Podgorica

Frederic Bastiat is one of the best economists! Frederic Bastiat is my hero!

In economics, every action, habit, institution or law cause not one, but a series of consequences. And only the first of all consequences is immediate. It manifests itself at the same time when the cause and is visible. The others can be reached gradually. They cannot be seen, but it would be useful to predict them. That is the difference between bad and good economists. The first only consider visible consequences, while the second not only them, but also those to be predicted.

Today, I meet more and more people who know a great deal about complex things, but at the same time they know very little, or nothing at all, about the simple, essential matters that are responsible for setting more complex things into motion. It is much easier to function on a complex plane than it is to examine the simple sources of economic trends. Nowadays, there are many economists who understand the consequences of events, while very few indeed understand the causes that result in certain consequences. More and more, we have a tendency to think in a compartmentalized way, rather than to see the picture as a structured whole. The fight for and over business, markets, progress and individual freedoms is blazing up again.

Frederic Bastiat wrote about the problems in such way that he presented the problem in a very simple way, from its cause to its consequence. He used plain and easy words that made a deep impression on his readers. A lucid and excellent writer and an impregnable advocate of the existence of an unrestrained, free market, destruction of protectionism and all forms of state control, gifted with a clean mind, clear thought, the ability to express himself in simple language, and had an excellent sense of humor.

His example of the broken window disproved the theory of the Keynesian economy almost a century before it was written. It is as though he walked one step ahead of his time, fighting for the good of the ordinary, busy person, who, due to increased time constraints, is less and less able to dedicate time to his education. All of these traits helped him to be accepted by his widest audience – ordinary people!

Bastiat was one of the first apostles of the economic freedom, free trade and individual rights and freedom. Millions of people today desire that these important principles be allowed to flourish, and still they are impeded by few. His work and messages, and brilliant and provocative essays, are as actual today as they were 150 years ago. Indeed, has the essence of the economy been changed meanwhile? Or are we in delusion that economic essence is changing to such extent.

Still, if we analyze the contribution of Bastiat in a way that the majority of

economists do today, then the conclusion would probably be that he should sink into oblivion and let the dust cover his name. He did not come up with any new theorem, economic law or conduct a research that would impress his contemporaries. Bastiat only in a refreshing and witty way displayed the plain truth about how economic processes develop. The best illustration of his method of writing is the *Petition of candle-makers, wax candles, lamps, maces, street lamps, wick scissors, tallow makers, and oil, and resin, alchocol and everything related to lighting*, where he discovers the nonsense of protectionism.

Frederic Bastiat was born in Bayonne in 1801, in the family originating from the place Murgon where he spent most of his life. He lost his parents when he was nine years old. He worked at his uncle's accounting company, and when he inherited the farm, he became involved in agriculture. Bastiat read the works of the political economists - Jean-Baptiste Say, Adam Smith, Destutt de Tracy, Charles Comte and Charles Dunoyer. He emerged from this reading a tireless exponent of *laissez faire* liberalism. After the revolution in 1830, he became politically active. The first paper that he wrote that caught people's attention was published in 1844 and was entitled '*The Influence of Custom Tariffs on England and France and the Future of Two Nations*'. A year later he moved to Paris. He published '*Cobden and League*' and started to write a series of texts for the *Journal des Economistes*. In 1846 he founded the *Association of Free Traders* and became its secretary. Together with Victor Igo, he founded an *International Peace Organization*. He published his first book, '*Sophisms and Protection*' in 1847. With the Revolution of 1848, Bastiat became a member of the parliament. In addition to many newspaper articles, he wrote a series of essays, amongst which the most famous are: '*What is seen and what is not seen*', '*Law, State Justice and Brotherhood*', and '*Peace and Freedom...*' His work '*Economic Harmonies*' was published in 1885, the same year that he died in Rome.

Nobel Prize Winner, Frederich Hayek, saw in Bastiat a great supporter of economic freedom. Josef Schumpeter called him "the most brilliant economic journalist that ever lived." For Murray N. Rothbard, Bastiat's strong focus on money taken away by the state and the privileged interests of the state, made "his political economy his weapon in the fight for freedom along with his important viewpoint in the analysis of welfare". Henry Hazlit described Bastiat as an economic promoter, who to a large extent exposed economic myths and became the most powerful champion of free trade in the continent of Europe. "Anyone who has ever read and understood Bastiat, has become immune to the disease of the illusion of protectionism and of the welfare state. We could use more Bastiat's today. In fact, we desperately need them." It is not too much to say that the "social rationalism" of Ludwig von Mises, resulted as a consequence of Bastiat's discussions about the nature of society and of economic life.

Naturally, it would not be logical if everyone had thought well of Bastiat. Karl Marx called him "the shallowest and therefore the best and most successful representative of apologists deriving from a vulgar economy." Was this opinion the result of Bastiat being such a strong opponent and severe critic of socialism? Or did it occur due to Marx's resentment towards a writer whose writing was clear and plain and who gained a large audience during his life? The fact is that, during the last two centuries, no one has asked what Bastiat really thought. In the case of Marx, a whole industry developed to express what Marx thought and wanted to say, but he didn't do what he said, nor did he mean what he said...

Bastiat often emphasized the importance of political economy that later on will be neglected and overflowed with many segmented economic directions which will undermine the systematic way of thinking in the economy. What makes political economy so important? "For if there are general laws that act independently of written laws, and whose action needs merely to be regularized by the latter, we must study these general laws; they must be the object of scientific investigation, and therefore there is such a thing as the science of political economy"³²⁹

Bastiat was one of the first, and one of the few, who could arguably explain the basic principles of economy. And one of the essential issues embedded into the grounds of all economic principles is the **issue of property**. "Is the right to property one of those rights which, far from springing from positive law, are prior to the law and are the reason for its existence? This is not, as might be thought, a theoretical question. It is of tremendous, of fundamental importance."³³⁰ Can the property be observed separately from the nature of human? Bastiat thought the property was a necessary consequence of the nature of man, that the man is born a proprietor, with wants whose satisfaction is necessary to life, and with organs and faculties whose exercise is indispensable to the satisfaction of these wants. "Property is nothing but an extension of the faculties". To separate a man from his faculties is to cause him to die".

Bastiat observed that many theorists have been falling into constructive mistake. Some of them has left profound impact in the history and to fight against such people, and the legacy of their ideas, was not easy. But, he did not restrain to get into the battle of opinions. Rousseau's view that "the law should transform persons and should create or not create property was shaken up by perfect logics: "In my opinion, society, persons, and property exist prior to the law (not prior to society!)"

³²⁹ Economic harmonies

³³⁰ Essays, page 96

and, I would say: property does not exist because there are laws, but laws exist because there is property"³³¹.

He successfully exposed the pessimism of the English classical economists, Rikardo and Maltus. Human wants, however, are not fixed. To satisfy our progressively increasing wants, we apply labor to material objects. In this process, "certain moral virtues such as orderliness, foresight, self-control, thrift, contribute directly to the improvement of our way of life."³³²

Beside property, Bastiat thoroughly analyzed the **issue of exchange**. Has the exchange been one of the essential elements of political economy? Is there a society without the exchange? Is there an exchange without the society? Does the exchange increase our prosperity and our power? Is it actually possible to live without exchange? "Society is our natural state, since it is the only state in which we can live at all"³³³. Extension of this form of social cooperation enlarges men's powers and consumption. Another offshoot of wider exchange networks is increased human interdependence. Bastiat writes that "the sort of dependence that results from exchange... is a reciprocal dependence. We cannot be dependent on a foreigner without his being dependent upon us. Now, this is what constitutes the very essence of society"³³⁴. Bastiat notes that it "produces two phenomena: the joining of men's forces and the diversification of their occupations, or the division of labor"³³⁵. Thus "the general nature of exchange is to lessen the amount of effort in relation to the satisfaction".³³⁶ Life becomes both richer and easier. The "disutility of labor" (Mises), that is, "the pain and drudgery" of producing exchangeable goods³³⁷ does not go away, but the time involved and the conditions of labor improve.

Bastiat looks into the "**social mechanism**" of exchange, which enables each individual to receive from his efforts "a million times more than he could have produced; yet no one has robbed anyone". This astounding fact rests on "a natural and wise order that operates without our knowledge". It is precisely the work of economics to understand this order. How from these roots today's problems of exchange look like? Deficit? Foreign balance of trade? Customs? Subventions? How natural such formations are anyway? To what extent are they contrary to the very human nature?

³³¹ Ibid, page 97

³³² Economic Harmonies, page 55

³³³ Ibid, page 60

³³⁴ Sophisms and Protection, page 99

³³⁵ Economic Harmonies, page 67

³³⁶ Ibid, page 76

³³⁷ Ibid, page 482

This complex order is grounded on self-interest, the very thing that the utopians reject when making arbitrary plans for social betterment. In contrast to this, political economy does take self-interest into account. However, when social order is controlled by few almighties, natural and spontaneous order necessary for the society to function freely and in harmony is not possible. The social chaos occurs. "Doctrine that puts all power into the hands of legislators and the Government, will cause expectations and responsibility where they should not exist. If there is a suffering, the Government is guilty. If there is a poverty, the Government is guilty. Is this the general and only driving force of society? If the engine does not work properly, it should be rejected and replaced with the new one".

"Socialism, like the ancient political philosophy from which it emanates, confuses government with society. That is why, every time that we do not want a thing to be done by the government, the socialists conclude that we do not want the thing to be done at all. We are opposed to state education; hence, we are opposed to all education. We object to state religion; hence, we do not want any religion at all.... It is as if they accused us of not wanting to eat, because we oppose the cultivation of grain by the state"³³⁸.

Regardless of the simplicity of the analysis of complex issues such as property, exchange and social relations in society that turn attention to his ideas, style of writing and the way of thinking, Bastiat achieved even bigger success by analyzing **protectionism**. His works were antidote for wide spread economic illiteracy and numerous misconceptions such as price control, customs duties, subventions...

Under the strong influence of mercantilist fallacies, protectionists wished to block imports and foster exports. "The protectionist system and the colonial system are, then, simply two aspects of one and the same theory. Preventing our fellow citizens from buying from foreigners and forcing foreigners to buy from our fellow citizens are simply two consequences of one and the same principle."³³⁹ If this doctrine were correct, "the general welfare depends upon monopoly, or domestic plunder, and conquest, or foreign plunder."

Bastiat points out that men "can secure the means of existence in two ways: by creating them or by stealing them"³⁴⁰ "The "prevailing illusion is that it is possible to enrich all classes at the expense of one another," would soon lead to "making plunder universal under the pretext of organizing it"³⁴¹. There were three possible

³³⁸ Essays, page 68

³³⁹ Sophisms and protection, page 86

³⁴⁰ Economic Harmonies, page 479

³⁴¹ Essays, page 61

paths: "partial plunder" associated with restricted suffrage, "universal plunder" allied to universal suffrage, and "absence of plunder,"- the liberal ideal not yet realized.³⁴²

Not only was protectionism an important form of plunder, by setting a precedent for state intervention in the exchange system. **"Protectionism has been the forerunner of communism;** ... it has been its first manifestation"³⁴³. However, once they realized the protectionism became a matter of sharing their own property too it alarmed the protectionists themselves. Hence "free trade has never been a question of customs duties, but a question of right, of justice, of public order, of property"³⁴⁴. In Bastiat's opinion it was idle to separate liberty and property: "I consider the right to property to consist in the freedom to dispose first of one's person, then of one's labour, and finally, of the products of one's labour - which proves, incidentally, that, from a certain point of view, freedom and the right to property are indistinguishable from each other"³⁴⁵ Can we be free and have limited right to property? Can we have rights and not be free?

Bastiat wrote about ideas that created many misconceptions. One of them was that "the law creates rights." "Steeped in Roman ideology, the jurists claim that property stems from law. But "whereas the jurists' principle involves virtual slavery, the economists' principle implies liberty. Property, the right to enjoy the fruits of one's labour, the right to work, to develop, to exercise one's faculties, according to one's own understanding, without the state intervening otherwise than by its protective action - this is what is meant by liberty"³⁴⁶. **The misconception that the law creates rights** was a recipe for wildly shifting policies, for a weird mixture of communism and private property settled by the ups and downs of partisan politics - a word, today's welfare-warfare state, which Francis Fukuyama famously claims as the "End of History". In Bastiat's terms, it is only the "death of good sense". Does the good sense exist where the boundaries of freedom end?

Bastiat knew that public policy rested less on venial intellectual error than on deliberate perversion of government from provision of protection to creation of privilege. "However well disposed or optimistic one may be, one is compelled to recognize that plunder is practiced in this world on too vast a scale, that it is too much a part of all great human events, for any social science – political economy least of all – to be able to ignore it" Where plunder was well entrenched, it raised up "a legal system that authorizes it and a moral code that glorifies it". The chief forms of plunder were war, slavery, theocracy, and monopoly. All these forms disrupted

³⁴² Essays, page 63

³⁴³ Economic Harmonies

³⁴⁴ Essays, page 111

³⁴⁵ Essays, page 210

³⁴⁶ Essays, page 109-110

"voluntary exchange of service for service. However, in their intention to create privileges, and by that to prevent voluntary exchange, politicians brought forward all manner of good deeds for the state to do: "Organize labour and the workers. Root out selfishness. Repress the insolence and arrogance of capital. Make experiments with manure and with eggs. Furrow the countryside with railroads. Irrigate the plains. Plant forests on the mountains. Establish model farms. Establish harmonious workshops. Colonize Algeria. Feed the babies. Instruct the young. Relieve the aged. Send the city folk into the country. Equalize the profits of all industries. Lend money, without interest, to those who desire it. Liberate Italy, Poland, and Hungary. Improve the breed of saddle horses. Encourage art; train musicians and dancers. Restrict trade, and at the same time create a merchant marine"³⁴⁷. Reflecting on the plundering process led Bastiat to formulate his famous definition of the state: "The state is the great fictitious entity by which everyone seeks to live at the expense of everyone else". Everyone wants to live on the account of the state. What everybody seems to forget is that the state wants to live on the account of everyone!

The attempt to set an artificial price through tariffs for Bastiat is evidently an effort to destroy the equivalence of services...." But the tariffs and customs duties are not the only mechanisms. Then "comes taxation". It has become a much sought-after means of livelihood." The constant growth of state employment comes about the more that people want their needs met "by that fictitious being, the state, which signifies a collection of salaried bureaucrats"

What is the future of intervention? Would intervention lead to strengthening society, its ethics, to further demokratization? **No, Intervention would usher in a general breakdown of public and private ethics!** Thus, "one might think it impossible that a whole nation should agree in seeing an increase in wealth in what the inhabitants steal from one another." But, no, "we have completely accepted this view in France, and are continually devising and improving methods of reciprocal robbery under the name of subsidies and protective tariffs" ³⁴⁸

"Once an abuse exists, everything is arranged on the assumption that it will last indefinitely; and, as more and more people come to depend upon it for their livelihood, and still others depend upon them, a superstructure is erected that soon comprises a formidable edifice". Is it possible to stop or reform such processes? Reform of an abuse was politically difficult: "The moment you try to tear it down, everybody protests; and the point to which I wish to call particular attention here is that those who protest always appear at first glance to be in the right, because it is

³⁴⁷ Essays, page 140-141

³⁴⁸ Sophisms and Protection, page 195

easier to show the disorder that must accompany reform than the order that should follow it".³⁴⁹

Despite the numerous discussions he started; hidden or open hostility of socialists and government supporters, Bastiat kept on writing about the market order based on private property. Economics is about want-satisfaction. In seeking to fulfil their needs, men learnt that "there are two kinds of utility".³⁵⁰ Some things are simply given in nature; others require transformation by human activity to make them useful: "It is not given to man, in fact, to add to or subtract from the existing number of molecules. His role is confined to modifying or combining for his use the substances he finds everywhere about him".³⁵¹

One of the best Bastiat's essays is "*What Is Seen and What Is Not Seen*" where he points to economic errors of economic analysts who get past the less obvious ("unseen") consequences and take into account only immediate, apparent ("seen") consequences. However, what is the influence of rights violated, economic opportunities foregone, costs imposed on society by political means.... It is a great mistake to imagine that such costs do not exist.

It is remarkable how fresh and modern his writing sounds even after 150 years. His essays easily reach even those who find themselves too busy, particularly for reading. I believe that there are far more ordinary than always busy people, who in the texts that follow would find sheer logics based on natural relations and principles that enable faster and more qualitative society development. And Bastiat himself often emphasized that his audience is exactly the public, ordinary man and consumer.

There has always been and always will be curious persons and of course those critically-oriented and know everything in advance. But still, it would be good to go back and to comprehend the conception of processes that last even today. To achieve this, it takes will, intellectual power and time.

Read Bastiat to sharpen your mind and preserve your conscience!

³⁴⁹ Sophisms and Protection, page 176

³⁵⁰ Economic Harmonies, page 27

³⁵¹ Economic Harmonies, page 62

Dr Maja Drakic*

Review of the book
Psycho-Philosophy of Business: Our Mentality Through A Dialogue
by Professor Veselin Vukotic

(Published On 2010-08-20 By Friedrich A. Von Hayek Institut ISBN: 3-902466-08-1)

The first book of a Montenegrin economist in English, published by a European Union publisher came to light in 2010, when prominent Hayek Institute from Vienna published the book *Psycho-philosophy of Business*, written by *Professor Veselin Vukotic*. Two editions of this book, although in Montenegrin, have already been completely sold in all countries of Balkan region (publishing house CID - first edition 2003; second edition 2007).

Professor Veselin Vukotic is one of the leading economists in ex-Yugoslavia and the Balkans. He was the member of the last government of “big” Yugoslavia (Prime Minister Ante Markovic), remembered by very successful program of economic reforms. He is the founder and Rector of University UDG and the person who introduced the idea of economic liberalism in Montenegro. In 1992, he founded Postgraduate Studies “Entrepreneurial Economy”. He also has been the founder of Center for Entrepreneurship and Institute for Strategic Studies and Prognoses. These three institutions – so called Economic Reforms Network – have become centers of, not only economic reforms, conducted in Montenegro in late 1990’s, and in new millennium. Professor Vukotic is the member of the Board of directors of Mont Pelerin Society, and is also active in Liberty fund. He is the senior research fellow at the Institute of Social Science from Belgrade. Professor Vukotic wrote many books, research papers, scientific and popular articles (see more at: www.vukotic.net), however *Psycho-philosophy of Business* is outstanding in many contexts.

As an author says, “this is not a book that explains what others should do for you! This is a book that attempts to motivate you to do things for yourself, your success, your life! How to move forward, how to liberate yourself from the masses, how to become free!...!”

* Faculty for International Economic, Finance and Business; University of Donja Gorica (UDG), Podgorica; Institute for Strategic Studies and Prognoses, Podgorica; maja.drakic@udg.edu.me

The author says that he: "did not intend to write a book like this one!". His idea was to "write something much simpler – to write one that would popularize business philosophy among young people!". However as professor Vukotic is one of the creators and leaders of economic reforms in Montenegro in last decades of previous and first decades of this millennium, "process of working on national reform, reading the literature of modern economic transition and eventually studying historical transitions such as Humanism, the Renaissance, and those of Ancient Greece and Rome, and working with students" he found himself "asking questions to which everyone except him seemed to have answers!"...

"For instance, why are Montenegrins so inert? Why do they think so uniformly? Why do so many of them fail to recognize reality? Why is there so much public prejudice? Why are people who are recognized as being part of an elite class creating obstacles to change? Why is transition so much harder than we expected? Is it enough for those in charge of transition to understand transitional rules that are generally applied in other countries or do they also need to develop their own set of guidelines? Are men the key source of transition? If they are, then how should one motivate them? I asked myself many other questions, too! For example, does a man know what he is talking about? Where is the gap between words and thoughts, words and deeds? Why do certain people boast although they have achieved so little? Why do some people like this sort of boasting? Why do negative people attract so much attention and respect?"

An idea the author puts in focus in "Psycho-philosophy of Business" is the idea of economic liberalism and open society – the idea of freedom and individualism. These concepts have never been attractive for authors from the Balkans. Multidimensional analysis in this book makes it as interesting to a sociologist, a psychologist, a historian or an anthropologist as to an economist. Thus we can describe the book as interdisciplinary – business is just the mean author use to deeply analyze that „mental shell created by culture, customs, moral, beliefs and attitudes“ of Montenegrin and moreover Balkan people.

The book is written in a form of dialogue between professor and his student. However, it is not the discussion, „about events or peoples' preferences but of success and failure! This is a discussion about experience, not mysticism! The aim is to understand the importance of thinking! Only thought can create, make things, and bring innovations into existence!" Through the dialogue, author succeeds to faithfully express the conflict between the "two worlds": "world which is static where nothing can be changed; the other is a world where anything can be changed if we want to do so! The first of these worlds is the world of the tangible, the know-it-alls, the suspicious, the obedient and the crowd! The second is a world of essences, creativity, free men and individuals!"

The dialogue is an incentive for each individual reader, to raises questions and gives answers – to him or herself. It gives the book one more dimension – to move the mind of an individual. Self-questioning is something that people usually run away from. In small environments and in the closed society, such as Montenegro, it creates the “mental shell”, which makes society resistant to changes. Those societies have the built-in “failure to make room for individual creativity!” Professor Vukotic writes not about Montenegro when he says: “those who downplayed the role of the individual in society were the very ones evaluating the work of individuals; equality was suffocating freedom!”

Author use interesting comparison between an individual who tries to break this mental shell of closed society and Herman Hesse’s little Sinclair. Sinclair was trying to leave “the world of his parents”... the world “called father and mother, love, discipline, and school”; the “world of chastity and honesty where everything was familiar and certain and where life was generally wonderful”; the “world of clean hands and clean suits and good manners”; the world in which “parents were always pointing the right way, which is, if obeyed, a way of straight lines leading to a good career and to the parents’ unfulfilled ambitions”. However, that is not the “real world”, which “can coexist under the same roof”. His school friend, Demian, revealed the secrets of “the real world” to Sinclair. Author believes that “many of those who have not had to face up to this same tension between the world of parents and the real world have not been able to achieve real fulfillment in life.” Demian wrote in his letter to Sinclair: “The bird fights its way out of the egg! The egg is the world! He who would be born must first destroy a world!”... “There is no new world inside the shell of an egg! You must emerge in order to achieve something!” Professor Vukotic relates this “breaking of the shell” to Schumpeter’s creative destruction and to Hayek’s principle of trial and error. This symbolically reveals that author’s way of thinking, deeply rooted in his life experience, follows the principles of Austrian School of Economics. After all, the book is published by an Austrian, Hayek’s Institute.

The Founder and Secretary General of Hayek’s Institute, Ms. Barbara Kolm said in the Preface to the book, professor Vukotic reaches his goals – to provoke questions, set your thinking, “to penetrate the mental shell created by our culture, customs, moral, beliefs, and attitudes”. The book raises questions not only on business philosophy, but it moves the reader to think about much more. The book emphasizes the importance of independent and critical thinking for young people, and not only them. This book will pleasantly surprise any reader and the one who reads it realize that “Thought sets you free”.



www.udg.edu.me
