The Making of a State: Transition in Montenegro

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The first Montenegrin state started to take shape in the 8th century with the arrival of the Slavs and their mingling with the local population. Originally it was called Doclea, whose ruler received a royal insignia by the Pope Gregory VII in 1078 (Andrijašević and Rastoder 2006). Montenegro fell under the Ottomans in the late 15th century, but acted as a de facto independent state until formal recognition came at the Berlin Congress in 1878. Despite being on the victors' side in the Balkan Wars and in World War I, it was annexed by Serbia and lost its sovereignty in 1918. After the Second World War it became a part of socialist Yugoslavia, where it remained until 1992.

Montenegro's political transition started in earnest after the Belgrade Agreement signed in March 2002. Montenegro held an independence referendum in 2006 and was subsequently admitted to the United Nations and other international organizations. Today Montenegro is engaged in accession talks with the European Union (EU).

Political Aspects of Transition in Montenegro

At the beginning of the 1990s, the process of opening a socialist society began in Montenegro, as it did in most other countries

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undergoing transition. The first multiparty ballot elections and the establishment of the first democratic government took place. Since the beginning of transition, the Democratic Party of Socialists (DPS), successor of the League of Communists, has been the main political driver in the country. One can say that the transition in Montenegro has been characterized by program changes of the DPS, which also defined the country's path.

At the beginning of transition, the political and economic processes in Montenegro were under the dominant influence of the transition processes in the bigger member of the federation, Serbia. At the same time, the character of the Montenegrin society, which was predominantly a traditional society, made for a slow opening up to Europe. This stage of transition is characterized by a clash within the communist elite, as a pro-reform opposition never took form (Darmanović 2003). Shortly after the changes, the Democratic Forum was established, a roundtable which prompted the establishment of multipartism.

In order to understand Montenegro's institutional setting, it is important to remember that the Yugoslav republics enjoyed significant rights stemming from the 1974 federal Constitution. Even prior to 1992, Montenegro had a number of institutions such as the constitutional court, parliament, government, Ministry of Foreign Affairs, and central bank. This institutional history makes Montenegro's situation somewhat different from other newly independent countries. Slovakia, for example, started creating institutions from scratch after the Velvet Divorce. So did the three Baltic countries after 1991.

Still, most of the political decisions were made in Belgrade, and Montenegro's institutions were quite weak. Additionally, the political process of transition in Montenegro was weighed down by civil wars in the former Yugoslavia and sanctions imposed by the United Nations in 1992. Thus, the political transition in Montenegro truly started after the clash in the ruling Democratic Party of Socialists in 1996. The DPS split into two factions: one that remained loyal to the Milošević regime in Belgrade with the then President Momir Bulatović at the helm; and the other, a pro-Western faction, led by Prime Minister Milo Djukanović. These intraparty clashes created conditions for a new stage in transition and resulted in the Agreement on Minimum Principles for Development of a Democratic Infrastructure in Montenegro. It provided guarantees to the opposition that the electoral process would be fair and to the pro-reform part of the ruling party that it would receive the necessary support to oppose the official stance of Belgrade. The result was the election of Djukanović as the President of Montenegro in 1997.

Not only did Djukanović oppose Milošević at a great personal risk, but he also steered the country toward economic reform. Montenegro was able to pursue many reforms including those in the second wave (mid- to end 2000s) that we were in the position to propose and implement.[1] On many occasions, such as the decision to introduce the German mark as a legal tender in late 1999, President Djukanović was under significant pressure from the international community to reconsider, but he did not waver.

However, this period did not see a democratic consolidation of Montenegro's political regime due to the unresolved issue of sovereignty. The political clash between Podgorica and Belgrade at times threatened to turn into a military clash. The defeated candidate in the 1997 elections, Bulatović, was later appointed federal prime minister in an attempt to discipline Montenegro—a position he retained until the fall of Milošević in 2000. This stage lasted until a political agreement was reached on transforming the Federal Republic of Yugoslavia into a new entity called Serbia and Montenegro in March 2002. The agreement established a union between Montenegro and Serbia for a three-year term. This was a crucial interim step toward independence. However, the implementation of the union took a full year following the signing of the Belgrade Agreement.

The watershed year was 2006, at which time referendum rules were defined with the intermediation of the international community. Those rules included the provision that more than 55 percent of those casting their vote must opt for independence for Montenegro to restore its statehood. The referendum was held on May 21, 2006, bringing victory to supporters of independence by a margin of 55.5 percent to 44.5 percent, with an almost 90 percent turnout.

The newly established independence and the smooth divorce from Serbia meant that the process of institutional development could start for real.[2] Immediately following the declaration of

[1] "We" refers to Igor Lukšić, Milorad Katnić, and Vladimir Kavarić, the current economy minister and earlier a colleague of Lukšić at the Ministry of Finance.

[2] We were very quick to divide assets and liabilities thanks to the fact that Serbia and Montenegro already operated as economically independent states. Thus, it took only two rounds of talks (June/July 2006) to reach the agreement over independence, which Lukšić signed with Serbian Finance Minister Mladjan Dinkić.

independence and after gaining international recognition, two key strategic state objectives were defined: membership in the European Union and in NATO. Those two goals largely act as an anchor for political reforms. Montenegro also signed the Stabilization and Association Agreement with the EU in October 2007, and shortly thereafter adopted the new Constitution, while acquiring EU candidate status at the end of 2010.

Entry into the EU meant progress in six institutional and legal areas as a condition for opening accession negotiations: the electoral process, judicial independence, fundamental human rights, the fight against corruption and organized crime, cooperation with the civil sector, and strengthening the independence of the media. By mid-2012, sufficient progress was made and Montenegro opened membership negotiations with the EU, thus entering the latest stage of economic transition. By June 2016, out of the total of 35 negotiating chapters 22 were opened.[3] Assuming a successful completion of negotiations by 2019 and the ensuing ratification of the future membership agreement, Montenegro could become a full member of the EU in 2021.

Concurrently with the process of European integration, Montenegro is taking steps toward NATO membership, at first in the form of the Partnership for Peace, and then through the Membership Action Plan. At the end of 2015, NATO made the decision to invite Montenegro to join the alliance, with full-fledged membership to occur in 2017.

The further development of democracy and economic reform in Montenegro should be geared toward developing a modern state. According to Freedom House (2015), Montenegro today is a "partially free country." The rule of law needs to be further developed by encouraging a political culture of dialogue, tolerance, transparency, and accountability. Countries in transition that have steered their political system in this direction have built functioning democracies and successfully implemented economic reforms—in particular, we studied the experience of Poland, Estonia, and Slovakia.

[3]After taking over the position of foreign minister in December 2012 until he stepped down in April 2016 to run for the position of the Secretary General of the UN, Lukšić led Montenegro's delegation in the intergovernmental conferences between the EU and Montenegro to open negotiating chapters.

Economic Aspects of Transition in Montenegro

The economic transition in Montenegro, like the political one, is a process taking place in several stages. The first stage is related to the period since the beginning of the 1990s, with the introduction of multipartism. The second relates to the period 1998–2002 when a definite discord took place between Podgorica and Belgrade. The third stage started with the election of the new government in January 2003 and lasted until the declaration of independence in 2007. The fourth stage occurred during the period between the restoration of independence and the opening of EU membership negotiations in 2012. The current and final stage will last until EU membership is obtained, hopefully in 2021.

Even though economic transition in Montenegro started in the same period as in other countries of the former eastern bloc, it was soon thwarted due to irregular political conditions in which the economic transformation was taking place. Politics came to dominate the economic process, and progress toward greater economic freedoms came to a halt. This period is characterized by the economic blockade imposed on Montenegro due to international sanctions introduced by the United Nations on the Federal Republic of Yugoslavia in 1992. Gradual withdrawal of sanctions began only in 1996. At the same time, due to the loss of the common market of socialist Yugoslavia on which Montenegro's economy predominantly depended, as well as wars in the neighborhood, the GDP took a dramatic plunge. Using 1989 as the base year (100), GDP fell to 89 in 1990, 70 in 1991, 61 in 1992, and 39 in 1993. Only in 1995 did the economy start growing again. This respite was cut short after the bombing of the Federal Republic of Yugoslavia in 1999, and GDP started falling again, thus significantly retarding the postcommunist recovery (ISSP 2004: 8).[4]

The war-torn period also led to a large inflow of refugees. At a certain stage, they made up more than 20 percent of Montenegro's population. Enormous increases in the number of inhabitants, mostly

[4]The Institute for Strategic Studies and Prognoses (ISSP) in Podgorica was the first proper economic think tank in Montenegro. Katnić worked at ISSP for a time and Lukšić drew upon ISSP's policy studies. Other prominent members of the government or administration also worked with the ISSP to promote economic liberalism.

vulnerable ones, exerted intense pressure on the already exhausted budget and social funds. Survival policies were implemented in this environment, and deeper economic reforms aimed at increasing economic freedoms were postponed.

The second stage of economic transition in Montenegro was dominated by the political conflict between Belgrade and Podgorica. That period can be divided into two subphases: 1998 until October 2000, when political changes occurred in Serbia; and October 2000 until January 2003, when Montenegro's new government was established. In this period, the functional and institutional sovereignty that preceded the formal restoration of independence was established. Functional sovereignty meant independent decisionmaking, while institutional sovereignty implied freedom and the possibility of establishing new institutions. The issue of state sovereignty dominated the period 1998–2002, thus slowing the process of economic transformation.

The establishment of an independent economic system began as well, in addition to distancing from the official politics of Belgrade. Montenegro adopted measures affecting monetary, financial, and fiscal policies, as well as foreign trade. Although nominally Montenegro remained part of the federation, the pursuit of economic independence gained pace. This process was strongly backed by President Djukanović who was the personification of the process in which the government was taking back different competences from the federal level step by step. At the same time, Montenegro took over the process of defining ownership rights and privatization. The key person in this process was Veselin Vukotić, a prominent economist, who inspired and implemented the overall economic reforms and the privatization agenda (see Vukotić 2002, 2003, 2005; also Vukotić and Pejovich 2002).[5]

[5]Vukotić (currently leading private university UDG) was the vice prime minister in the last Yugoslav reformist government led by Ante Marković that lasted until the dissolution of the SFRY. He was in charge of implementing the privatization agenda. After returning to Montenegro, he reemerged as the key personality in late 1990s helping the government adopt the policy of economic liberalism, privatization, and entrepreneurship. Lukšić and Katnić were Vukotić's students in the 1990s, and Prime Minister Djukanović was a student in the 1980s. Vukotić was also pivotal in putting together and later implementing the Economic Reform Agenda that was the centerpiece of the Djukanović government (2003–06), when Lukšić was finance minister and Katnić was deputy finance minister in charge of international cooperation and financial policies.

Monetary Reforms as the Cornerstone of Other Reforms

The most important change in the economic system occurred in the monetary sphere, in November 1999, when the German mark was introduced as parallel legal tender to the Yugoslav dinar. The German mark was previously often used in Montenegro and Serbia for both savings and exchange, due to the long experience of hyperinflation. However, it was not an easy decision because it took a lot of effort to get well-prepared, and there was political risk. After the NATO intervention in 1999, which ended in June, there was tangible risk of hyperinflation. The government and local experts led by Vukotić (assisted by some foreign experts like President Djukanović's advisor Steve Hanke, who had assisted in establishing the currency board in Bulgaria) started to consider and reflect on different options to ensure a sound currency. Two options were considered: a currency board and direct introduction of the German mark as the legal tender. The first option was eventually dropped, because it assumed backing of the IMF and World Bank, which was difficult under the circumstances. The second option was opposed by Belgrade, because it was a step in the direction of economic independence for Montenegro. It was also opposed by the international community, which feared it would lead to a new conflict in the Balkans and eventually the dissolution of what remained of socialist Yugoslavia. In the winter of 1999–2000, tensions were high but Montenegro's leadership endured. As of 2001, the German mark became the only official currency in Montenegro, which has been replaced by the euro as of March 2002.

Emphasis then shifted toward fiscal policy and control of public spending. It was no longer possible to print and to borrow money from the central bank for the purpose of bridging the budget gaps and resolving solvency issues. Economic imbalance became more visible, and there was no possibility of shifting responsibility to the federal level. The budget deficit was reduced, and the first fiscal surplus was produced in 2006. This reform led toward deeper economic changes, but politically it went even further. Both "one country, two systems" and confederation were eventually dropped in favor of full independence.

The process of economic liberalization took place simultaneously with monetary, financial, and fiscal reform. Administrative price controls were removed, trade constraints were eased (prohibition, quotas, contingents, duty rates), and capital flows were liberalized, while the privatization process was stepped up. Voucher privatization, during which all adult Montenegrin citizens became owners of vouchers that could be invested into six privatization funds or 221 companies, took place during 2001 and 2002, concurrently with the process of sale of shares in state-owned enterprises.[6]

With the benefit of hindsight, the results of the privatization process were less positive than expected. Privatization led to the transformation of ownership and greater efficiency of companies that survived transition. Citizens became shareholders overnight and acquired free ownership in companies. However, a number of big socialist-era companies ceased to operate or substantially reduced their business activities and the number of employees. In addition, following a stock market boom in the years of expansion, the share prices fell dramatically in the majority of enterprises and funds. These processes, particularly a large number of older people who lost their jobs and who could not find new ones, still cause social pressure and make most citizens think of privatization in negative terms.

Economic Reform Agenda

Following the elections in January 2003, the government adopted the Economic Reform Agenda, which prescribed the tasks that should be fulfilled in order to continue economic transition. The most important task was to promote entrepreneurship as a moving force of economic growth. Simultaneously, a number of structural reforms and reforms aimed at improving the business environment were initiated.

One of the main tasks mentioned in the Economic Reform Agenda is reducing the gray economy. The issue of the gray economy is typical for all economies in which social-economic relations were

[6]In the first phase of economic transition (1990–98), the only important investments were privatization of Trebjesa Brewery at the end of 1997 and introduction of mobile telephony through the company Promonte in 1996–97. Only with the process of voucher privatization in 2001, and the parallel sale of the state property, did substantial foreign direct investment (FDI) occur in a number of companies after 2003. Privatization of state property included the oil distribution company, national telecommunication company Telekom, large industrial systems, as well as firms in the financial sector. The last large privatization of state property occurred with the sale of a minority package of shares in national Electric Power Company of Montenegro during 2009. After these actions, almost 90 percent of the economy was privatized.

established in irregular conditions. The introduction of international sanctions directly influenced the dramatic growth of the gray economy. The subsequent opening of Montenegro toward Europe influenced the reduction, but not the elimination, of the gray economy. The gray economy was notably present in the field of distribution of excise products, as well as the labor market, which was burdened with rigid regulations and high taxes and contributions that were at the level equal to or higher than paid salaries (see Ivanović and Kuchta-Helbling 2003).

The main topics of the Economic Reform Agenda were the substantial reduction in duty rates, liberalization of the foreign trade regime and its harmonization with the World Trade Organization (WTO) and EU standards, along with adoption of the new antitrust law. Participation in the global integration processes became even more important after the introduction of the "twin track" in the EU accession process, and after approval of individual membership of Montenegro in the WTO by the WTO assembly at the end of 2004. An important element of liberalization is the removal of all remaining quantitative import restrictions, as well as the implementation of new regulations in the field of accounting and auditing, in line with international practice.

Important tasks were also defined in the field of local self-governance. An important segment of overall reforms is the structural adjustment of the system, which implies the reform of extra-budgetary funds and the pension system—through reform of the intergenerational solidarity system and introduction of the third pillar of voluntary pension insurance.

Montenegro entered the 21st century with relatively high public spending. The largest part of public spending consisted of funds allocated for salaries, pensions, health care, and social benefits. The period from 2002 to 2006 was also characterized by the three-year arrangement with the IMF, which contributed to macroeconomic stabilization and acted as a catalyst for a number of structural reforms. The budget deficit was tightly controlled and tended to decrease. At the end of 2004, for the first time in its history, Montenegro received a credit rating from Standard & Poor's.

Tax Policy

After introducing the VAT in 2003, the next major reform of tax policy was initiated in 2004 through the gradual reduction of payroll taxes. There was a lot of apprehension about a loss of revenue once tax rates were lowered. As finance ministers, we still vividly remember fighting with the IMF on the decision to cut payroll taxes by 10 percent. It proved to be a good decision. Every tax cut led to a higher level of revenues and a reduction in the share of the gray economy. The corporate profit tax rate was also lowered and was successful. In addition, in 2005, a flat tax was put in place. Flat taxation was quite popular and we were very keen to transfer experience from Slovakia, signing a cooperation agreement with Slovak Finance Minister Ivan Miklos in 2004. After that, Montenegro promoted the concept of single-digit taxation on income and profit, gradually reducing the income tax rate to the same level of 9 percent. This made Montenegro's tax regime one of the most competitive in Europe.

Macro Policy

One of the important transition reforms that occurred in late 2007 was transformation of the right to use land into proper property rights. This was a precondition for a series of foreign direct investments (FDIs) in the tourism sector. Time suggested weaknesses in our approach. Montenegro's lesson of transition in this segment is that the state property should be identified during the very early stage and the issue of restitution should be regulated under reasonable conditions, while voucher and other types of privatization should take place subsequently.

The implementation of economic reforms including the adoption of the euro, the flat tax of 9 percent, the removal of capital controls, and equal treatment of foreign and national investors made Montenegro a favored investment destination. A large inflow of capital through the FDI and banking channels led to a strong growth of the economy (Table 1). A comprehensive process of introducing European standards was also initiated, primarily through the implementation of the Stabilization and Association Agreement with the EU.

In only six years, 2003 to 2008, nominal GDP per capita nearly doubled, from approximately EUR 2.5 thousand to EUR 4.9 thousand. The real economic growth rate in this period averaged 6.2 percent per year. Economic growth was particularly dynamic during the last three years of the period before the eurozone crisis (2006–08) when the average real growth rate was nearly 9 percent.

TABLE 1
Basic Macroeconomic Indicators
2000–2015

	2000	2001	2002	2003	2004	2005	2006	2007
GDP (EUR mil)	1,065.7	1,295.1	1,360.3	1,510.1	1,669.8	1,815.0	2,148.9	2,680.5
Real GDP Growth	3.1	1.1	1.9	2.5	4.4	4.2	8.6	10.7
GDP per Capita	1,768.7	2,149.5	2,257.7	2,506.3	2,771.4	3,012.3	3,443.0	4,280.0
Inflation	25.7	27.9	9.4	6.2	4.3	1.8	2.0	8.0
Unemployment Rate (end of the period)	32.7	31.5	30.4	25.8	25.4	21.1	16.8	13.6
FDI (% of GDP)	n/a	0.8	6.4	2.6	3.0	21.0	21.7	21.2
Loans (% of GDP)	10.7	9.6	9.2	13.3	16.9	20.7	50.2	93.1
Current Account Balance (% of GDP)	14.3	23.6	12.9	−6.7	−7.2	−8.5	−24.7	−39.5
Own-Source Revenues (% of GDP)	n/a	32.0	31.7	39.8	39.2	39.9	45.5	49.5
Public Spending (% of GDP)	n/a	39.5	40.9	42.1	40.6	41.5	42.3	43.3
Budget Balance (% of GDP)	n/a	−7.5	−9.2	−2.3	−1.3	−1.6	3.2	6.3
Public Debt (% of GDP)	n/a	n/a	84.5	47.1	44.5	38.6	32.6	27.5

(Continued)

TABLE 1
Basic Macroeconomic Indicators
2000–2015 (*Continued*)

	2008	2009	2010	2011	2012	2013	2014	2015
GDP (EUR mil)	3,085.6	2,981.0	3,104.0	3,234.0	3,148.9	3,327.0	3,457.9	3,594.9
Real GDP Growth	6.9	−5.7	2.5	3.2	−2.5	3.3	2.0	3.2
GDP per Capita	4,908.0	4,720.0	5,011.0	5,211.0	5,074.0	5,356.0	5,561.0	5,781.0
Inflation	7.3	1.5	0.7	2.8	5.1	0.3	−0.5	1.0
Unemployment Rate (end of the period)	12.2	13.0	13.8	13.2	13.5	14.9	14.9	17.2
FDI (% of GDP)	18.9	35.8	17.8	12.0	14.7	9.7	10.4	11.6
Loans (% of GDP)	95.9	88.7	81.1	72.9	74.4	72.6	69.8	66.4
Current Account Balance (% of GDP)	−49.8	−27.9	−22.9	−17.7	−18.7	−14.6	−15.2	−14.5
Own-Source Revenues (% of GDP)	50.1	45.4	42.3	39.7	41.6	43.0	45.3	42.5
Public Spending (% of GDP)	50.4	51.1	47.2	43.4	47.3	47.7	48.2	47.7
Budget Balance (% of GDP)	−0.4	−5.7	−4.9	−3.7	−5.6	−5.3	−3.0	−5.3
Public Debt (% of GDP)	29.0	38.3	40.9	46.0	54.0	58.2	57.3	63.2

Source: Official data and calculations made by the authors.

FDI was largely absent prior to 2005; after that, it exceeded on average 20 percent of GDP through 2009. There was also a rapid increase in the total amount of loans from less than 20 percent of GDP at the beginning of 2005 to almost 100 percent of GDP in 2008. After the sale of property (real estate and shares), which had became valuable overnight, citizens quickly received money that was predominantly used for current spending. The small and nondiversified Montenegrin economy could not produce the goods required by its citizens; therefore, a majority of goods were imported. From 2005 to 2008, imports of goods and services increased from EUR 1.1 billion to approximately EUR 3 billion. Exports did not follow the increase in imports; hence, the current account deficit in 2008 reached more than EUR 1.5 billion (almost 50 percent of GDP). The growth of bank credit was exceptional reaching 170 percent in 2007 compared to the previous year.

The large inflow of capital and imports, along with the increase in domestic consumption enhanced tax revenues, resulting in a budget surplus equal to 3.2 percent of GDP in 2006 and 6.3 percent in 2007. Growth of the economy, the regular servicing of debts and early repayment of debt to the World Bank, along with the partial write-off of debt to the Paris Club of creditors, led to a decrease in public debt from more than 80 percent of GDP in 2002 to less than 30 percent in 2008.

The years of expansion led to reductions in unemployment and the growth of employment, with substantial increases in salaries. Increases in household incomes and income from the sale of property helped reduce the poverty rate from 11.3 percent in 2006 to 4.9 percent in 2008.

In small open economies the greatest danger for stability lies in exogenous shocks. Montenegro did not fully anticipate the risk of the eurozone crisis, which led to an abrupt reduction of FDI, credit, and spending. When the cycle of prosperity within a short time turned into recession (in 2009) it was hard to accommodate the rigid budgetary expenditures, which caused a considerable fiscal deficit financed through borrowing. Montenegro's distinct characteristics were also reflected in the fact that exports were concentrated on only a few commodities (aluminum and steel) whereas imports were significantly diversified since many goods cannot be produced in a competitive manner.

The dramatic drop in aluminum and steel prices seriously impacted those industries and their workers. At the same time, due to the negative experience with the loss of bank savings in the past, citizens started to withdraw deposits. In only several months, over 20 percent of all deposits were withdrawn from Montenegro's banks. In this context, the government used the budget surpluses to help support the banking sector and the depressed industries. In the gloomy annual meetings of the IMF and World Bank in 2008, we were looking for any idea that could help prop up our failing system back home. We introduced a temporary blanket guarantee for all bank deposits and used emergency mechanisms to keep the banking system afloat. The cushion in the wake of the crisis was the large stock of household deposits and low public debt (about 30 percent of GDP) thanks to the previous policies.

The eurozone crisis showed the vulnerability of Montenegro's economy. As a consequence of the spread of illiquidity to the Montenegrin economy, and the accumulation of a large amount of nonperforming loans, new credit was practically suspended. Those few credits that were offered to prudent borrowers were subject to significantly higher interest rates and shorter terms. The debt was partially paid off, followed by the absence of new credit. The high level of nonperforming loans was addressed through specially organized factoring companies that played the role of bad banks who took over the loans. This process was supported by the foreign subsidiaries of Montenegrin banks.

The reduction of credit activities and relocation of nonperforming loans from bank accounts led to the reduction of total credits from 96 percent GDP in 2008 to less than 70 percent at the end of 2014. In the same period, the public debt grew from less than 30 percent of GDP to about 60 percent, which compensated for the drastic drop in the money supply. Thus, the combination of all credits and borrowings of the state at the end of 2014 was almost at the same level as in the precrisis year at the end of 2008 (i.e., 125 percent).

Labor and Pension Reforms

While the consequences of the eurozone crisis are still present and reflected through on-going fiscal adjustment, the reaction to the crisis also involved the implementation of structural reforms and improvement of the business environment. Structural reforms were implemented primarily in the area of pension insurance where the system of intergenerational solidarity was reformed so that the age limit for retirement was increased to 67 for both genders, with a transitional period. Milorad Katnić had to work it out within the government as it took efforts to convince colleagues from the labor ministry and our coalition partners.

The conditions for early retirement became more rigorous and the adjustment formula was changed. The reform of the social protection system resulted from the need to increase the activity of the working-age population and to make a transfer from the gray zone to the formal sector through incentive measures.

Reforms of labor legislation were implemented with the aim of overcoming problems related to inflexibility of the labor market. Amended regulations introduced more flexible models of employment. Contracts became more widely used for regulating relations between employers and workers, and dismissal procedures became simpler and cheaper.

Business Regulation

Montenegro has made considerable progress in improving the business climate. This is indicated by relevant international ratings. According to the World Bank's *Doing Business* report, Montenegro, which was ranked 92nd during the federation with Serbia in 2005, improved its position by 46 places after the restoration of independence. In the 2015 report, Montenegro ranked 46th. The worst-ranked indicators in the report include the execution of contracts, obtaining construction permits, and registration of real estate, which implies that in these areas we need to make additional reforms in order to make our business environment one of the most attractive in the world.

The improvement of the business environment and the institutional infrastructure implied facing the ingrained problems of the Montenegrin society. Corruption is certainly one of the most perceived problems. According to Transparency International's Corruption Perception Index (CPI), since 2007 Montenegro has improved its position but is still far from satisfactory (Table 2).

The opening of Montenegro's economy with constant improvement of the business environment was also recognized through the increase of economic freedoms. According to the Heritage

TABLE 2
Montenegro in International Reports

International Indicator	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Doing Business (World Bank, revised rankings)	70	84	77	65	56	56	51	44	47	46
Corruption Perception Index (Transparency International)	—	84	85	69	69	66	75	67	76	61
Index of Economic Freedom (Heritage Foundation)	—	—	—	94	68	76	72	70	68	66
Economic Freedom of the World (Fraser Institute, report year)	—	60	58	81	66	37	28	49	38	62
Global Competitiveness Index (World Economic Forum)	87	82	65	62	49	60	72	67	67	70
Freedom in the World (Freedom House) (F = free; PF = partially free)	F (S&M)	PF	PF	PF	F	F	F	F	F	PF

Note: S&M = Serbia and Montenegro.

Foundation's *Index of Economic Freedom* report, since 2009, Montenegro has improved its ranking from 94th to 66th, and according to the Fraser Institute's *Economic Freedom of the World* report in the same period, Montenegro's ranking has improved from 81st to 62nd.

In the *Global Competitiveness Report* of the World Economic Forum (WEF) for 2015–2016, Montenegro ranks 70th, which is a drop of 3 places compared to the previous year's report and a decline of 21 places relative to 2010. In order to improve competitiveness, according to the WEF report, Montenegro needs to improve its institutional environment by adopting the rule of law and establishing an independent judiciary, and also needs to strengthen macroeconomic stability and improve the physical infrastructure.

The Transition of Values

The vital support to economic transformation comes from the transition of values as it is supposed to be the true purpose of the process (Lukšić 2015). In fact, international processes have that role, helping to define new rules of the game. In this sphere, it is necessary to work hard. This is supported by opinion surveys. According to the opinion of respondents in a survey of the local NGO CEDEM (Centre for Democracy and Human Rights) in 2004, already in the early transition, freedom of speech, independence of the media and judiciary, as well as political association, were widely accepted—by 55.6 percent, 66.4 percent, 70.6 percent, and 45.7 percent of respondents, respectively (CEDEM 2004).

However, this does not mean that values such as egalitarianism were replaced by values like entrepreneurship and self-responsibility. According to the same survey, on the question of evaluating the necessity of great differences in incomes for the purpose of stepping up economic development, 24 percent of respondents "strongly agreed" or "agreed," while 63 percent "disagreed" or "strongly disagreed." Moreover, 84.5 percent of respondents "strongly agreed" or "agreed" that differences in incomes are too big, and 87 percent of respondents "strongly agreed" or "agreed" that the state is responsible for reducing income inequality. Moreover, according to the survey, 88 percent of respondents were certain that the government should ensure jobs for all who are willing to work, while almost 95 percent were certain the government should ensure a minimum living standard. Although 64.7 percent of respondents "strongly agree" or "agree" that the state should protect private entrepreneurs and capital investments, as well as prevent strikes, 93.1 percent "strongly agree" or "agree" that the state should reduce differences and protect the poor and vulnerable. Such results indicate that Montenegro still harbors collectivistic values.

When we compare these findings with the results of the survey on preferences of young people carried out in 2013 by Ipsos Strategic Marketing in Montenegro for the Joint United Nations Youth Program, we understand how much the role of education in a broader sense is important. According to the survey, the aspirations of young people are the usual ones—completion of schooling, employment, and forming a family. Generally speaking, the citizens of Montenegro and the youth advocate social activism and believe it could contribute to development. They believe that only by actively looking for a job can one reach a desired result and that among people there is solidarity and readiness to help others. Still, the findings also show that there are doubts about the future (Ipsos Strategic Marketing 2013).

Regarding expectations about how to deal with poverty, four of five high school students in Montenegro plan to attend college after high school, while 70 percent of the general population and 80 percent of young people believe that further schooling can successfully prepare young people for the labor market. The survey also shows that almost 70 percent of the population (including youth) would rather accept a job outside their profession for a better salary than a job in their own profession for a smaller salary (Ipsos Strategic Marketing 2013).

Nearly 60 percent of the respondents also think that the unemployed do not get adequate support from public institutions and organizations, which indicates that there is a broad paternalistic attitude as far as the economic role of the state is concerned. Only 20 percent of the respondents plan to start their own businesses, which indicates an attitude of fear and lack of entrepreneurship, as well as timidity with regard to the value of self-responsibility. Particularly disconcerting is the fact that more than half of the youth wish to work in the public rather than the private sector. The main reason is job security. Finally, less than 10 percent of young people claim they prefer working in the private sector because of the salary (Ipsos Strategic Marketing 2013).

Conclusion

Every transition process has its specifics. Montenegro's transition is no different, with further reforms needed in several areas. However, one has to be aware that there is transition fatigue. More needs to be done in the fields of fiscal consolidation, structural reforms, and improving the business environment. The inflexible labor market not only hampers economic growth, but it also motivates people to operate in the gray economy. The banking sector has started to recover from the crisis but interest rates remain high. The public health system is still far from consolidated as it takes some important but very hard political decisions. Political reforms should continue as more transparency is needed, and the judicial system and rule of law have to strengthen as preconditions for the solidification of market reforms. Demographic change becomes a big challenge (Katnić and Krsmanović 2012), as does youth unemployment despite efforts like the new apprenticeship law passed in 2012.

However, the process of integration into the EU and NATO provides the necessary anchor. Further democratic consolidation and limits to government power by cultivating the rule of law are essential in establishing a robust political and economic system. In the long run, the biggest challenge lies in education. Instilling free-market liberal values in our children and ensuring a free market in ideas are critical for future success in transforming Montenegro into a mature market economy.

A lot has been done. What was one of the poorest republics of the former Yugoslavia today runs third, in terms of per capita income, after Slovenia and Croatia. However, we are obviously only halfway through, and one of the lessons learned is that, until consolidated, the economic liberalism agenda is still much too fragile. It is important to understand that the transition process is by no means a one-way street and that the job is done only through technocratic changes. Full transition requires the consistent pursuit of the rule of law and economic freedom.

Unfortunately, the Montenegrin society does not seem too willing to push for all the liberal/libertarian reforms. The political elite is generally left leaning and finds it hard to restore the economic liberalism agenda from the early 2000s; deep structural reforms are never popular. Politicians sometimes want to achieve the impossible by facing conflicting goals given a usually time-pressing election horizon. The need for fiscal consolidation stands in sharp contrast with the wish to quickly develop infrastructure. The political establishment is not much helped with the current state of Europe—both political and economic. In addition, the process of European integration, given the state structure it often stimulates, may be too much of a burden for Montenegro's small economy. We would have wished to call this article "Transition in Montenegro: The Making of an Entrepreneurial Society," but that transition will take more time and effort.

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