

BTI 2008 | Montenegro Country Report

Status Index	1-10	7.28	# 30 of 125
Democracy	1-10	7.85	# 26 of 125
Market Economy	1-10	6.71	# 38 of 125
Management Index	1-10	6.16	# 30 of 125

scale: 1 (lowest) to 10 (highest) score rank

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	0.7	HDI	-	GDP p.c.	\$	3,147
Pop. growth ¹	% p.a.	-	HDI rank of 177	-	Gini Index		-
Life expectancy	years	-	UN Education Index	-	Poverty ³	%	-
Urban population	%	-	Gender equality ²	-	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006 | European Bank for Reconstruction and Development, Transition report update 2007. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

During the period under review, Montenegro's democratic and economic development was shaped by the dissolution of the State Union with Serbia, the parliamentary elections and the negotiations on a Stabilization and Association Agreement with the European Union. Montenegro declared its independence on 3 June 2006, following a referendum on independence held on 21 May 2006. Of the registered voters, 86% cast a valid vote, and 55.5% voted for independence while 44.5% voted against it. Very soon after the referendum, most countries in the world officially recognized Montenegrin independence. On 28 June 2006, Montenegro became a member of United Nations. Montenegro and Serbia have settled the issues arising from the dissolution of the State Union in a cooperative spirit and in accordance with the State Union Constitutional Charter. A new parliament was elected on 10 September 2006. The governing Coalition for a European Montenegro, led by Milo Djukanovic, was confirmed in office as it won 48.6% of the vote and an absolute majority of the seats in parliament. Djukanovic, Montenegro's most influential political leader, resigned from the post of prime minister but retained the leadership of the main governing party. A new constitution was being prepared in order to clarify the institutional setup of the newly independent state, but had not been adopted as of January 2007. Montenegro has made progress on its way toward membership in the European Union, as it managed to negotiate a Stabilization and Association Agreement with the European Union, which is considered a key step leading to accession. Previous negotiations with the State Union of Montenegro and Serbia had been suspended by the European Union due to Serbia's lack of cooperation with the International Criminal Tribunal on the Former Yugoslavia. Following Montenegro's independence, the European Union quickly resumed negotiations on 29 September 2006, and the text of an Agreement was initialed on 15 March 2007.

History and Characteristics of Transformation

The final decade of the twentieth century was extremely turbulent and traumatic for Montenegrin citizens as it was for all those living in Southeast Europe or the Balkan region. The toleration and emergence of political pluralism in the Socialist Federative Republic of Yugoslavia (SFRY) and its six constituent republics brought political elites into power that instrumentalized nationalist ideologies and stereotypes to advance their nation-state projects. Irreconcilable aims and nationalist mobilization led to the collapse of the federation and the emergence of Bosnia and Herzegovina, Croatia, Macedonia and Slovenia as independent states. In Bosnia and Herzegovina, Croatia and Slovenia, wars of different duration and intensity began when the Yugoslav National Army attacked the republics, assisting the rebellions of ethnic Serb communities in Bosnia and Croatia against the secessions.

The wars involved neighbors and people that were born and had lived together in the same country for many years. Suddenly, friendships disappeared, families were broken and diverted from a basic, honest and community based lifestyle into a variety of activities not countenanced before. Many have migrated to safe havens elsewhere. For those that remained, especially the young - the trauma of the unfolding events and images of the war in the Balkans remains vividly in their minds as mental wounds.

Montenegro was the only republic of Yugoslavia that preferred to retain a status as a joint state with Serbia in the early 1990s. This policy was not only advocated by the post-communist political elite that had won the first democratic elections, but was also supported by a substantial part of Montenegro's citizens, who felt closely associated with the Serbian nation. In 1992, Montenegro and Serbia established a Federal Republic of Yugoslavia (FRY) to succeed the SFRY. While the Constitution of the FRY envisaged a parity between Montenegro and Serbia in federal institutions, the common state was de facto dominated by Serbia economically and politically. Facilitated by the wars and nationalist mobilization, Serbia's president, Slobodan Milosevic was able to establish a semi-authoritarian system that included Montenegro and kept him in power until 2000. His regime was based on clientelist networks within the state administration, police, military and the state-dominated economy, all of which enabled him to exercise control over the electronic media, skillfully forge elections and thus engender the effective fragmentation and isolation of the political opposition. These methods enabled him to control the Socialist Party and political leadership in Montenegro. With the election of the reform socialist president Milo Djukanovic in October 1997, Montenegro increasingly evaded Serbia's control and implemented reforms aimed at establishing a market economy. Economic reforms focused on openness, the protection of property rights, and freedom of contract (including the protection of investors), implementing a credible currency (the euro), maintaining a

low level of business regulations and a low level of taxation, implementing the rule of law, fostering entrepreneurship, private initiatives, and innovations. Faced with a loss of power and legitimacy, the Milosevic regime increased political repression and started a war against the ethnic Albanian community in Kosovo. NATO air strikes forced the regime to end the violent deportation of Kosovo Albanians and to accept a UN-led interim administration for Kosovo. In the wake of the Kosovo war, the Montenegrin government in August 1999 proposed to transform the FRY into a confederation of two states with independent foreign policies. As the Milosevic regime rejected this proposal and unilaterally abolished the equal representation of Montenegro in the federal parliament, Montenegrins boycotted the federal presidential and parliamentary elections in September 2000.

After the fall of the Milosevic regime, Montenegro and Serbia negotiated a loosely integrated “State Union” in order to replace the FRY. The talks were mediated by the European Union, which feared the destabilizing effects of another disintegrating state in the Balkans. Whereas the Montenegrin government wanted to establish an independent state, the Montenegrin opposition parties and most parties in Serbia preferred to preserve the common state framework. The negotiations led to an agreement in 2002 and a Constitutional Charter in 2003, defining the State Union and its institutions. The agreed aims of the Union were the accession to the European Union and the creation of an internal market in accordance with EU principles and standards. The State Union’s powers were essentially limited to the enforcement of international law and cooperation with international courts, military issues and defense, and standardization, intellectual property rights, statistics, borders, asylum, immigration and visa issues. To accommodate Montenegrin interests, the Constitutional Charter of the State Union envisaged the option of an independence referendum held three years after the creation of the State Union. The referendum was organized on the basis of this provision.

Transformation Status

I. Democracy

1 | Stateness

The state's monopoly on the use of force covers the entire territory. Police and military forces provide security in all areas of the country and there are no organizations such as guerrillas, mafias, clans. There were isolated attempts to destabilize the system, but these attempts failed due to the efficiency of police forces. A prime example of such an event took place after the referendum when Montenegrin state prosecutor Vesna Medenica accused the members of the group called "The Movement for the Rights of Albanians" in Montenegro of planning terrorist attacks in the area of Tuzi, about 20km south of Podgorica and close to the border with Albania. The aim of the plan, code-named "Eagle Flight," was to intimidate the non-Albanian population there and gain autonomy for the region, which is dominated by ethnic Albanians, but due to police force efficiency, these attempts failed.

Monopoly on the use of force

In the most recent census, 32% of Montenegro's citizens identified themselves as ethnic Serbs, while ethnic Bosniaks or Bosnian Muslims comprise 14% of the population and ethnic Albanians 7%. Despite this multiethnic composition, Montenegro has remained a zone of relative peace and quiet during the breakup of Yugoslavia. Relations with the ethnic Albanian community in Montenegro have been characterized by accommodation a sustained involvement of ethnic Albanians in Montenegro's political system. Among the reasons for this was the fact that inter-ethnic tolerance in Montenegro was and still is exemplary. Social cohesion forged over many generations in Montenegro managed to override the raw and divisive forces of nationalism and ethnic disharmony that became the order of the day in other parts of the region. A substantial minority of Montenegro's citizens rejected an independent state in the referendum on 21 May 2006. Relations between ethnic Montenegrins and ethnic Serbs, however, did not deteriorate considerably due to the independence process. A Serb list that had emerged from the Serbian National Party successfully campaigned as the party defending the interests of Montenegro's ethnic Serbs. This party has argued that

State identity

Montenegro should be constitutionally defined as a state of Serbs and Montenegrins rather than as a state of its citizens. The political representatives of the ethnic Bosniak minority have also demanded a status of a constituent people in the constitution. Moreover, ethnic Serb representatives neither accept Montenegrin as an official language nor accept the independent status of the Montenegrin Orthodox church. As a consequence, ethnic cleavages have become increasingly pronounced in the party system of Montenegro.

Religious dogmas do not interfere with politics, and the churches are separated from the state and its bodies. The three major religious groups in the country are Orthodox, and Catholic Christians (which are further divided into several sub-groups) and Muslims, though there are also many other smaller religious groups. The independence of the Montenegrin Orthodox church is the subject of controversy, as it is not acknowledged by the Serbian Orthodox church.

No interference
of religious
dogmas

Administrative structures maintaining a system of public security and order exist and operate throughout the entire territory of Montenegro.

Basic
administration

2 | Political Participation

Montenegro's unicameral parliament consists of 81 deputies who are elected under a proportional representation system with a 3% threshold. On 10 September 2006, parliamentary and local elections were held in accordance with international and European standards. Voter turnout reached a relatively high level of 71.7%. Elections were monitored by numerous observers from domestic organizations and from the Organization for Security and Cooperation in Europe (OSCE). According to the OSCE report, broadcast media, including the public television and radio, favored the governing parties during the campaign. The electoral law limits the transparency of deputy selection by enabling a party or coalition to freely distribute one half of its obtained mandates among the candidates on its list irrespective of the order of names on the list. On 21 May 2006, the referendum on the state status was held. Supporters and opponents of Montenegro's independence had previously agreed that a clear majority of 55% of the votes cast was required for the approval of an independence decision. The turnout of 86.5% of all registered voters indicated a high level of mobilization and underscored the legitimacy of the vote. More than 3000 observers from different international organizations supervised the referendum process. The results of the referendum were not accepted by the opposition parties, which claimed that votes had been manipulated. However, the opposition's complaints were not confirmed by investigations and the international observers attending the referendum did not draw the clear pro-independence majority into question.

Free and fair
elections

Democratically elected rulers have the effective power to govern. There were no attempts by any institution to exercise veto powers or similar measure in order to disable democratically elected rulers to govern. As such, it is possible to state that democratically elected governance has fully functioned. With the dissolution of the State Union, Montenegro established a Ministry of Defense to supervise the military, but the parliament still lacks capacity to provide a civilian oversight of the military.

Effective power to govern

The freedoms of association and assembly are constitutionally guaranteed and unrestricted within the basic democratic order. Political and civic organizations can form and act freely. There are no obstacles on their activities unless they violate the law.

Association / assembly rights

There are approximately 70 broadcast media outlets - including more than 20 public TV or radio channels – which operate in Montenegro, broadcasting locally as well as nationwide. The public broadcasting channel, Radio and Television of Montenegro (RTCG), has been subject to political control exercised by the governing parties. The opposition parties and the OSCE criticized the RTCG for its biased coverage of the referendum process in 2006. The parliamentary majority prevented NGO representatives from joining the council supervising RTCG. The operation and status of RTCG is regulated media legislation that was adopted by the Montenegrin Parliament in 2002. The media legislation also provides for the creation of local public media outlets. All privately owned broadcast media currently operating in Montenegro are registered and licensed with the Broadcasting Agency of Montenegro. This state body is also in charge of their supervision. No licensing process is required to publish a newspaper. The print media market is characterized by a diversity of opinions and political positions. However, the concentration of media ownership has not been regulated.

Freedom of expression

3 | Rule of Law

The separation of powers is restricted partially and temporarily due to the weakness of the legislative and judicial branches of government compared with the executive. The parliamentary control of government is generally weakly developed, and legislation is dominated by the executive. In particular, the parliamentary supervision of the military sector and security services has been insufficient. To improve the rule of law, a new constitution was prepared but had not been adopted as of January 2007. Montenegro's president is directly elected, but may not appoint or dismiss the prime minister without parliamentary approval and his legislative veto may be overridden by a simple majority in parliament. During the review period, President Filip Vujanovic was affiliated with the leading party in government.

Separation of powers

The judiciary in Montenegro is established as a distinct profession and operates relatively independently but its functions are restricted by corruption, low professionalism and politicization. According to opinion surveys, many citizens believe that courts are biased and dependent on political or economic influences. Since parliament elects judges and prosecutors from a pool of nominees selected by a Judicial Council, appointments may be influenced by political considerations rather than professional criteria. The government has initiated a judicial reform strategy in order to improve the independence and efficiency of courts.

Independent
judiciary

Corrupt officeholders are not prosecuted adequately under the law but occasionally attract adverse publicity. There is no appropriate legal framework to address conflicts of interest, because the Montenegrin parliament failed to modify the existing law. During the period under review, political parties did not comply with the requirements for reporting their assets and campaign financing. The state has developed control mechanisms to check the judiciary but in some cases corrupt judges slipped through political, legal and procedural loopholes.

Prosecution of
office abuse

Civil rights are violated occasionally. Mechanisms by which citizens can seek redress if their rights are violated exist and are exercised in courts. According to a report published by the European Committee for the Prevention of Torture in May 2006, the material situation of prisons and police detention facilities did not correspond to European standards. Allegations of ill-treatment in police custody or during interrogation have been frequent. In April 2006, the parliament adopted a new law on minority rights and freedoms, banning discrimination against minorities and establishing national councils representing minorities and the Republican Fund for Minorities. However, the law's provisions on the a priori allocation of parliamentary seats to minority representatives were declared unconstitutional by the Constitutional Court. According to the UN High Commissioner for Refugees, in 2006 there were 26,193 refugees and internally displaced persons in Montenegro. The local integration of these people is hampered by the lack of access to employment and housing.

Civil rights

4 | Stability of Democratic Institutions

Democratic institutions perform their functions in principle, but there is some waste due to friction between institutions. The opposition parties did not participate in the parliamentary committee charged with the preparation of a new constitution because they did not agree with the procedure envisaged to adopt this document. While the parties opposing independence initially refused to accept the results of the referendum, they did not boycott the ensuing parliamentary elections. The proclamation of independence stipulates that the legislation of the former State Union is to be applied until the respective legislation has been adopted by Montenegro. This document causes legal ambiguity, however, as it

Performance of
democratic
institutions

makes the validity of State Union laws contingent upon their compatibility “with the legal order and interests” of Montenegro. In July 2006, the parliament adopted new procedural rules that strengthened the role of parliamentary committees in legislative debates and enabled the opposition parties to chair or co-chair parliamentary committees. The number of parliamentary seats was increased from 75 to 81 after the 2006 elections.

All relevant political and social players accept democratic institutions as legitimate, despite the disagreement over the status of the state. Formal institutions and rules are sometimes rendered ineffective by practices of informal agreement.

Commitment to democratic institutions

5 | Political and Social Integration

Though fundamentally established and socially rooted, the party system is somewhat shaky. In the parliamentary elections of 10 September 2006, the governing coalition – comprising the Democratic Party of Socialists of Prime Minister Djukanovic and the smaller Social Democratic Party of Montenegro – again emerged as the strongest political force, capturing 48.6% of the vote and 41 out of 81 seats. The Serb List (SL) and an electoral coalition led by the Socialist People’s Party of Montenegro (SNP), that had advocated the preservation of the State Union, won 14.7% respectively and 14.1% of the votes, which corresponded to 12 and 11 seats in parliament. While this result implied a loss for the SNP, the SL – which had claimed to represent ethnic Serb interests during the referendum campaign – was strengthened. The newly established liberal-conservative Movement for Changes attained 12.9% of the vote while parties of the ethnic Albanian and Bosniak minorities gained six seats in parliament. The effective number of parties and the volatility of the party system have slightly increased since the previous elections in 2002.

Party system

There is large number of associations that articulate and advocate interests of many groups in society, including professional associations, business associations, associations of workers, minority shareholders, and associations of certain minorities. Their network is relatively close-knit, but dominated by a few strong interests.

Interest groups

Consent to democracy as a form of government is high, and political protests do not tend to call the constitutional framework into question. Citizens are aware they can use all mechanisms of democratic procedure to protect their rights and fight for their goals, and they use these mechanisms extensively, especially through different forms of nongovernmental associations and initiatives. The success of some of these initiatives has encouraged citizens to use all available democratic mechanisms and has increased their confidence in the system. One

Consent to democratic norms

such success story is that of an initiative which prevented government from building a hydro-power plant on the Tara River in the interest of preservation.

There is a robust but heterogeneous web of autonomous, self-organized groups, associations and organizations. A liberal NGO law has led to the emergence of a large number of NGOs, though only a few of these organizations perform watchdog functions or engage in public policy advocacy or civic education. Most NGOs are apolitical, trying to achieve goals and objectives of different groups in the society. These groups articulate interests of their membership, seek to protect the rights of this constituency and are fairly efficient in conducting this function. Despite the heterogeneous nature of these organizations' activities, many laws and regulations have been adopted due to their work. For example, NGO campaigns for free access to information have pressured ministries and government agencies into respecting laws concerning free access to information. One NGO has transformed itself into a political party, the Movement for Changes, and entered parliament in September 2006.

Associational
activities

II. Market Economy

6 | Level of Socioeconomic Development

Social exclusion is quantitatively and qualitatively limited and structurally not very ingrained. With a gross national income of \$3,280 per capita in 2005 (at current exchange rates), Montenegro belongs to the lower-middle income countries of the world, ranking lower than Croatia and Bulgaria, but higher than Macedonia or Bosnia and Herzegovina. Montenegro's Gender Index Development (GDI) for 2004 was 0.787, which is slightly higher than in 1991 (at the beginning of the transition process and political crisis in the region) and significantly higher than in 1999.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	€ mn.	1.30	1.39	1.54	1.64
Growth of GDP	%	1.7	1.5	3.7	4.1
Inflation (CPI)	%	-	-	-	-

		2002	2003	2004	2005
Unemployment	%	36.7	33.5	31.3	27.3
Foreign direct investment	% of GDP	-	-	-	-
Export growth	%	-	-	-	-
Import growth	%	-	-	-	-
Current account balance	\$ mn.	-158	-116	-149	-180
Public debt	\$ mn.	-	-	-	-
External debt	\$ mn.	-	-	-	-
External debt service	% of GNI	-	-	-	-
Cash surplus or deficit	% of GDP	-	-	-	-
Tax Revenue	% of GDP	-	-	-	-
Government consumption	% of GDP	-	-	-	-
Public expnd. on edu.	% of GDP	-	-	-	-
Public expnd. on health	% of GDP	-	-	-	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	-	-	-	-

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security | European Bank for Reconstruction and Development, Transition report update 2007

7 | Organization of the Market and Competition

Market competition has a strong institutional framework, but the rules are not always consistent or uniform for all market participants. As the share of public consumption in GDP and the level of economic freedom show, Montenegro still leans toward its communist past. The informal sector plays a minor role. Montenegro began to privatize its economy in the early 1990s but greatly improved the process with the establishment of the Privatization Council. The government rewrote its laws and institutions to create free markets. This effort has been strongly supported and managed in a coordinated effort by the Government of Montenegro and unilateral donor agencies such as USAID. This has led to tax, banking and customs reforms; the development of a new capital market and the creation of a new private sector. Both economic reform and privatization, though not complete, are fairly well-advanced. A stronger push for

Market-based
competition

the reform process started in 1998. The aim was to build a small, open, free market-oriented economy with minimal government intervention, based on the concept of Montenegro as a microstate. The key idea of the microstate is to build a minimalistic but efficient state rather than a state that is paternalistic and omnipresent but nonetheless weak. The reform process envisages the evolution of a public administration that is small, efficient, well-equipped and well-paid. The basic principles of the evolving economic system include the sanctity of private property, the protection of property rights, the freedom of contract and the protection of investors, openness and internationalization, the rule of law, equal treatment of foreigners across all sectors of the economy, economic freedom, encouragement of the development of entrepreneurship, private initiatives and innovations, deregulation of the economy at all levels via reduced state influence, and macroeconomic stability.

The formation of monopolies and oligopolies is regulated inconsistently. In November 2005, Montenegro has adopted a law on competition. This law was prepared by the Ministry of Economy of the Government of Montenegro with help and support from USAID. This law entered into force on 1 January 2006. Correspondingly, the anti-monopoly law of Serbia and Montenegro which was adopted in 1996 was invalid from that date forward. The main reasons given for the adoption of this law were that the long-term orientation of Montenegrin economy is to become a market economy as other well-developed countries which are characterized by free competition and effective anti-monopoly policies. Also, since Montenegro wants to become a part of European Union, it is necessary to legislate competition policy in accordance with modern standards. This new law and institutional framework will disable all acts and activities at the market that are unfair behavior in modern market economies. So far, Montenegro has not formed an independent competition agency.

Anti-monopoly
policy

Foreign trade is liberalized in principle. Striving for openness, Montenegro significantly reduced all customs tariff rates on imports. In addition, it eliminated tariffs on exports and quotas on either imports or exports. However, the signing of the Belgrade Agreement required that Montenegro increase its tariffs on imports, thus raising the average tariff from 2.81% to 6.13%. This was seen as a step backwards for Montenegrin trade policy. In December 2004, while still part of the State Union, Montenegro submitted a claim for separate accession to the World Trade Organization (WTO). The WTO accepted the proposal, and on February 15, 2005, negotiations started for the separate accession of Montenegro to the WTO. Montenegro adopted the New Law on Customs in December 2005. This law abolished all remaining non-tariff barriers to trade in Montenegro (such as variable levies and seasonal custom rates). Thus, trade policy was further-liberalized despite the increase in the average nominal tariff rate to 6.19%. Accession to the WTO is a priority of the Montenegrin government, and this

Liberalization of
foreign trade

accession requires further liberalization of trade policy. However, if Montenegro were to join the European Union, it would have to make changes to trade policy counter to the ones in progress.

The system of banking and capital markets are differentiated, internationally competitive and oriented in principle to international standards, but they are vulnerable to severe fluctuations due to extreme dependence on outside factors and a de facto lack of supervision. The Central Bank of Montenegro (CBM), which began operations in March 2001, oversees the financial services sector. The banking sector continues to undergo a major reform effort to attain full compliance with internationally recognized standards. All regulations passed over the past two years are in accordance with Basel I principles and EU norms. There are currently ten commercial banks in operation. The trade of securities is conducted only on stock exchanges established for the purpose of creating conditions to match the demand and supply of securities. Established capital markets represent not only a mechanism for privatizing state-owned enterprises, but also for developing an active trading environment which would be attractive for domestic and foreign investors. Also, it is planned that capital markets make company financing easier. Today, Montenegrin companies are able to get necessary capital not only by taking banking loans but also by issuing shares and bonds. There are two stock exchanges operating in Montenegro: NEX Montenegro and the Montenegro Stock Exchange.

Banking system

8 | Currency and Price Stability

Controlling inflation and an establishing an appropriate foreign exchange policy are recognized goals of economic policy. Montenegro uses the euro as its official currency. The Central Bank of Montenegro cannot print money, and acts independently of the government as it is managed by a council whose members are chosen by parliament. The Central Bank of Montenegro has no issuing function. Having the euro as legal tender has significantly impacted trade and investment flows by lowering the transaction costs associated with international trade.

Anti-inflation /
forex policy

There is a culture that advocates policies aimed at stability, but it lacks institutional safeguards. The fiscal policy contributed to the decreasing aggregate demand in Montenegro. Positive developments in public finances influenced movements in the economy, and on the other hand, movements in the economy had a positive impact on the public sector. At the end of 2005 Montenegro had a budget deficit of -1.8 % of GDP, while in 2006 Montenegro reached a budget surplus at the level of 1.9% of GDP. The tax revenue increased slightly from 22% of GDP in 2004 to 25% in 2006. Public debt had fallen from 88.3% in 2002 to 36.9% of GDP in 2006.

Macrostability

9 | Private Property

Property rights and the regulation of the acquisition of property are well defined in principle. Mass voucher privatization that was finished in 2002 was a very important step in developing ideas of ownership and private property in Montenegro. More than 90 percent of individuals used their vouchers and became shareholders, either in former state-owned companies or in a privatization investment fund. The rise of capital values was a strong incentive for people first to sell the shares they had acquired free of charge in mass voucher privatization. Subsequently, many of them saw good opportunity to earn more money. They started to invest the money they had earned, bearing the investment risks. This process was very important to develop a sense of responsibility in a society that had gone through a more than 50 years of socialism. Many people now trade on the stock exchange every day, have their own brokers, and regularly read stock reports. The development of capital markets can be rightly judged as one of the most successful achievements of the reforms. By volume and in terms of the impact of the capital markets reform, Montenegro is in the leading position in the region. A law on property restitution was adopted in 2004.

Property rights

Private companies represent the backbone of the economy, but there are still state companies and strong market concentrations such as oligopolies; concentration of market power is tolerated by the state. The legal framework for a functional private sector exists in Montenegro. More than 85% of the Montenegrin economy is privatized. The privatization or remaining stake of state is completely consistent with other market principles. Along with the privatization process, Montenegro has conducted reforms aiming at improving the overall business environment, resulting in easy business entry and strong incentives for greater entrepreneurship (according to the OECD, Montenegro has a leading position in the region when it comes to business entry and founding new companies). One can set up a limited liability company in Montenegro within four working days with the start-up capital of one euro by submitting three documents: the “Founding Agreement,” bylaws and the official Commercial Court’s form for founding a company. Business exit, which had long been a problem, has now been simplified through the implementation of new legislation on bankruptcy, which caps the procedure period to eight months. In addition to bankruptcy laws, business regulations in Montenegro have been changed by legislation that regulates the position of foreign investors in the Montenegrin economy, the free movement of capital introduced through the new law on capital transactions, tax-free profit repatriation, and the adoption of the euro as legal currency. In addition, goods and services prices are almost entirely freely determined. Business regulation in Montenegro is now friendlier to entrepreneurship. Moreover, the legal framework in Montenegro is aimed at encouraging foreign investments.

Private
enterprise

Thus, foreign investors can establish a company and bring capital in the same way as Montenegrin citizens. Foreign investors are given the same treatment, as the same regulations apply for domestic investors and foreign investors. Also, there are no restrictions on the ability to remit profit, dividends, or interest.

10 | Welfare Regime

Social networks are well-developed in part due to the legacy of the state socialist system. However, these systems and contribution levels are not sustainable under the new conditions of a private market economy. The number of users of social benefits and the level of the compensation they receive is unsustainable. Preliminary data shows that expenses on social benefits in 2006 amounted to 15% of GDP, =11.3% of which was accounted for by pension payments, while 1.6% was unemployment compensations and expenses on employment policies and 2.1% for social protection. The total figure of 15% amounted to 3.4% (or measured by share in GDP 0.5% higher) higher than in 2005. Expenses for direct social and children's protection have decreased from 3% of GDP to 2.1% GDP during the same time period, while expenses on pensions (which accounted for 10.4% GDP in 2005) rose by almost 1%). Employment compensation rose by 0.4% (from 1.2% of GDP in 2005 to 1.6% in 2006). Social transfers are not managed well. Only 54.2% all social transfers goes to households in the bottom income quintile, while other transfers go to families that might not be considered as poor, keeping consumption in mind as a criteria for measuring poverty. As a consequence, social protection compensation is often not high enough to satisfy basic needs of poor families. This does have one positive consequence in that relevant households are seeking jobs which will provide them with a source of income to satisfy all basic needs. This means that social benefit structures still need to be reformed with the goal of decreasing number of benefit recipients such that only those who are in real need gets the help, and that the assistance delivered is enough to provide satisfaction of all basic necessities.

Social safety nets

There are a number of institutions to compensate for gross social differences, however insufficient. Members of all ethnic and religious groups have equal access to public services, and there is no discrimination of any kind. However, this does not mean that all ethnic and national groups equally use the opportunities that are equally available for all citizens. It should be kept in mind that despite the fact that public services of all kinds were free of cost during the socialist era, some ethnic groups have traditionally not used all of them. One example of this is the fact that Roma children often did not even attend primary school. Much has been done in this area in last decade. Non-governmental institutions, Roma associations, international donors and government bodies have successfully conducted several campaigns in order to bring Roma children to schools.

Equal opportunity

11 | Economic Performance

GDP growth and other results achieved to date illustrate the impact of the Montenegrin reforms. The GDP was sinking before the reforms in the period between 1989 and 1992 and continued to do so until 1993. While this trend was eventually reversed, it was only in 2002 that GDP recovered to 1992 levels – and, as of 2003, it was still below 1989 levels. The real growth rate has risen every year since 2002. While GDP grew by 4.1% in real terms during 2005, the growth rate in 2006 measured 4.5%. Inflation – as measured by CPI – decreased from 9.2% in 2002 to 2.5% in 2005, registering a slight rise to 2.8% in 2006. These inflation rates are on par with and below the level of those in EU member-states. Unemployment has also decreased significantly, from 30.45% in 2002 to 19% in 2005 and 14.62% in 2006. The share of investment in GDP rose from 22.75% in 2005 to 31.9% in 2007. According to figures from the European Bank for Reconstruction and Development (EBRD), Foreign direct investment increased from €375 million (20% of GDP) in 2005 to €500 million in 2006, with the help of investments not only in the banking and tourism sectors but also thanks to further privatization. Public finances are recovering. While the budget deficit amounted to 1.8% of GDP in 2005, in 2006 it reached a surplus of 1.9% of GDP. The share of total government consumption relative to GDP increased from 26.1% in 2004 to 27.9% in 2005 to 29.2% in 2006. The main sources of the rising level of government consumption are public services and state administration bodies, which remain large employers due to Montenegro's socialist past. Public debt has been significantly reduced, from 88.3% of GDP in 2002, 48.4% in 2004, 42.6% in 2005, and 36.9% in 2006. Currently, Montenegro has no problems with public debt.

Output strength

12 | Sustainability

Environmentally compatible growth is taken into account at the institutional level in important aspects of economic life but tends to be subordinated to growth efforts. Montenegro is defined as an environmental state in its 1992 constitution. In 1996, parliament adopted a law on environmental protection. Plans are also underway to create a national action plan for the protection of the environment. The country's natural resources are expected to contribute significantly toward economic growth through tourism. Generally, the quality of the environment in Montenegro is well-preserved, which has facilitated the comprehensive and dynamic development of Montenegro on principles of sustainable development. With the help of the EBRD and the World Bank, a regional water supply project that will provide potable water from Lake Skadar to the municipalities along the Montenegrin coast is planned for 2007. This will help to bring the facilities into

Environmental
policy

compliance with national and EU environmental standards. The government drafted a strategy of sustainable development that was adopted in the first quarter of 2007. It promotes environmental protection as a general objective of all government policies.

Institutions for primary, secondary and tertiary education are present to a large extent but remain weakly developed, with key deficits in research and development. Reforms in the area of education are taking place. Elementary education is mandatory. School programs are in the process of being reformed, and the duration of school attendance has been increased from eight to nine years. Education laws permit the establishment and administration of private schools, limited numbers of which operate in Montenegro. A new law on higher education adopted in 2003 allows founding of private universities. One private university and a private school (faculty) of higher education have been established as alternatives to the state university. A further private university was founded by the former prime minister and still-powerful political leader Milo Djukanovic that is likely to provide an attractive alternative within the Montenegrin system of higher education. Investments in education amounted to €1.36 million or .074% of GDP in 2006. Science and research work in Montenegro is developed within an institutional network created several decades ago and need to be significantly improved in future.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

The structural constraints on governance are high and the socialist legacy sometimes endangers the capacity of political leaders to govern, particularly with regard to the continued large number of employees in the public sector. Also problematic is the fact that any and all means of rationalizing and reducing public spending has the potential to cause social discontent. Some of these structural difficulties have been overcome, an example thereof being the fact that the government has successfully conducted the processes of privatization. On the other hand, conflicts in the region not in control of the Montenegrin authorities caused some problems, particularly in light of the large number of refugees and internally displaced people, which have acted as a constraint on the government. Most of such problems are solved, but some of them still remain open and limit the ability of authorities to govern.

Structural
constraints

NGO activity in Montenegro increases every day, though the tradition of civil society remains weak. No institutions of civil society existed or operated in the Former Yugoslavia during the five-decades of socialism. The NGO sector boomed after 1990 and it has achieved much success since then, but one still can not speak about significant traditions of civil society. However one can state that this tradition is gradually being built up in Montenegro.

Civil society
traditions

There was no serious ethnic religious or social conflict in Montenegro, unlike other countries in the west Balkan region. Despite its national, ethnic and social diversity, Montenegro is the only country in the region whose citizens seem to have proven themselves capable of overcoming such differences. Montenegrin diversity is its strength and a source of energy in Montenegrin society. The peaceful co-existence of different social, ethnic, religious and national groups has always been a feature of Montenegrin society. Differences and diversity have always been visible and never hidden in Montenegro, but have not escalated in conflict.

Conflict intensity

II. Management Performance

14 | Steering Capability

The political leadership pursues long-term aims, but it sometimes postpones them to achieve short-term political benefits. Montenegro began building a new economic system in 1998 that drew upon the conception of Montenegro as small open economy based on private property, the protection of property rights, freedom of contracts and protection of investors, openness, the rule of law, equal treatment of foreigners and domestic persons in economic activities, development of entrepreneurship, private initiatives and innovations, deregulation and economic liberalization, and macroeconomic stability. All of these principles have guided the first wave of reforms, which lasted from 1998 until 2002. Following these principles, the Montenegrin government introduced the German deutschmark and later replaced it with the euro as a legal tender, privatized and undertook other reforms. This wave of reforms was implemented through the Economic Reform Agenda 2002-2007. In 2006 Montenegro regained independence. Macroeconomic stability has meanwhile been achieved and the political leadership has now established the development of Montenegro's economy as the main objective in its agenda for the country's economic development from 2007 to 2011, while adhering to the basic principles and concept of reforms adopted in 1998.

Prioritization

The government is committed to democracy and market economy but has had only limited success in implementing its reforms. The macroeconomic indicators described above indicate the effective implementation of reforms in that area. However, mostly due to the socialist legacy, the influence of the state and its administration has remained strong in many areas. State administration can be described as paternalistic and omnipresent, but weak in many ways.

Implementation

The political leadership responds to mistakes and failed policies with changes, but its policy frequently remains stuck in the same routines. Learning processes occur, but rarely affect the knowledge base or cognitive framework on which policies are based. For example, the fact that the Montenegrin government embarked upon economic reforms and tried to build an independent economic system while still being part of the same state with Serbia constrained the scope and impact of its reforms.

Policy learning

15 | Resource Efficiency

The government uses most available resources efficiently, and is led by capable leaders that are devoted to economic reforms. However, the use of human and economic resources is not as efficient as it could be. The share of public consumption in GDP in Montenegro still remains fairly high, largely due to its communist past. The inefficiency of public administration has a negative impact on economic freedom, which has otherwise been significantly improved by reforms in other areas of the economy. Local administration and the burden it imposes on the business sector increase transaction costs and thus inefficiency in resource allocation.

Efficient use of assets

The government tries to coordinate conflicting objectives and interests, but has only limited success. Intra-governmental friction, redundancies and lacunae are significant. The government seeks to coordinate various policy objectives, particularly conflicting objectives within different sectors of government. Experience shows that the cabinet sometimes succeeds and sometimes fails. The most obvious conflicting objectives are in area of protection of employees' rights and protection of investors' and owner's interest. Privatization transactions must satisfy the interests and goals of many stakeholders, including the state, employees in company, investors (i.e., the new owners), and existing owners in company. These objectives often conflict, as the government must strike a balance between protecting the interests of workers and that of the new owner. To balance these interests, privatization transactions must be well-negotiated, so as to avoid strikes and the obstruction of workers, and to prevent investors from being driven away. The sale of the Montenegrin telecommunication company is a positive example of the skillful coordination of conflicting interests in such a way as to satisfy the goals of all stakeholders. Mechanisms of inter-ministerial coordination are only weakly developed.

Policy coordination

Most integrity mechanisms are functioning, albeit with limited effectiveness. The government has established a number of mechanisms to achieve integrity, including a new independent auditing institution to supervise public spending (established in 2006). It has also introduced laws regulating the financing of political parties, ensuring that citizens and media outlets have access to public information, and obliging government employees and other civil servants to declare their assets. The government did not modify the existing law on conflict of interests which does not constitute an effective integrity mechanism. A law on public procurement was adopted in order to comply with EU requirements, while a code of ethics for civil servants and public employees was adopted in December 2005. In August 2006, the government adopted an action plan to combat corruption and organized crime. Some of the laws and procedures in this area are inefficient and must be revised.

Anti-corruption policy

16 | Consensus-Building

The major political actors, both the governing and opposition parties basically agree on market economy and democratic society as strategic goals. Differences, however, exist on the understanding of the role and scope of state in society: political actors either fight for a free market economy with a minimal but strong state (defined by a free market with no interference of state into economy, a high degree of economic freedom, private businesses), or welfare state in which the state is a significant actor on the market as well as in regulating social life, state property over resources in many areas, EU mediators managed to accommodate the concerns of the political actors favoring the preservation of the State Union, preventing them from boycotting the referendum. As a consequence, the law on the referendum of the state status was supported by nearly all political groups in parliament.

Consensus on goals

There are no major political actors who explicitly pursue antidemocratic goals. Montenegro's political leadership has been able to co-opt potentially anti-democratic veto actors or to prevent them from becoming influential anti-democratic forces.

Anti-democratic veto actors

The political leadership has established a tradition of balancing visible differences and diversities. Co-optation, for example of ethnic Albanian political representatives, informal agreements, side payments and accommodating policies have hitherto enabled the government to depolarize political differences. These consensual practices have been facilitated by the country's small size and its correspondingly small political elite, informal loyalties rooted in traditional kinship structures, the absence of radical socioeconomic change and, more recently, the integrative prospect of EU accession.

Cleavage / conflict management

The political leadership takes into account and accommodates the interests of civil society actors. Although no strong tradition of civil society exists in Montenegro, the nonprofit sector acts as very important factor in democratic procedures and decision-making process. The government and parliament have involved NGO representatives in their work. Many laws has been drafted and enacted on initiative on nonprofit sector.

Civil society participation

The political leadership recognizes the need to deal with historical acts of injustice and has sought to develop cordial relations with all former republics of the former Yugoslavia.

Reconciliation

17 | International Cooperation

The political leadership works with bilateral and multilateral international donors and tries to make use of international assistance to improve its domestic reform policies. Key international partners that have supported Montenegrin reforms since it had begun are the United States, the European Union and, more recently, NATO. Besides, cooperation has been established and support provided by the United Nations and all its agencies, World Bank, IMF, all EU institutions, and many others. The political leadership has utilized international assistance for its domestic policy agenda. Results of reforms in previous period confirm this.

Effective use of support

The government tries to act as a credible and reliable partner, but major international actors still express doubts regarding its reliability. Standard and Poor's index upgraded the country's credit rating to BB with positive outlook from BB and foreign investors have shown strong interest.

Credibility

The political leadership cooperates with many neighboring states in the western Balkans and complies with the rules set by regional and international organizations. Montenegro promotes regional and international integration and signed the renewed Central European Free Trade Agreement on 19 December 2006. Following independence, the country also joined the Central European Initiative and the South East Europe Cooperation Process. Integration is especially important for regional markets in a number of sectors, including those of energy, services, education, and tourism.

Regional cooperation

Strategic Outlook

Montenegro's independence has relieved the republic from the necessity of negotiating compromises with Serbia through the State Union framework. However, as a small state with numerous inherited economic problems and external vulnerabilities, Montenegro will have much less national and international scope of discretion than many supporters of independence might have expected. Montenegro's political leadership should take into account that expectations may be disappointed in this fashion. The challenges of economic and political modernization will put a strain on the conditions that have hitherto facilitated Montenegro's consensual political model. Informal loyalties rooted in traditional kinship structures are not compatible with the European models of rational-legal, professional administration or a competitive, open market economy. Economic restructuring and adaptation to the European Union's internal market undermine the relative socioeconomic stability. The independence process has created an imbalance in the fragile inter-ethnic equilibrium and strengthened ethnopolitical interest representation. The future of Montenegro depends upon a balance being maintained between the supporters and the numerous opponents of independence. Avoiding a deepening of the conflict between these two groups and a split of society will be crucial for the future of Montenegro. Therefore the opponents of independence must be integrated and their concerns must be taken seriously. To proceed toward EU membership, comprehensive institutional, political and economic reforms are necessary, including the adoption of a new constitution that is compatible with European law. Montenegro also needs to develop a targeted strategy to cope with bottlenecks in administrative and judicial capacity as well as the widespread corruption and organized crime.