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The Bureaucracy Vs Economic Freedom: The Case of Montenegro

In March 2002, representatives of Serbia, Montenegro, (federal) Yugoslavia, and EU (Solana) signed the Constitution Chapter of the Union of Serbia and Montenegro (hereafter: S&M Union). A major function of S&M Union is to secure considerable political and economic autonomy for Serbia and Montenegro. Since Serbia and Montenegro have different economic systems, that is not an easy task. For example, legal currency in Serbia is dinar. In Montenegro it is euro. Legal barriers and administrative costs of establishing new firms are lower in Montenegro than in Serbia. Taxes, including customs, are also lower in Montenegro. While price controls and subsidies are almost nonexistent in Montenegro, they have endured in Serbia. Foreigners entering Montenegro do not need visa. Serbia requires entry visa from a number of countries.

To promote the political stability and economic freedom in Serbia and Montenegro, S&M Union has committed to (1) significantly reduce the size of federal bureaucracy, (2) go slow on the harmonization of laws and regulations between Serbia and Montenegro, and (3) let Montenegro keep euro as its legal currency. Within a few months, S&M Union has reneged on those commitments.

Instead of dismantling federal bureaucracy, S&M Union has begun to enlarge it. The vehicle of choice is the creation of “temporary federal agencies.” Whatever the façade of words, the real purpose of those temporary agencies is to strengthen the political power of federal bureaucracy in Belgrade. Being 15 times smaller than Serbia, the retention of political power by S&M Union translates into less political and economic rights for Montenegro.

EU is a major threat to the economic autonomy of Montenegro. While the Constitutional Charter of S&M Union requires the harmonization of laws between Serbia and Montenegro to take place over three years, EU wants Serbia and Montenegro to harmonize their laws within a month. Solana, the chief EU negotiator in Belgrade, considers the harmonization of laws to be merely a technical issue that could and should be quickly resolved. On the other hand, many Montenegrins, especially the young people, see the harmonization of laws as a substantive step in changing the balance of political and economic rights in S&M Union in favor of Serbia.

The harmonization of customs systems is the first major test of the future of S&M Union. Average tariffs in Montenegro, Serbia and EU are 2.9%, 11% and 4.2% respectively. Tariffs on food are 11% in Serbia and 1% in Montenegro. Negotiations to harmonize tariffs are currently (April) held in Belgrade. The position held by each interested party can summarized as follows:

Montenegro: We prefer not to increase our custom taxes. However, if EU insists on the harmonization of rates we shall agree to increase them to the level of WTO or EU over the agreed upon period of three years.

Serbia: We have to protect specific areas of our economy such as agriculture and textile industry. Hence we can decrease our custom taxes only over a long period of time.

EU: Montenegro should immediately make its custom taxes equal to those charged by Serbia. Then, Serbia and Montenegro should gradually decrease tariff rates toward the EU level. Otherwise, Montenegro will bear the consequences of its non-cooperation!

S&M Union: They (more or less) support EU because custom taxes can be the major source of S&M Union budget.

It was disheartening to watch delegates from Montenegro preparing for the meeting in Belgrade. They wasted hours of taxpayers money sitting around big table with tons of paper before them trying to decide what should custom taxes be for each and every conceivable product The leader of the delegation said: “Professor, we are using the experience of many countries from all around the world.... and we'll protect interests of Montenegro.”

He meant well. Yet, he was also very wrong. The critical issue that bureaucrats do not understand or prefer not to understand is who should define the interest that needs to be protected? Should those who collect taxes (bureaucrats in Podgorica, Belgrade and Brussels) or those who pay taxes define that interest (entrepreneur, investor, businessman and customers)? Tax decisions are not a technical problem; they have consequences affecting economic development?

To promote its control over S&M Union, European Union is financing research projects whose purpose is to show that Montenegro should suffer no losses from raising its tariffs to match those in Serbia. The argument is that since current prices in Montenegro are higher than prices in Serbia, raising tariffs in Montenegro should have no effect on consumers and entrepreneurs. The effects of substantial subsidies in Serbia, which practically do not exist in Montenegro, on relative prices are ignored.

The Institute for Strategic Studies and Prognoses, which I founded five years ago, has a well-trained group of young economists. They have produced research projects demonstrating that higher tariffs would have harmful effects on economic development of Montenegro. In fact, the Institute argues that long-run benefits from completely eliminating tariffs would exceed short-term cost of making EU and Serbian bureaucracies unhappy. The argument is that a small country with 660 000 people, GDP of \$1.3 billion, and 200 miles of beautiful coast needs more trade instead of higher taxes. In other words, the government of Montenegro should worry more about the future of its citizens and less about making alien bureaucracies unhappy.

Finally, the Serbian National Bank and EU were pressing Montenegro to switch from Euro to Dinar. So far, Montenegro has resisted those pressures, and for good reasons. On the one hand, the behavior of a Balkan's national banks often resembles the behavior of a mosquito in the nudist colony. On the other hand, euro, being a relatively stable currency, lowers the cost of making decisions that have long-run consequences.

By strengthening federal bureaucracy, forcing Montenegro to raise tariffs, and pressuring the country to give up euro in favor of dinar, S&M Union is safeguarding the legacy of sixty years of socialism at the expense of real free-market reforms. It is also changing the balance of power between Serbia and Montenegro in favor of the former. However, bureaucrats in Belgrade continue to promise economic reforms. Those promises give politicians something to shout about. They supply journalists and academicians with ideas and concepts to write about. And international lending agencies couldn't resist incentives to support economic reforms with low interest loans. In time, bureaucrats will waste those funds, politicians will have a new set of promises to shout about, journalist and scholars will find new things to write about, taxpayers will start servicing low interest loans, and economic reforms wont happen because "the market does not work".

Montenegro has an out. The people of Montenegro could still choose to pursue their own economic reforms and bear the consequences, good as well as bad, of their decisions to create a free-market, private-property economy. Or, they could let the bureaucrats in Belgrade and Brussels determine their country's future.

The young people are the greatest hope for the future of economic freedom in Montenegro. They deserve a chance.

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