Theoretical Analisis of the Effects of Fiscal Policy in Montenegro

Damir Šehović

Faculty of Economics, Jovana Tomaševića 37, Podgorica, Montenegro

***Abstract*: The introduction of dollarization (euroization) in Montenegro has had its consequences for the subsequent economic policy, whose main pillar has become the fiscal policy. Given that fiscal policy must be directed towards the achievement of a number of fiscal and non-fiscal objectives, the importance of the careful and adequate management by its holders gains special importance. In the context of the euroized Montenegrin economy, fiscal policy is the most important, and practically the only relevant instrument of macroeconomic management in Montenegro, especially in terms of the realization of the effects of stimulus, stabilization and redistribution.**

***Keywords*: fiscal policy, effect, stimulus, stabilization, redistribution, government debt**

1. Introduction

In Montenegro, fiscal policy is the only instrument of economic policy that can be used in function of the management of strong demand pressures so as to realize a number of stabilization and development goals which are selected as relevant.

The relevant theoretical and empirical studies in the period before the Global Economic Crisis confirm the importance of fiscal policy and the effects that it achieves. The brief post-crisis period went even a step further, additionally stressing its importance and the need for its better management so as to achieve the set objectives, which may relate to full employment, price stability, the improvement of the balance of payments, promotion of economic growth and redistribution of incomes and assets.

Fiscal policy, as one of the most important instruments of economic policy, produces a range of different effects that can be grouped into the effects of demand and the liquidity effects, or else the effects of stabilization, the effects of stimulus and the effects of redistribution. This in turn means that fiscal policy measures may affect the stimulation of economic growth (the stimulus effect), the regulation of unemployment and price level (the stabilization effect) and the redistribution of income and assets (the effects of redistribution).

2. Theoretical analysis of the stimulus effect in Montenegro

In Montenegro, as in the majority of other countries, the current dilemma is whether it is advisable, in the situation of low aggregate demand and an economic growth well below the potential, to stimulate the economic activity by the increase in public spending, or it is preferable to continue with the "austerity policy" and fiscal consolidation, which entail the lowering of public expenditure and fiscal deficit. In order to provide an adequate answer to this question it is necessary to analyze several factors, of which the most important ones are the quantitative effect of the public spending increase on the production volume be (fiscal multiplier), whether it would be possible to finance the high fiscal deficit caused by the said fiscal stimulus, and whether the level of public debt to GDP ratio resulting from the budget deficit would in this case be sustainable.

Thus, the effects of fiscal policy on economic growth can be assessed based on the size of fiscal multipliers. In this regard, many theoretical and empirical studies carried out in recent years have been devoted to the estimation of the size of said multipliers. Accordingly, Romer and Bernstein [35], based on old Keynes models, calculated that the size of the government spending multiplier in normal conditions is 1.6. On the other hand, Coenen, Straub et al. [10], Cogan et al. [11], Cwik and Wieland [13], based on DSGE models, estimated that the government spending multiplier – also in normal conditions – is between 0.6 and 0.77, due to the crowding out effect.

Iizetski, Mendoza and Vegh [17], in an extensive empirical study covering both the developing and the developed countries (under normal conditions) – which is why the results may be applicable to Montenegro – estimated that the cumulative long-run government spending multiplier in developed countries is 0.85, while in the developing countries it is 0.37. In brief, these authors came to the conclusion that:

- The fiscal multiplier is larger in the developed than in developing economies;

- The fiscal multiplier is close to zero in the economies with flexible exchange rates;
- The fiscal multiplier is smaller in more open economies which are exposed to international trade;
- The fiscal multiplier is close to zero in high-debt countries in which the external debt is over 50% of the GDP;
- The government investment multiplier is a more important factor of production growth in the developing than in the developed countries.

In order to obtain an objective view on the size of fiscal multipliers in such circumstances, it is also necessary to draw attention to the results of the research conducted by Romer and Burstein [35], which show that the size of the fiscal multiplier is even higher than 3 in the aftermath of the financial crisis. They were followed by Barro and Redlick [2], who demonstrated that the size of the fiscal multiplier is about 1 in the cases when unemployment is higher than 12% (which is the case in Montenegro).

For the aforementioned reasons, it is possible to draw a general conclusion that the effect of the implementation of expansionary fiscal policy in the form of an increase in government spending in order to achieve a positive impact on the economic growth in Montenegro is almost minimal, while the space for its application is more than constrained. This is for the reason that in the next few years Montenegro will witness fiscal deficits, so an increase in government spending in order to stimulate the production would extend the duration of the deficit by at least another few years. This would be problematic for several reasons, not the least of which are the limited access to capital markets and the expensive financing of fiscal deficits which should be expected in the future, i.e. the fact that the financing of the said increased deficit would be unsustainable, especially taking into account the overall macroeconomic environment and the economic trends that are expected in Montenegro.

An additional constraint is the dynamics of the increase of public debt, as well as the current level of government debt of Montenegro, since the government debt to GDP ratio is on the very limit of the established Maastricht criteria, as shown in the following figure:

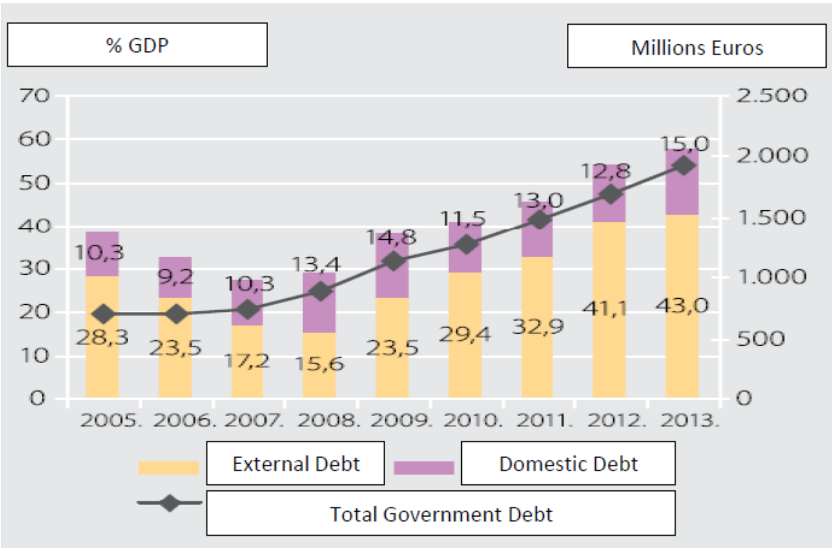

Figure 1. Trends in government debt (domestic and external) in the period from 2005 to 2013
Source: Ministry of Finances of Montenegro

Namely, the government debt has been growing during 2013 (at the end of 2013, it amounted to 58% of GDP) under the budget deficit spillover effect, which in the same year was higher than expected for 1% of GDP, amounting to 3.8% of GDP (128.3 million). Just compared to 2012, the government debt in 2013 increased by 13.8%. External debt, on the other hand, amounted at the end of 2013 to 43% of GDP (1433 million), and in comparison to the end of 2012 was up by 10.7% (138 million). Generally, the tendency of increasing external debt in the coming period affects the reduction of the fiscal multiplier, which was one of the findings of the abovementioned research.

When there is a mismatch between public spending and public revenue, and when public spending cannot be funded from the regular public revenue, an accumulation of debt occurs. If, moreover, the increase in public spending is not accompanied by more abundant tax revenue, the budget deficit is created, which in order to be financed often requires additional indebtment. The economic theory represents the link between the aforementioned concepts in the following equation [22]:

$$\frac{Debt\ (t) - Debt\ (t-1)}{GDP(t)} = \frac{Public\ expenditure\ (t) - \ Public\ revenue\ (t)}{GDP(t)} + \frac{Deficit\ debt\ adjustment}{GDP(t)}$$

In addition, the contemporary theory of government debt management emphasizes the link between government debt sustainability and the economic stability of a state, which is realized through savings, investments, the nominal and real interest rates, and productivity. Therefore, it is necessary to sustainably manage the amount of government debt, its maturity and structure. Government debt sustainability depends on many factors, not the least of which are the GDP growth rate, the government bond yields, the government debt level which is usually measured by the share of government debt in the GDP, the aging population etc. Based on these parameters, it is possible to arrive to the debt sustainability criteria:

$$s \geq (r - g) * d$$

In which:

s – the primary budget balance;
r – real yields on long-term government bonds;
g – growth rate of the real GDP;
d – share of public debt in the GDP.

The relevant theoretical and empirical studies particularly emphasize the negative effects of the so-called "point of public debt" [31],[33]. It can be concluded that countries with high public debt are more likely to experience a constant stagnation (or contraction) of economic activity than those which are not faced with the problem of public debt. For example, Reinhart and Rogoff [34], Cecchetti, Mohanty and Zampolli [6] prove that in times in which the ratio of public debt exceeds 90% of GDP, countries are faced with lower economic growth by 1%. Modern theories of public debt prove that out of 26 cases of high public debt, in developed economies, 23 cases were associated with low economic growth lasting for at least 10 years in the countries concerned [21].

Other relevant findings indicate that the impact of public debt on economic growth is in the short term positive, while subsequently the positive impact decreases to zero level and loses significance when the ratio of public debt to GDP reaches 67%. For the high public debt to GDP ratio (over 95%), additional debt has a negative impact on economic activity [4].

In light of the above, in the face of the more than alarming dynamics of public debt growth in Montenegro, there is a need to analyze the so-called debt sustainability criteria, based on which it may be concluded that the debt has so far represented a high burden of the public finances, while in 2015 and 2016, according to the projections of fiscal indicators, the said burden will be even more pronounced, as seen in table 1:

Table 1. Debt sustainability scenario

		2013	**2014**	**2015**	**2016**
s	Primary budget balance, in % GDP	-4,4%	0,17%	-4,64%	-4,08%
r	Real yield on long term government bonds, in %	5,56%	5,56%	5,56%	5,56%
g	Growth rate of the real GDP	3,3%	2,5%	3,5%	3,8%
d	Share of public debt in GDP	57,95%	58,8%	60,3%	62,3%
s ≥ (r - g) d		**-4,4 ≥ 1,3**	**0,17 ≥ 1,79**	**-4,64 ≥ 1,24**	**-4,08 ≥ 1,09**
		High burden for the public finances	High burden for the public finances	High burden for the public finances	High burden for the public finances

This is why it is necessary to accept the responsibility of improving the fiscal position of the country, given that the stabilization of public finances with the existing macroeconomic parameters that point to the abovementioned dynamics of public debt growth, with the existing high interest rates, cannot be sustainable in the long run. Due to the fact that high indebtment, combined with the openness of the Montenegrin economy, causes its excessive sensitivity to external shocks, which significantly limits its development potentials, a key objective of public finances must be its stabilization and consolidation.

In addition, the already compromised fiscal sustainability represents the second biggest risk for the financial stability of Montenegro. (The first risk relates to the external surrounding due to the insufficient recovery of the EU countries and the other important economic partners of Montenegro [36]. Key channels of influence on the global economic movements are related to: influence of the food and energy prices, exchange of goods, external influences on the tourism-related income, capital flows, foreign direct investments and so on.) The vulnerabilities in the previous period have particularly contributed to this situation – the expenditures for the activated state guarantees, interests on the payments by court decisions, insufficient accumulation of income in the trade sector, as well as the further growth of public debt relative to GDP (Council for Financial Stability, 2014, p. 60). If we bear in mind the need for the increased funding of major capital projects that will likely complicate the fiscal position of Montenegro, the spillover risks caused by the new recessionary tendencies and exogenous shocks, resulting from the increasing instability in the close and distant surroundings of the Eurozone, as well as the reduction in available income in these countries which would also cause new pressures on public finances, we come to the conclusion that the fiscal space for new indebtments, resulting from a possible increase in public spending, has already been used up.

This conclusion is further justified if we take into account that there is a real risk of declining FDI inflows – on which the Montenegrin economy unfortunately still depends upon – because this decline would cause a further drop in aggregate demand, budget revenues and the deepening of the already pronounced illiquidity problems at all levels. On this wise, the net FDI inflow in 2013 was lower by 29.8% compared to the year 2012. This clearly confirms the existence of the previously mentioned risk, given that the reduction in revenue on this basis is a danger to the growth model of the Montenegrin economy, which is unfortunately largely dependent on high expenditure and high imports, and which needs to be changed for these reasons among others.

It also necessary to bear in mind that the fiscal multiplier in the open economies is lower compared to those which are not, as it has been confirmed by the findings of the aforementioned studies of Barro and Redlicki [2], and the fact that the Montenegrin economy is indeed small, but highly open. We conclude that in the existing circumstances the fiscal stimulus in the form of an increase in public spending would not have sufficient influence to stimulate production, while on the other side the space for its introduction, as well as its funding, are very limited. This in turn means that the fiscal adjustment is still a more acceptable option than insisting on increasing public spending in order to encourage economic activity. Therefore, in the coming period, it is necessary to continue with the ongoing consolidation of public finances and the restrictive fiscal policies with respect to current government spending, in line with the macroeconomic environment.

Public spending must be adapted to the fiscal capacity of the economy and the population, in order to avoid an increase in the fiscal deficit and the additional indebtment in a situation of deteriorated economic conditions on the domestic and international capital market. The repayment of increased principals and high interest rates may significantly jeopardize the economic growth of the country. The dynamics of the public debt growth must be stopped, as it represents one of the essential pre-requisites for ensuring macroeconomic stability and fiscal sustainability of Montenegro.

3. Theretical analysis of the stabilization effect in Montenegro

In theory, the effect of stabilization is usually achieved through the impact of fiscal policy on the unemployment rate and the price level. When talking about the first indicator, it is a proven fact that, one of the most dominant macroeconomic disturbances in Montenegro is the unacceptably high unemployment rate, mainly a result of structural unemployment, labor supply and demand mismatch, high levels of unregistered unemployment, lack of harmonization between the educational system and the needs of the economy, slower economy growth and, consequently, the reduced potential for the growth of employment. For this reason among others, it is necessary to use the fiscal policy instruments in order to stabilize the aforementioned deviations. The justification for the use of appropriate instruments of fiscal policy in the context of employment is offered by many theoretical and empirical studies, such as

Monacelli, Perotti and Trigari [30] and Holden and Sparman [16].

The negative effects of the economic crisis, particularly pronounced in Montenegro during 2009, affected the labor market in a way that reduced the number of employees, above all in the industrial sector, i.e. in the manufacturing industry and the mining and quarrying sector, which was the one most affected by the crisis. According to the data of the Employment Agency of Montenegro, the unemployment rate was 12.6% in 2007, 11.3% in 2008, 11.6% in 2009, while in 2010 it amounted to 11.8% . The unemployment rates data coming from the Labour Force Survey done by MONSTAT are somewhat different but show a similar trend: in 2007 the rate was 19.4%, while in 2008 there was a significant reduction to 16.9%. After this period, the rate again shows a rising trend, amounting to 19.2% in 2009 and 19.9% in 2010. The impact of the economic crisis on the labor market started to show particularly in the fourth quarter of 2009, when the trend of declining labor demand and the rise of labor supply started, hence causing the slight rising of the unemployment rate. The movements in the unemployment rate since 2004 can be seen in figure 2:

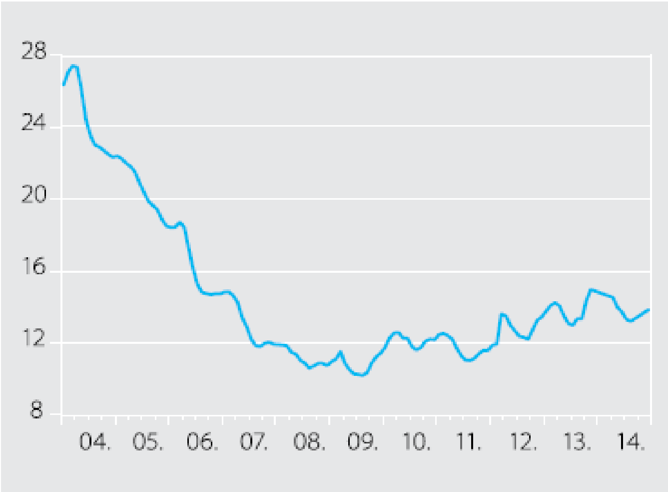

Figure 2. The movements of the unemployment rate from 2004 to 2014
Source: The Central Bank of Montenegro [8]

Strategic document in the field of employment recognizes a series of synchronized measures and instruments, including also the domain of fiscal policy, which is directed towards generating higher employment, i.e. which aim to create a balance between flexibility, productivity and safety of the labor market. The said measures include:

- Amendments to the labor legislation;
- Improved support for the realization of employee rights and for improving health and safety at work;
- Reducing motivation for the employment outside formal economy;
- Encouragement of social dialogue;
- Provision of adequate labor supply;
- Further improvement of the business environment;
- Encouraging of the creation of new jobs through the development of clusters, and so on (for further information see [28], [29].

In 2010, labor market policies expenditure at the EU level in 27 countries averaged 2.2% of GDP. On the other hand, the key measures used to intervene on the labor market in the EU, as well as their share in the total expenditure dedicated to interventions in the labor market, are represented in figure 3.

We must also bear in mind the fact that a special study of the issues in the functioning of Montenegrin companies indicates that the key problems in the sphere of labor market which the enterprises in Montenegro face are under-educated workforce (11.2%), the restrictive legislation in the labor market work (8.2%) and the low work ethics of the local workforce (5.3%).

Generally speaking, the policy objectives related to fiscal policy in the most direct way, such as the macroeconomic stability, favorable business environment, investment in the human capital and the rule of law, are essential not only for economic growth, but also for the creation of new jobs. The necessary additions to this are also well thought out labor policies, as well as strategic policies which would determine which jobs will contribute most to general development.

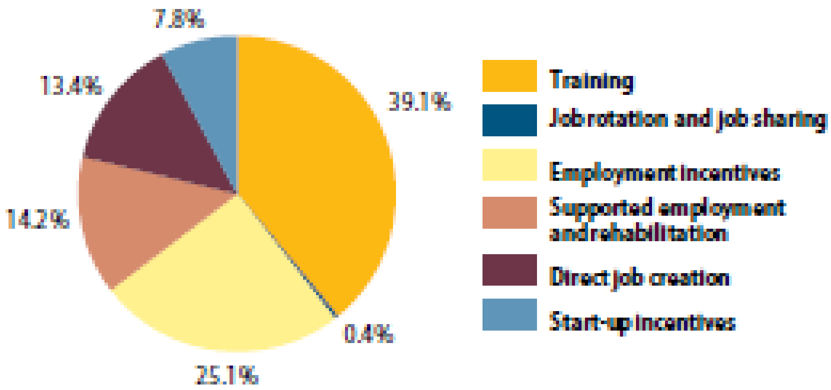

Figure 3. Structure of labor market policy expenditures in the EU countries
Source: European Social Statistic

A possible (new) growth model of the Montenegrin economy – which would certainly provide a higher employment rate and whose important segment is surely the fiscal policy – may be based according to some authors on the construction of a national innovation system whose pillars are university and research centers, business incubators, technology parks, clusters, the so-called Green Field Investments as part of the national innovation system, and the development of ICT and education system [32]. Therefore, in order to accelerate the employment growth in future, Montenegro should focus in the long run on a fiscal policy that is based on productivity and which encourages knowledge, while in the short run it should aim at the sustainability of the fiscal sector, given that fiscal consolidation is its priority at the moment, especially in view the alarming key fiscal indicators. This has not been the case so far, because in the period from 2000 to 2010, the economic growth had been largely driven by the accumulation of capital, while to a much lesser extent by the contribution of labor, and with almost no contribution by the productivity.

We must also bear in mind that the economic analyses have clearly demonstrated that only the economies with high levels of investment in human capital and knowledge – in which cases the marginal rate of return increases – also have high rates of economic growth, or high employment rates in the long run. It is also important to stress that the investment in science or education in Montenegro is significantly lower compared to the EU average. In the light of the above, we come to the conclusion that fiscal policy measures which aim in this direction must be significantly more prevalent in Montenegro than what is currently the case. This is because the contribution of knowledge in a broader sense to the economic growth rate in Montenegro, according to the latest studies, amounts to 6.27%, while its contribution in other developed and less developed countries is somewhere between 35% and 40% ([23], [24], [25], [32]).

In addition to other measures which have to be applied in the context of fiscal policy, it is also necessary to continue to increase the effectiveness of the active employment measures realized through a variety of programs by the Employment Agency [26]. Moreover, in order to encourage the tax competitiveness of the region, it appears useful to introduce various tax incentives and tax reliefs for the new employment and the investments into the underdeveloped areas in Montenegro [15]. The validation for the use of this type of fiscal policy for the stabilization purposes has recently been proven by Feldstein [14] and Tcherneva [37].

Another activity that needs to be implemented in the coming period is the more generous credit support for self-employment, as well as the creation of preconditions for the development of social entrepreneurship. Due to the problems of unregistered work activities, as well as the unregistered labor in registered activities, it is necessary to intensify the activities concerning the implementation of the already initiated measures against the gray economy which affects the labor market [27]. In addition, it is also paramount in the coming period to work on the continued improvement of the business environment and to intensify the activities regarding the development of clusters, especially in the field of agriculture and tourism [7].

Although the traditional literature has stated that it is possible, through a variety of different channels, to affect the price level (reduction of transfer payments, increase in the tax burden, reduction of tax incentives, reduction of public expenditure etc.) by using the appropriate instruments of the restrictive fiscal policy through the regulation of the aggregate demand, most economists in the pre-crisis period have not been keen on using the discretionary fiscal policy for the purposes of achieving a stable price level, which is certainly not the case in the post-crisis period.

In theory, the use of the euroization regime in Montenegro should ensure a low inflation rate that would approximately be equal to the rate of inflation in a country with "reserve currency". Euroization has after all contributed to the establishment of price stability in the medium term. However, due to the inability to use the key instruments of monetary policy for the stabilization purposes, the impact on the inflation rate is predominantly achieved through the instruments and tools of fiscal policy, taking into account its critical role in managing the demand pressures.

In Montenegro, inflation most often occurs as a result of cost inflation and structural inflation, or as a result of external factors, and usually it has the characteristics of imported inflation. However, it is possible to react appropriately to a number of factors that can affect the price increase – grouped into internal and external ones and resulting from a disturbance in aggregate demand – only by using discretionary fiscal policy in Montenegro, which is directed towards limiting the aggregate demand by applying restrictive fiscal policies in function of achieving a countercyclical effect.

Some of the measures in the field of fiscal policy which may have the effect of stabilizing the price level in Montenegro are: the budget surplus policy, because it accepts the postulate of cyclical rather than permanent budget balance; the implementation of fiscal reforms aimed at enhancing the business environment; reducing the level of public spending, especially in the area of salaries in the public sector because of the effects on the inflation of demand; adjustment of the fiscal burden on certain groups of products which may be responsible for inflationary trends; continuation of structural reforms, and others. However, the 2007 and 2008 experience, when evident inflationary growth was present in Montenegro, significantly higher than normal, has taught us that, in this period, fiscal policy in some of its elements (increase in gross income in 2007 was as much as 30%) had the characteristics of an expansive, rather than restrictive fiscal policy. This represented a powerful stimulus for the inflation of demand, which entitles us to conclude that at the time fiscal policy did not have the necessary countercyclical character.

4. Theoretical analysis of the effect of redistribution in Montenegro

Taking into account the fact that primary distribution is performed in the market through the price mechanism, the secondary distribution is done between the state on one side, and the economy and the population on the other. Income redistribution and the elimination of irregularities that occur in the primary distribution are performed precisely though fiscal policy, which is why progressive income taxation and social protection transfers become especially important in its framework. In theory, progressive income taxation is achieved by reducing income inequalities which are generated in the process of distribution, whereby it is important to keep in mind that this may also contribute to the reduction of efficiency, due to the fact that individuals may change their behavior in order to avoid the redistributive effects of the aforementioned tax. However, given that the tax system as a whole is not characterized by progressiveness, because there are numerous regressive effects of taxation that in some ways neutralize the said progressivity of the income tax, it becomes increasingly important to use the specific types of transfers which further affect the reduction of inequality in income distribution.

Measuring distribution inequalities is done in various ways, the one used most often being the wide inequality measures represented by the Lorenz curve and the Dalton-Atkinson's rule, or the so-called Gini coefficient, as the numerical indicator of the unevenness of income distribution in a society. In this regard, the trends of income inequality measured by the Gini coefficient in the pre-crisis period can be seen in figure 4. We conclude that the differences in income inequality between the regions are greater than the changes in income inequality within the regions.

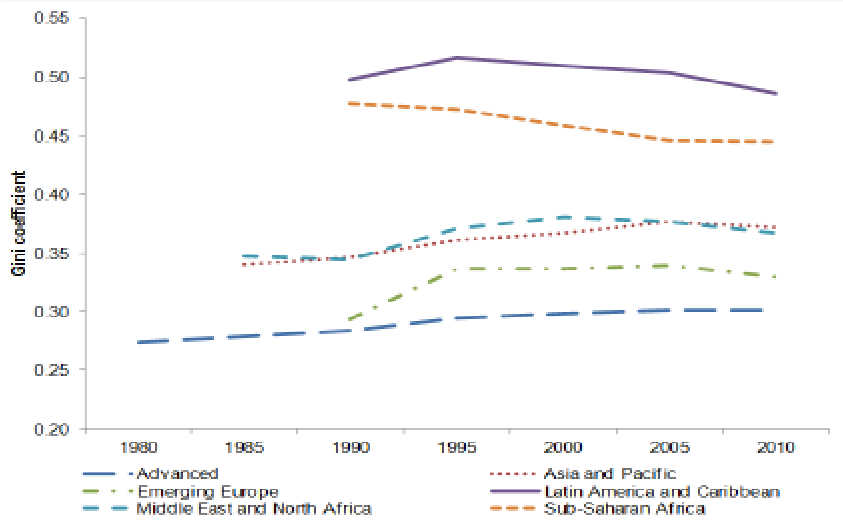

Figure 4. Trends of income inequality in the world
Source: Bastagli, Coady and Sanjeev [3]

It is also important to take into account the fact that fiscal policy has played a significant role in reducing the inequalities in income distribution in the developed economies, particularly in those with pronounced inequalities. Every year from 1985 to 2005, according to OECD data, the fiscal policy, i.e. and the impact of direct taxes and especially social transfers, reduced the Gini coefficient by one-third, or 15%, while the redistribution effect of fiscal policy was more pronounced until the 90s, when it gradually began to weaken [31].

Unlike the developed countries, the redistributive effect of fiscal policy in the developing countries is limited because of the low taxes and social transfers, as well as the reliance on regressive tax instruments ([18], [12] [9].

According to the available data, the inequality in income distribution in Montenegro is still less pronounced than the average values in European and Central Asian countries. In 2010, the Gini coefficient in Montenegro was 24.3, and was lower than the coefficient of 31.9 recorded in Europe and Central Asia. However, the Gini coefficient shows a rise in inequality in Montenegro in 2011, reaching the level of 25.9.

On the other hand, it should be noted that the application of a single proportional tax rate removed the automatic stabilizers from the tax system, which has significantly amplified the pro-cyclical elements in the Montenegrin tax system. This could be especially dangerous in case of the occurrence of external demand shocks, due to the increased reliance on imports as an important source of fiscal revenues, mainly related to the value added tax.

Due to the lack of progressivity in taxation, the Montenegrin tax system is being exposed to the action of regressive tax instruments, most notably the VAT. Being practically the only way to reduce the irregularities in the distribution of income, it represents the use of social protection transfers. This fact, when interpreted together with the pro-cyclical elements of the tax system in Montenegro, points to the conclusion that the challenges facing a redistributive fiscal policy are particularly pronounced.

Due to the deterioration of almost all fiscal parameters in Montenegro, it is necessary to insist on a rational budget spending, which is why in the coming mid-term period, the emphasis should be placed on the continued fiscal adjustment and fiscal consolidation. Such orientation of the fiscal policy will certainly leave a mark on the unequal distribution of income in a way that will make inequality even more pronounced.

Fiscal consolidation exerts influence on economic inequality in a way that it reduces output and increases unemployment in the short term, which is usually associated with salary reduction, while in turn salary reduction fosters an increase in inequality due to the relatively higher share of lower income earnings in the total income ([5], [19], [20]). Consolidation will also affect the level and structure of taxes and transfers, as the key instruments for achieving redistributive fiscal policy objectives. Income inequality will tend to increase if the state continues to rely more on the revenues from indirect taxes characterized by regressive effects, as is the case in Montenegro. It should be particularly emphasized at this point that fiscal adjustments in the developing countries, due to the size of the adjustment, have a significant impact on the income and the unemployment rate, which in the long run may contribute to the solution of macroeconomic imbalances which brought to the need for the adjustment in the first place, but which will in the short term certainly contribute to increasing the inequality [1]. This is especially true if there are no automatic stabilizers that would mitigate these effects. All the said facts raise the expectation that the tendencies related to the increase in unequal income distribution will be present in Montenegro during the period of fiscal consolidation, which has been implemented in a relatively concretely manner since 2009.

5. Conclusion

The effect of the application of expansive fiscal policy through the increase in public spending, which aims at positively influencing the economic growth, is minimal. Moreover, the space for its implementation is depleted, which is why fiscal adjustment is a much more acceptable option than the increase in public spending which is directed towards the stimulation of economic activity.

In order to accelerate the growth of employment, Montenegro must focus in the long run on the fiscal policy which is based on productivity and which encourages knowledge, while in the short term it aims at achieving the sustainability of public finances, especially taking into account the alarming fiscal indicators. Due to the inability to use the key instruments of monetary policy for the stabilization purposes, the influence on the inflation rate can be achieved by using the instruments and tools of fiscal policy.

The common application of the single proportional tax rate and the lack of progressivity in the taxation have removed the automatic stabilizers from the Montenegrin tax system, and have amplified the elements of procyclicality. Hence the only instrument for the elimination of irregularities in the income distribution is represented by the social protection transfers, which is why the challenge for a redistributive fiscal policy in Montenegro is particularly pronounced.

REFERENCES

[1]. Agenor, P. R. (2004). Macroeconomic Adjustment and the Poor: Analytical Issues and Cross-Country Evidence. *Journal of Economic Surveys.* Vol. 18, No. 3.

[2]. Barrow, R. and Red Lick, C. (2011). Macroeconomic effects from government purchases and Taxes. Quarterly Journal of Economics. 126, 51-102.

[3]. Bastagli, Francesca, Coady, David, and Gupta, Sanjeev. (2012). Income Inequality and Fiscal Policy, *IMF Staff Discussion Note.*

[4]. Baum, A., Checherita-Wesrphal, C. and Rother, P. (2012). Debt and growth: new evidence for the euro area. Working Paper Series 1450. European Central Bank.

[5]. Blanchard, Olivier and Perroti, Roberto. (2002). An Empirical Characterization of the Dynamic Effects of Changes in Government Spending and Taxes on Output. *The Quarterly Journal of Economics*.

[6]. Cecchetti, G. Stephen, Mohanty, M. S., and Zampolli, F. (2011). The real effects of debt. BIS Working Papers.

[7]. Centralna banka Crne Gore. (2013). Preporuke Vladi Crne Gore za ekonomsku politiku u 2013. godini. Podgorica: Centralna banka Crne Gore.

[8]. Centralna banka Crne Gore. (2014). Godišnji izvještaj o radu. Podgorica: Centralna banka Crne Gore.

[9]. Coady, D. (2006). The Distributional Impacts of Indirect Tax and Public Pricing Reforms. *Analyzing the Distributional Impact of Reforms: A Practitioner's Guide to Pension, Health, Labor Market, Public Sector Downsizing, Taxation, Decentralization and Macroeconomic Modeling,* Volume 2, ed. by A. Coudouel and S. Paternostro (Washington: World Bank).

[10]. Coenen, G., M. Mohr, and Straub, R. (2008). Fiscal Consolidation in the Euro Area: Long–Run Benefits and Short–Run Costs. Economic Modelling. 25(5), 912–932.

[11]. Cogan, J., Cwik, T., Taylor, J. and Wieland, V. (2010). New Keynesian vs. Old Keynesian Government Spending Multipliers. Journal of Economic Dynamics and Control. 34. 281–295.

[12]. Cubero, R. i Hollar, I. (2010). Equity and Fiscal Policy: The Income Distribution Effects of Taxation and Social Spending in Central America. IMF Working Paper WP/10/112 (Washington: International Monetary Fund).

[13]. Cwik, T. and Wieland, V. (2009). Keynesian government spending multipliers and spillovers in the euro area. CEPR wp 7389.

[14]. Feldstein, S. Martin. (2009). Rethinking the Role of Fiscal Policy. *National Bureau of Economic Search Working Paper Series.*

[15]. Gemmell, N. and Morrissey, O. (2005). Distribution and Poverty Impacts of Tax Structure Reform in Developing Countries: How Little We Know. *Development Policy Review*, Vol. 23, No. 2, pp. 131–44.

[16]. Holden, Steinar and Sparrman, Victoria. (2011). Do Government Purchases Affect Unemployment? *The Research Council of Norway*.
[17]. Ilzetzki, Ethan and Végh, Carlos A. (2008). Procyclical Fiscal Policy in Developing Countries: Truth or Fiction? *NBER Working Paper* 14191 (Cambridge, Massachusetts: National Bureau for Economic Research).
[18]. Immervoll, H., H. Levy, C. Lietz, D. Mantovani, C. O'Donoghue, H. Sutherland and Verbist, G. (2006). Household Incomes and Redistribution in the European Union: Quantifying the Equalising Properties of Taxes and Benefits, in *The Distributional Effects of Government Spending and Taxation*, ed. by D. B. Papadimitriou (Hampshire: Palgrave Macmillan).
[19]. International Monetary Fund. (2012). *Iceland: Staff Report for 2012 Article IV Consultation.* IMF Country Report 12/89.
[20]. Jenkins, S., A. Brandolini, J. Micklewright, i Nolan, B. (2012). *The Great Recession and the Distribution of Household Income* (Milan: Fondazione Rodolfo Debenedetti).
[21]. Kobayashi, Keiichiro. (2013). A Theory of Public Debt Overhang. Institute of Economic Research. Hitotsubashi University.
[22]. Lojsch D. H, Rodríguez–Vives M and Slavík M. (2011). The size and composition of Government debt in the Euro Area, *ECB Occasional Paper No 132.*
[23]. Madison, A. (1972). Explaining Economic Growth. Banca Nazionale del Lavoro Quarterly Review.
[24]. Madison, A. (1987). Growth and Slowdown in advanced Capitalist Economies: Techniques of Quantitative Assessment. *Journal of Economic Literature.*
[25]. Madison, A. (1995). Monitoring the World Economy, 1820-1992. Development Centre Studies. The Organization for Economic Cooperation and Development. Paris.
[26]. Ministarstvo finansija. (2012). Pretpristupni ekonomski program za Crnu Goru 2012-2015. Podgorica: Ministarstvo finansija.
[27]. Ministarstvo finansija. (2013). Akcioni plan za suzbijenje sive ekonomije za 2013. godinu. Podgorica: Ministarstvo finansija.
[28]. Ministarstvo rada i socijalnog staranja. (2007). Nacionalna strategija zapošljavanja i razvoja ljudskih resursa 2007-2011. Podgorica: Ministarstvo rada i socijalnog staranja.
[29]. Ministarstvo rada i socijalnog staranja. (2012). Nacionalna strategija zapošljavanja i razvoja ljudskih resursa 2012-2015. Podgorica: Ministarstvo rada i socijalnog staranja.
[30]. Monacelli, Tommaso, Perotti, Roberto and Trigari, Antonella. (2010). Unemployment Fiscal Multipliers. *Carnegie Rochester Conference.*
[31]. OECD. (2008). Growing Unequality Income Distribution and Poverty in OECD Countries.
[32]. Popović, Milenko. (2010). *Privredni rast Crne Gore*. Centralna narodna biblioteka Crne Gore.
[33]. Reinhart M. Carmen, Vincent R. Reinhart, and Rogoff, Kenneth S. (2012). Debt Overhangs: Past and Present. *NBER Working Paper* No. 18015.
[34]. Reinhart, C. and Rogoff, K. (2010). Growth in a Time of Debt. *American Economic Review.*
[35]. Romer, Christina i Bernstein, Jared. (2009). The Job Impact of the American Recovery and Reinvestment Plan. Council of Economic Advisers.
[36]. Savjet za finansijsku stabilnost. (2014). Izvještaj o radu Savjeta za finansijsku stabilnost 2013. godina. Podgorica: Savjet za finansijsku stabilnost.
[37]. Tcherneva, R. Pavlina. (2011). Fiscal Policy Effectiveness: Lessons from the Great Recession. Levy Economics Institute of Bard College, *Working Paper No. 649.*

Corresponding author: Damir Šehović
Institution: University of Montenegro, Faculty of Economics Podgorica, Jovana Tomaševića 37, Podgorca
E-mail: damirsehovic@yahoo.com