

# Economic Freedom and New Economic Paradigm

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**Summary:** Are economic freedoms going to clear our way to prosperity? Is the growth of economic freedoms our path to prosperity? Is it in the base of the new understanding of development?<sup>1</sup> If yes, what will necessarily have to be changed in the economic practice of every country and whole world in general? What will be changed in economic theory? What are potential consequences of an attempt to offer resistance to the new concept of development? These are just some of the questions discussed in this paper, whereas the starting point is the economy and economic development of Montenegro.

**Key words:** Economic Freedom, Economic Paradigm, Global economy, National state

**JEL:** F02, O43, B52

## 1. The background of an idea

The new economic system in Montenegro is based on the idea and concept of economic freedom<sup>2</sup>. In other words, the concept of economic freedom is the concept that removes the barriers to doing business, i.e. facilitates business activities for entrepreneurs, investors, and managers. Implementation of this concept in Montenegro meant reductions of many international trade barriers; reduction of taxes and contribution fees; reduction of public spending; affirmation of private property; encouraging development through entrepreneurship; equal treatment of domestic and foreign companies; and the introduction of DEM (later replaced by the EURO) as the official currency. The procedures to start a business are simplified and financial and capital markets are strengthened. Montenegro has opened and internationalized the economy. As a result, we have the highest level of economic freedom in the region, according to the Fraser Institute's Economic Freedom of the World Index. Besides, many other economic indicators are the best performing, compared to the region such as real GDP growth rate or foreign direct investment inflow.

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<sup>1</sup> Miles, Mark (editor): "The Road to Prosperity – the 21<sup>st</sup> Century Approach to Economic Development", Heritage Foundation, Washington, 2006

<sup>2</sup> Vukotić, Veselin: "Conceptual Basis of New Economic System in Montenegro", Institute for Strategic Studies and Projections, Podgorica, 2006, second edition

The foundation of the new concept lies in promoting entrepreneurship and innovations; it is oriented towards **development**, not **macroeconomic stability**. It is the concept of entrepreneurial instead of distributive or social economy, concepts that focuses on the relation between economic development, on one side, and business and private capital instead of state, protectionism and state companies, on another. This is the concept which tries to globalize the Montenegrin economy as much as possible and make it an organic part of the global economy.

Is this concept convenient for Montenegro and will it lead the country to prosperity? Or maybe it will result in poverty and isolation of Montenegro, as opponents of the concept claim?

In order to avoid quasi-political discussions, these “alternatives” (liberal concept or protectionist concept) should be analyzed in the context of the development of mega-trends in economic practice and economic theory of the contemporary world. In other words, the “alternatives” should be analyzed in the context of a future that has already begun.

## 2. What is economic freedom?

If we speak about economic freedoms in terms of definition, it is freedom of business entry, i.e. freedom to start a business, as well as freedom of business exit, i.e. freedom to close your business.<sup>3</sup>

However, in this paper, I am discussing the concept of economic freedom! The concept is a complete theoretical and practical expression of an idea!

In this respect, economic freedoms are an **idea**! The idea requires full consistency and an evolutionary approach! In other words, processes and process thinking are important elements of the validity of the idea, instead of a partial and incoherent approach to reality! The idea requires holistic instead of fragmentary approach! As Plato puts it: the difference between concepts is the difference between starting ideas!

What is the idea of economic freedoms? **It is freedom of an individual to do business (earn money), as well as the belief that business is the key factor of a society’s development and individual wealth.**

This idea is in contrast with the idea of its opponents, who claim that state - national state - is the key factor of society’s development.

Our notion of economic freedoms starts from a transformation of a national state into a state which would be able to understand new trends of development. The concept of economic freedom we are promoting asks for a trans-

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<sup>3</sup> Economic Freedom Network: „Economic Freedom of the World 2007 Annual Report“, 2007

formation of the classical role of the state - as a ruler of the society, into the state - as a part of the society. **For us, the society is much more than the state itself, and that is where economic freedoms begin.** This is opposite from the idea that state is the master, the owner of the society, i.e. it should provide job and salary to each individual in the society, or customers and market to each company! Our approach is opposite from the idea that the State is the God and is given by God!

The consequences of the differences in these ideas lead us to deeper layers of reality! They lead to differences in theoretical understanding of economics; but also lead to differences in understanding the paradigm of reality and every day's life.

In a nutshell, these are two completely different views on the world. Both are legitimate; and neither one, nor another, is sinless.

Which approach should we choose on the practical level in Montenegro? In my opinion two facts are important for making such decision:

- 1) Existence of a global economy;
- 2) Size and economic power of Montenegro, i.e. 650.000 people and GDP of 2.5 billion EUR.

Is there a possibility to keep the state closed and maintain a self-sustainable national economy within a globalized economy? Does the size allow Montenegro to be a closed and competitive system at the same time?

In my opinion, both facts warn us on the need to completely open Montenegro! **Openness** makes the essence of economic freedom!

### **3. Why is the idea of economic freedoms important?**

Economic freedoms are the bridge that leads us to a global economy; to the global stage, as K. Ohmae<sup>4</sup> says.

We should accept the fact that globalization has already taken place! The question for rational people is not **yes** or **no** to globalization; rather, the question is 'what comes next?' Bill Gates points out that the modern world experiences changes every 10 years. The question thus becomes 'how do we cope with reality and be successful in this world of permanent and rapid changes?' How can an individual, a company, or a nation be successful?

**Different times require new scenarios!** You should always face towards the future; you should design your activities according to the events that will occur in the future, and should not discuss the past events.

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<sup>4</sup> Ohmae, Kenichi: "Next Global Stage – Challenge and Opportunities in Our Borderless World", Mate, Zagreb, 2007

Still, are there some messages of the past that prove integral in understanding the importance of the idea of economic freedoms?

#### 4. The Lesson and Messages of the Past

What is the reason some nations are wealthy, while others are poor? This question is discussed by David Lendis in his detailed study “Wealth and Poverty of Nations”<sup>5</sup>!

Progress and development ask for initiatives, and the initiatives never fall from the sky! The initiatives always have obstacles! Countries that have removed those obstacles to new initiatives are developed today! Initiatives lead to private property and strengthening institutions based on private property! Private property was the mean to limit power of rulers and its despotism. Today we know that collective property disables entrepreneurial activity and makes progress difficult: why would an owner invest capital and assets in order to earn the money if someone will take his earnings away?

Edmund Burke puts this as: “**The Law against property is the law against industry (business)**!” This was the European model, while despotism was the living style in Asia. Lendis noticed that societies which leave the space for initiatives on lower social levels progress more rapidly than the societies with an initiative-friendly environment operating strictly on higher social levels (pp.50). Medieval Europe was one of the most inventive societies in history. In other words, Europe discovered the invention and its benefits! For example, the water mill, eyeglasses, the mechanical clock, the printing-machine and powder are just some of the European inventions during the Middle Ages. All these technological improvements and inventions required market expansion and specialization. This brought discovery of other parts of medieval market. Technological improvement caused globalization and states that took part in medieval global flows are developed today.

This is also a very short explanation of the fact that Western countries (Europe and USA) are the most developed countries in the contemporary world.

The country which loses touch with its time will stay underdeveloped and poor. Is this a lesson that Montenegro should draw out from history?

Do we understand the African proverb which says: “a hand which begs is always below the hand which gives“?

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<sup>5</sup> Lendis David: „The Wealth and Poverty of Nations“, Beograd, 2006

## 5. Lessons of the Future

In my opinion, four mega-changes that are taking place in the contemporary world are very important for understanding the idea of economic freedom:

- 1) The development of the global economy;
- 2) Weakening of the national states;
- 3) New economic theory;
- 4) New view on the world.

Someone would say that these are “deep theoretical claims” and are not directly related to economic freedoms. But, in my opinion, the theory is the best practice, and at the same time the practice is the best theory. The part of the paper below should be understood in this context.

### *5.1. Global economy*

Western countries have become the most developed due to technology improvements, investments into knowledge and market expansion. Most of these countries keep that position until today. Is this causal relation still important for some countries? Did the countries leaders of economic progress in the contemporary world realize this relation from history and implement it in new circumstances?

Are Ireland and Finland the countries which confirm this relation? Both countries went along the path of investments into technology and knowledge, i.e. investments into people! Both countries promoted freedom of entrepreneurial activity and freed the society of fear from foreigners and foreign capital. Both countries got rid of the myth about the importance of the national market. Both countries implemented a strategy that focused on the development of domestic companies through selling products on markets through national borders.

Thus, Ireland was promoted as a brand of the “electronic heart of Europe,” while Nokia became the keystone of Finnish success. Finland made one more important step! As the local language is very difficult for foreigners, Finland introduced English as the official national language! They were not thinking of it as a danger to their national culture or language.

Both countries changed the strategic vision of their development! The new vision was established on the belief that despite their size, the countries can be strong. Both, Ireland and Finland developed their economies as **the platforms for business** with the rest of the world.

Besides belief in its own strength, both countries have one more important element of success: the nations were flooded by a wave of self-confidence and trust into knowledge and products they have and make.

You can find similar examples of success in countries such as: China, the Asian Tigers, Estonia, Chile, and Australia.

World markets tie the whole world into the global economy, i.e. the world market is the base of globalization. Ulrich Beck says that globalization **creates connections between people and forces people to connect among each other.** Examples of Ireland and Finland, the countries that joined the world market, show how the world market mechanism encourages the development of those who understood its logic and its uncertainty.

The global economy is unpredictable! There are not many debates on the issue of a global economy in national parliaments. The debates about a global economy are taking place in the computer terminals or credit cards transactions, where everything overlaps and the owner never sees his or her money. How can this uncertainty be understood in a head of the person who believes in visible and mechanical things only?

A global economy has **no limits.** Borders between states are not strong any more. There are not as many obstacles as in the past. Technology and bilateral agreement turn the world into a place with no borders. Custom services disappear and numerous countries become aware of the fact that they need other countries in order to achieve economic progress and development.

Nevertheless, official borders between countries still do exist; however, the world has become a place with no borders with respect to the four factors of business life. Ohmai names these four factors as the 4 “C’s” - communication, capital, corporation, consumers.

- a) The development of technology leads to development in communication, especially through the improvement of internet services;
- b) Capital flows benefit from a world without borders due to deregulation in the financial services sector. Following the mechanism of economic freedom, capital flows to regions where earning expectations are the highest;
- c) Many corporations do not have to try to overcome all obstacles in their business imposed by one national state, but just need to move some of their operations out of the national borders of the country. It is very common today that different parts of the company are located in different areas of the world;
- d) The consumers do not suffer because national borders do not exist anymore. Internet, e-banking, credit cards, and similar instruments enable the consumers to become part of the global economy with no borders.

The question to be asked is not whether the global economy exists! The real question is how it will influence, among other things, the role of the state, the

understanding of economics and the way we understand regular economic activities.

### **5.2. Global economy and nation-state**

A global economy is an economy that abolishes state borders.<sup>6</sup> How do we experience this change in our head, especially if we know that the prevailing way of thinking, not only in economics, is based on classical nation-state? Economics, as a science, used to be tied to the concept of a nation-state, and thus initiates the title **political economy**.

“The concept of nation-state became strongly rooted in the intellectual, cultural and political view on the world. However, this concept was more talkative, illegal tenant, than it was the tenant which has the right to occupy the space. This happened thanks to the process of flattering. The concept of nation-state imposed itself as something that logically follows from the natural development of human organization. National state protects and gives the solution to our problems. How can we live without it?”<sup>7</sup>

Many people would think that the concept of a nation-state is very old. But, they are wrong! The first concept of a national state was defined by French Bodin in the mid-XVI century. This idea was born as an attempt to avoid conflicts between small social and political entities. In order to avoid conflicts, the society needed large bureaucracy, which was financed by taxes. Thus, the idea of bureaucracy was extremely expensive from its very beginning. The greater the power you have, the more expensive it is.

The state was additionally strengthened through the conquests and colonization conducted by European countries in the 17<sup>th</sup> and 18<sup>th</sup> centuries. If national states were successful, they had opportunity to become wealthy. These countries wanted to protect the wealth they had and the **protectionism** was born as a legitimate theoretical approach in economics.

The authorities in a nation-state have to protect national interests, which includes the economy and domestic production, among other things! In order to do so, the authorities turned to inside capacities: markets within the national borders. The outside world (markets outside of national borders) was understood as corrective. External markets are usually considered as something to be afraid of, not as a place where you can satisfy your interests. This analysis shows that the concept of a closed economy was born long before Keynes. A national state does necessarily have its **symbols, national territory, national currency and a Central Bank**, which protects national currency. Economic policy is expected to protect the national economy from strong foreign competition. The founder of

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<sup>6</sup> Beck, Ulrich: „What is Globalization“, Vizara, Zagreb, 2007

<sup>7</sup> Ohmae, Kenichi, 2007, opcit. str 82

this concept of a national plan was German economist Friedrich List. **The army** used to be a mandatory element of national states.

What happens with these key elements of a national state when you open national borders? Is there a purpose for the existence of custom services and export-import control in the era of internet? Can the national state keep strong political functions in the new conditions, if we know that a part of political sovereignty is transferred to entities outside the national borders? Should the state become the economic entity, instead of being the political entity? Regardless, should the state become what Ohmai calls the **region-state**, or should it be the **cosmopolitan state**, according to Ulrich Beck?

Undoubtedly, one trend is clear: a global economy requires much more of the economic state than it requires what we have today – the political state! This has inconceivable consequences on the future developments in this century.

### *5.3. Global economy and economic theory*

Can the prevailing approach in economics remain the same in the new conditions featured by the existence of a global economy and the weakening of national states? Is there a need to change the dominant economic paradigm, which lies on the concept of the nation -state? Don't we remember The Bible of economics – Smith's book "Inquiry into the Nature and Causes of the Wealth of Nations"<sup>8</sup>, which puts the emphasis not only on the individual, but also on the nation?

Are we, as economists, looking in the heart of the economy; are we looking in what is going on around us, or we are still analyzing economic theories from the past and thus try to explain contemporary economic reality using past economic law? When I got deeply into economic analysis I wondered: **Why did these famous economists think of economic reality in this way?** Did they succeed to "catch" some natural economic laws and we should just further develop them, as in the science of physics? We have to understand their theories, and once we do so, we just have to work it out and develop further. But, what if we are on the wrong path? What if we are following the wrong trail? What if we did not give an answer to the question: why Smith thought of the reality in such a way? Why Ricardo and Keynes developed such a thought? **Did they achieve great success in economic thought because they encountered natural laws of economics or because their thought and their ideas are the product of historical circumstances and the environment they used to live in?** If this is true, is the theory from the past still valid today and has no defect? Smith wrote much about factories but nothing about services? David Ricardo wrote only about comparative advantages in the time when his homeland England was a super-

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<sup>8</sup> Smith, Adam: „An Inquiry into Nature and Causes of the of Wealth of Nations“, Global Book, Novi Sad, 2000



power.<sup>9</sup> Keynesian general economic theory was created as an answer on the Big Economic Crisis!<sup>10</sup> Hayekian and Misesian theory were developed as an answer to the power of the welfare state!<sup>11</sup>

It is extremely important to understand that changes in economic circumstances - changes in the economic environment - change relevant economic theories!

If economic thought was more evolutionary (meaning that it adapts to the circumstances) then physical (as in natural law), do medicines that cured the old economy still heal economic wounds today?

If a global economy is reality, is classical macroeconomics (Keynesian macroeconomics) still applicable today? Is the macroeconomic stability, i.e. relation between employment and inflation, a key goal of economic policy? Are the macro-models of interdependent economic systems more applicable in the conditions of economic dependency between countries? Are current statistical methodologies still relevant? What is the meaning of the GDP aggregate, when one product is being produced in many countries? Indisputable, postulates of the prevailing way of thinking in economics so far (closeness, causal relation and predictability of economic events) are debatable! They are under question mark. Which way should we choose? Which way to go?

There are two approaches: (a) **to stay in the dream of the big economic theoreticians from the past**; (b) **to open our eyes widely and look for the heart of the economy that is taking place around us**. It means that we need to reject all the prejudices we adopted in school or in life and return to some prejudices we have thrown out of our way of thinking, whether consciously or unconsciously.

Technology has changed the world we live in, or better said, technology has changed the dominant perception of the world. This changes the essence of the economy as well. The economy and the economic environment are as stable as meteorology. Really, meteorology is the association for the global economy. Any kind of economic prognosis, especially long-term economic prognosis, can hardly be more reliable than meteorological prognosis! But, meteorological processes have no limits!

#### ***5.4. Global economy and new view on the world***

Throughout the history of civilization people had the need to create a mental framework which is used as a means to organize human activities. That mental framework is the base from which people draw out answers on many questions. We use this framework to answer questions of “why” or “how” some events

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<sup>9</sup> Ricardo, David: „Political Economy“, Cekade, Zagreb, 1986

<sup>10</sup> Keynes, John Maynard: „General Theory of Employment, Interest and Money“, Kultura, Beograd, 1965

<sup>11</sup> Hajek, von Fridrih: „Road to Serfdom“, Globus, Novi Sad, 2000

from everyday life occurred. This mental framework is similar to the light reflector: it lights up the space, but does it light up the whole space? Is there reality out of that mental framework; is it some alternative, inexplicable world?

People are prisoners of this mental framework! It is usually inherited! We accept many things without thinking why we do so. The mental framework in modern history has deep roots in scientific thinking. The presently dominant view on the world was created around 400 years ago under the influence of a Newton mechanistic paradigm. Aside from Newton, the architects of the mechanic view on the world also include: Francis Beckon, who ridiculed Plato and Aristotle with the claim that their theories were “empty tales,” and Rene Descartes, who found that mathematics is the key to world development. Newton used the theory developed by Descartes and came to the law which explains how planets move around the sun and why an apple always falls to the ground.

The mechanistic view is related to the “cause – consequence” mechanism; to the natural laws. In other words, it is related to the certainty and determinism. It is the “objective” world, visible; world of tangible; material world. Was there any influence of this view on economic thought? Can we find the coincidence between, for example, Newton and Smith: Newton’s invisible gravitation forces coordinate the planetary system while Smith’s invisible hand (competition) manages the economic system? The competition is understood as the gravitation force! Can we analyze the postulates of Keynesian economics from this point of view: when interest rate rises, employment is falling; inflation rate is going down if unemployment is growing, etc?

However, analysis of atomic and subatomic nucleus in the 20<sup>th</sup> century revealed the unexpected limits of classical ideas and thus introduced the need to make a radical revision of many, even very basic, notions.

“The notion of substance in subatomic physics is, for example, completely different from traditional ideas and material essence of classical physics. This is also true for the notions such as space and time, cause and consequence. These ideas are, however, the base of the prevailing view on the world, so their radical change started to change it.”<sup>12</sup>

The real world is much more complex than classical physics presented it. Quantum physics encountered that complexity (Heisenberg, Bore).<sup>13</sup>

But, what happened with the creation of quantum physics? Did we enter the world of uncertainty? Did we enter the world of chaos, the world of anarchy? Is there any similarity between the world of complex quantum physics and a global economy? The world of a global economy is full of interdependent variables. It is one dynamic system and it is not always predictable! In that world of complexity, a small change, even if it is very small, can cause great and inexpli-

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<sup>12</sup> Carga, Fritjof: „Tao of Physics“, Filip Višnjić, Beograd, 2006, pp.5

<sup>13</sup> Ibid.

cable changes on some other place (this is known as “butterfly” effect in chaos theory).

If this is true, can we use the term quantum economy as a synonym for a global economy, due to its similarity to quantum mechanics?

A new, holistic view on the world, which respects principles of chaos and uncertainty, provide a better framework to explain and understand a global economy.

## **6. Montenegro between a shock of globalization and a global economy**

Which way of development should Montenegro follow, if we have in mind all previously presented trends in our global economy? What is the vision Montenegro should develop, if we respect the reality of global megatrends?

Should we go along the path of economic freedom or we should accept a revived protectionist philosophy in Montenegro? Should we choose the way which strengthens business and adopts the belief that money is created only in business, or should we follow the belief that state is the money producer? Should we believe that money is earned on the market or wait for the money from donations, foreign help, foreign funds, loans, the World Bank, or European funds? What is more important for us: should we utilize the market or foreign help? What is important for our development: good quality products and services produced in Montenegro that can be sold abroad or selling political concepts from Montenegro to the world?

What does a global market valorize: investment into research and knowledge, or investment into politicians and bureaucracy? Should we respect private property or keep domination of state and party property?

Should we develop an open economy, or, as neo-protectionists advise us, a closed and controlled economy? What would be the adequate answer on globalization challenges: to open the economy, or as neo-protectionists advice us, to close the market and develop a **hedgehog-economy**? Are protectionists in shock because, on one side, they have no possibility to control flows of imports and exports in a borderless global economy, or, on the other, they fear that they do not have products and services good enough to offer them to the global market? The global economy threw them out of the saddle!

All of these questions should be analyzed in a context of the global economy! Those who understand that a global economy is reality and that, if we reject it, it is as useless as if we would plow the sea, promote one development concept of Montenegro. Those who think that the global economy does not exist, who are against globalization, have their concept, or at least they say so.

Here we come to the point that the role of the state and its organization is important. In our approach, the state should be much more economic then it

should be a political element within society. A global economy revokes national borders. The model of a nation-state, i.e. political state, assumes the existence of national borders. The national state losses power! A new force, a new power is being created: the power of a global economy,<sup>14</sup> i.e. the power of a (capital) market! It is the invisible power! It is the power without coercion! If you want, open the borders and create conditions for capital to come into the country and stay there! If you do not want to do so, capital will go somewhere else! If the investors go around the country, the country will be condemned to stay underdeveloped! This raises the question about the growth of budget consumption in Montenegro: is it a force that will attract capital? Does Montenegro need around 40.000 and more, people who get the salary from state budget?

We proposed the concept of a microstate, the concept of an economically efficient and pro-development oriented organization of the state, which would encourage the development of an open and knowledge-based society. We also offered an alternative to present political system in Montenegro – the introduction of a presidential system and gave several other solutions.<sup>15</sup>

The concept is trying to be in accordance with the vision of Montenegro included in global economic flows. But, those who have no knowledge or sense for principles of a global economy can hardly understand the concept of a microstate.

As our opponents discuss and analyze our concept in the context of a mechanistic paradigm and mechanical view on the world, the notion *micro* is understood as something unacceptable for tall people from Montenegro! But, if the strength lied in height and weight, we would have given the atomic bomb another name!

Let us ask ourselves: what dimensions of the state enable economic development - economic development of an open economy which is just one of many organic cells of a global economy? That is why our concept leans on a limited number of state functions on one side, and strengthening the power of the state in those areas, on the other.<sup>16</sup>

It is the concept for the state which has the power to implement the law. It is the concept which makes the difference between the scope of state activities and the strength and power of state institutions. We promote big power of the state in some areas, but it does not mean a wide scope of state activities. How to have powerful and strong authorities through minimal state?

The new economic thought, which is born in Montenegro, will probably influence the presently dominant way of thinking. From the very beginning of transition we understood that many problems we live with are new problems and

<sup>14</sup> Beck, Ulrich: „Power in Global Age“, Školska knjiga, Zagreb, 2006

<sup>15</sup> Vukotić, Veselin: „Montenegro – microstate“, International Conference „Policies for Viable Microstates“, ISSP, Podgorica, 2003

<sup>16</sup> Fukuyama, Frensis: „State Building“, Filip Višnjić, Beograd, 2002

cannot be solved using recipes of old economic theories. There are no recipes, especially in a contemporary world of complexity and interdependence; the world of new technology and knowledge; in the world which replaces the old paradigm based on **physics** with **the new paradigm** based on biology; in the world which experiences transition from the law of physics ruled reality, into world of uncertain and undetermined evolution; in the time when new economic theory is being developed. All of this requires a new approach to economics, on both a theoretical and practical level! It might be that the economists are the only professionals in Montenegro that have followed this path since transition has started. Maybe that is the reason we, the economists, bear the strongest criticism.

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