

DIGITALES ARCHIV

ZBW – Leibniz-Informationszentrum Wirtschaft
ZBW – Leibniz Information Centre for Economics

Primorac, Zeljka (Ed.); Bussoli, Candida (Ed.); Recker, Nicholas (Ed.)

Conference Paper

Economic and social development : 16th International Scientific Conference on Economic and Social Development - "The Legal Challenges of Modern World" ; book of proceedings ; Split, 1-2 September 2016

Provided in Cooperation with:

Varazdin Development and Entrepreneurship Agency

Reference: (2016). Economic and social development : 16th International Scientific Conference on Economic and Social Development - "The Legal Challenges of Modern World" ; book of proceedings ; Split, 1-2 September 2016. Varazdin, Croatia : Varazdin Development and Entrepreneurship Agency.

This Version is available at:
<http://hdl.handle.net/11159/504>

Kontakt/Contact

ZBW – Leibniz-Informationszentrum Wirtschaft/Leibniz Information Centre for Economics
Düsternbrooker Weg 120
24105 Kiel (Germany)
E-Mail: [rights\[at\]zbw.eu](mailto:rights[at]zbw.eu)
<https://www.zbw.eu/econis-archiv/>

Standard-Nutzungsbedingungen:

Dieses Dokument darf zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden. Sie dürfen dieses Dokument nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, aufführen, vertreiben oder anderweitig nutzen. Sofern für das Dokument eine Open-Content-Lizenz verwendet wurde, so gelten abweichend von diesen Nutzungsbedingungen die in der Lizenz gewährten Nutzungsrechte.

<https://zbw.eu/econis-archiv/terms-of-use>

Terms of use:

This document may be saved and copied for your personal and scholarly purposes. You are not to copy it for public or commercial purposes, to exhibit the document in public, to perform, distribute or otherwise use the document in public. If the document is made available under a Creative Commons Licence you may exercise further usage rights as specified in the licence.

Varazdin Development and Entrepreneurship Agency
in cooperation with
Faculty of Law, University of Split and University North

Economic and Social Development

16th International Scientific Conference on Economic and Social Development –
“The Legal Challenges of Modern World”



Editors:

Zeljka Primorac, Candida Bussoli and Nicholas Recker

Book of Proceedings

ISSN 1849-7535



9 771849 753006 >

Split, 1-2 September 2016

Varazdin Development and Entrepreneurship Agency
in cooperation with
Faculty of Law, University of Split and University North

Editors:
Zeljka Primorac, Candida Bussoli and Nicholas Recker

Economic and Social Development

16th International Scientific Conference on Economic and Social Development –
“The Legal Challenges of Modern World”



Book of Proceedings

Split, 1-2 September 2016

Title ■ Economic and Social Development (Book of Proceedings), 16th International Scientific Conference on Economic and Social Development – “Legal Challenges of Modern World”

Editors ■ Zeljka Primorac, Candida Bussoli and Nicholas Recker

Scientific Committee ■ Marijan Cingula, University of Zagreb, Croatia (President); Ayuba A. Aminu, University of Maiduguri, Maiduguri, Nigeria; Gouri Sankar Bandyopadhyay, The University of Burdwan, Rajbati Bardhaman, India; Haimanti Banerji, Indian Institute of Technology, Kharagpur, India; Alla Bobyleva, The Lomonosov Moscow State University, Russia; Leonid K. Bobrov, State University of Economics and Management, Novosibirsk, Russia; Rado Bohinc, University of Ljubljana, Slovenia; Ratko Brnabic, University of Split, Croatia; Adnan Celik, Selcuk University - Konya, Turkey; Angelo Maia Cister, Federal University of Rio de Janeiro, Brasil; Mirela Cristea, University of Craiova, Romania; Sreten Cuzovic, University of Nis, Serbia; Oguz Demir, Istanbul Commerce University, Turkey; T.S. Devaraja, University of Mysore, India; Alba Dumi, Vlora University, Vlore, Albania; Ksenija Dumcic, University of Zagreb, Croatia; Galina Pavlovna Gagarinskaya, Samara State University, Russia; Fran Galetic, Zagreb University, Croatia; Mirjana Gligoric, Faculty of Economics, Belgrade University, Serbia; Mehmet Emre Gorgulu, Afyon Kocatepe University, Turkey; Hana Horak, University of Zagreb, Croatia; Anica Hunjet, University North, Koprivnica, Croatia; Oxana Ivanova, Ulyanovsk State University, Ulyanovsk, Russia; Irena Jankovic, Faculty of Economics, Belgrade University, Serbia; Lara Jelenc, University of Rijeka, Croatia; Myrl Jones, Radford University, USA; Ana Jovancai Stakic, Univerzitet Dzon Nezbit, Belgrade, Serbia; Gorazd Justinek, Graduate School of Government and European Studies, Slovenia; Hacer Simay Karaalp, Pamukkale University, Turkey; Dafna Kariv, The College of Management Academic Studies, Rishon Le Zion, Israel; Salih Katircioglu, Eastern Mediterranean University, Northern Cyprus, Turkey; Hilal Yildirim Keser, Uludag University, Bursa, Turkey; Sophia Khalimova, Institute of Economics and Industrial Engineering of Siberian Branch of Russian Academy of Science, Novosibirsk, Russia; Marina Klacmer Calopa, University of Zagreb, Croatia; Mirko Klaric, University of Split, Croatia; Vladimir Kovsca, University of Zagreb, Croatia; Goran Kozina, University North, Koprivnica, Croatia; Lejla Lazovic Pita, School of Economics and Business, University of Sarajevo, Bosnia and Herzegovina; Robert Lewis, Les Roches Gruyère University of Applied Sciences, Bulle, Switzerland; Ladislav Lukas, Univ. of West Bohemia, Faculty of Economics, Czech Republic; Pascal Marty, University of La Rochelle, France; Vaidotas Matutis, Vilnius University, Lithuania; Marjana Merkac Skok, GEA College of Entrepreneurship, Ljubljana, Slovenia; Daniel Francois Meyer, North West University, South Africa; Marin Milkovic, Rector, University North, Koprivnica, Croatia; Gratiela Georgiana Noja, West University of Timisoara, Romania; Zsuzsanna Novak, Corvinus University of Budapest, Hungary; Mislav Ante Omazic, University of Zagreb, Croatia; Matko Pajcic, University of Split, Croatia; Vera Palea, Università degli Studi di Torino, Italy; Dusko Pavlovic, President DIU Libertas International University, Zagreb, Croatia; Zeljka Primorac, University of Split, Croatia; Miroslaw Przygoda, University of Warsaw, Poland; Nicholas Recker, Metropolitan State University of Denver, USA; Zeljko Radic, University of Split, Croatia; Kerry Redican, Virginia Tech, Blacksburg, USA; Robert Rybnicek, University of Graz, Austria; Katarzyna Szymanska, The State Higher School of Vocational Education in Ciechanow, Poland; Ilaria Tutore, University of Naples Parthenope, Italy; Mladen Vedris, University of Zagreb, Croatia; Ilko Vrankic, University of Zagreb, Croatia; Rebeka Danijela Vlahov, University of Zagreb; Mladen Vukcevic, President of the Judicial Council of Montenegro; Thomas Will, Agnes Scott College, USA; Li Yongqiang, Victoria University, Australia; Peter Zabielskis, University of Macau, China; Tao Zeng, Wilfrid Laurier University, Waterloo, Canada; Snezana Zivkovic, University of Nis, Serbia.

Review Committee ■ Marina Klacmer Calopa (President); Ana Aleksic; Ayuba Aminu; Mihovil Andjelinovic; Josip Arneric; Lidija Bagaric; Tomislav Bakovic; Sanja Blazevic; Leonid Bobrov; Ruzica Brecic; Ratko Brnabic; Anita Ceh Casni; Mirela Cristea; Oguz Demir; Stjepan Dvorski; Robert Fabac; Ivica Filipovic; Fran Galetic; Mirjana Gligoric; Tomislav Globan; Anita Goltnik Urnaut; Tomislav Herceg; Irena Jankovic; Dafna Kariv; Oliver Kesar; Hilal Yildirim Keser; Mirko Klaric; Tatjana Kovac; Vladimir Kovsca; Petar Kurecic; Angelo Maia Cister; Vaidotas Matutis; Marjana Merkac Skok; Daniel Francois Meyer; Natanya Meyer; Josip Mikulic; Ljubica Milanovic Glavan; Guenter Mueller; Ivana Nacinovic Braje; Gratiela Georgiana Noja; Zsuzsanna Novak; Alka Obadic; Claudia Ogorean; Matko Pajcic; Igor Pihir; Najla Podrug; Vojko Potocan; Zeljka Primorac; Zeljko Radic; Sanda Renko; Souhaila Said; Armando Javier Sanchez Diaz; Tomislav Sekur; Lorena Skufflic; Mirko Smoljic; Petar Soric; Mario Spremic; Ana Jovancai Stakic; Matjaz Stor; Lejla Tijanic; Daniel Tomic; Boris Tusek; Mladen Vedris; Rebeka Daniela Vlahov; Ilko Vrankic; Thomas Will; Zoran Wittine; Tao Zeng; Snezana Zivkovic; Berislav Zmuk.

Organizing Committee ■ Zeljka Primorac (President); Domagoj Cingula (Co-President); Hana Horak; Marina Klacmer Calopa; Erlino Koscak; Miroslaw Przygoda; Rebeka Danijela Vlahov.

Publishing Editor ■ Domagoj Cingula

Publisher ■ **Design** ■ **Print** ■ Varazdin Development and Entrepreneurship Agency, Varazdin, Croatia Faculty of Law, University of Split, Croatia
University North, Koprivnica, Croatia

Printing ■ Online Edition

ISSN 1849-7535

The Book is open access and double-blind peer reviewed.

Our Books are indexed and abstracted by ProQuest, EconBIZ and CPCI (WoS) databases and available for download in a PDF format from the Economic and Social Development Conference website:

<http://www.esd-conference.com>

© 2016 Varazdin Development and Entrepreneurship Agency, Varazdin, Croatia; Faculty of Law, University of Split, Croatia; University North, Koprivnica, Croatia.

All rights reserved. Authors are responsible for the linguistic and technical accuracy of their contributions

CONTENTS

The Legal Challenges of Modern World

Damir Primorac, Maja Buhovac	CRIMINAL JUSTICE ASPECTS OF CAUSING FALSE BANKRUPTCY	2
Ivana Markovinovic Zunko	APPLICABLE LAW FOR CONSUMER CONTRACTS ACCORDING TO THE REGULATION (EC) NO 593/2008 ON THE LAW APPLICABLE TO CONTRACTUAL OBLIGATIONS (ROME I)	113
Dario Klasic	LEGAL ASPECTS OF PACKAGE TRAVEL CONTRACTS	23
Davor Muhvic	FAIR AND EQUITABLE TREATMENT STANDARD IN INVESTMENT TREATIES AND GENERAL INTERNATIONAL LAW	33
Ines Medic	LEX CONTRACTUS AND OVERRIDING MANDATORY RULES. WHAT CAN WE LEARN FROM THE CJEU CASE LAW?	43
Ivan Vukusic	CRIMINAL PROTECTION OF ENVIRONMENT - ORGANIZED CRIME AND EFFECTIVE REGRET	53
Katarina Knol Radoja	THE EFFECTIVENESS OF CIVIL PROTECTION OF THE ENVIRONMENT.....	64
Nikol Ziha	CROATIAN PROPERTY LAW BETWEEN TRADITION AND TRANSITION: A REVIVAL OF THE ROMAN PRINCIPLE <i>SUPERFICIES SOLO CEDIT</i>	73
Jelena Kasap	THE INFLUENCE OF LEGAL AND ECONOMIC CONDITIONS ON THE APPEARANCE OF THE INSTITUTE OF <i>PRECARIUM</i> IN MODERN REGULATION OF CIVIL-LAW	84
Zeljko Mirjanic, Jasna Cosabic	PROTECTION OF WHISTLE-BLOWER'S EMPLOYMENT STATUS	97
Zvonimir Jelinic	HOW TO ENSURE IMPARTIALITY OF ARBITRATORS?	108
Ivana Radic	SOCIAL-CRIMINAL PREVENTION PROGRAMMES FOR JUVENILES	117

Ratko Brnabic, Mario Ivancev	PECULIARITIES OF THE FORWARDING CONTRACT	131
Tunjica Petrusevic	THE RELATION OF HUMAN RIGHTS AND MARKET FREEDOMS IN CJEU CASE LAW	142
Ratko Brnabic	PRODUCTION SHARING CONTRACTS IN THE OIL AND GAS INDUSTRY	151
Slavko Simundic, Danijel Barbaric, Sinisa Franjic	SAFETY OF ELECTRONIC COMMUNICATION AND COMPUTER CRIME	161
Strahinja D. Miljkovic, Vanda Bozic	CRIMINAL RESPONSIBILITY OF LEGAL PERSONS IN THE LEGISLATION REPUBLIC OF SERBIA AND THE REPUBLIC OF CROATIA	170
Susana Sousa Machado	THE DYNAMICS BETWEEN RELIGIOUS FREEDOM AND EMPLOYMENT CONTRACT: A JURIDICAL CHRONICLE	185
Marija Boban	DIGITAL SINGLE MARKET AND EU DATA PROTECTION REFORM WITH REGARD TO THE PROCESSING OF PERSONAL DATA AS THE CHALLENGE OF THE MODERN WORLD	191
Visnja Lachner	LEGAL ASPECTS AND PROBLEMS OF ENVIRONMENTAL PROTECTION IN LATE 19th AND EARLY 20th CENTURY IN TOWN OSIJEK	202
Marko Dimitrijevic	LEGAL REGULATION OF TAX INCENTIVES FOR INVESTMENTS IN SERBIA	210
Paula Poretti	COUNCIL REGULATION (EC) NO 1206/2001 OF 28 MAY 2001 ON COOPERATION BETWEEN THE COURTS OF THE MEMBER STATES IN THE TAKING OF EVIDENCE IN CIVIL OR COMMERCIAL MATTERS AS A GUARANTEE OF THE RIGHT TO EFFECTIVE JUDICIAL PROTECTION	219
Merica Pletikotic, Majda Tafra Vlahovic	THE PUBLIC AND INTERESTED PUBLIC IN ENVIRONMENTAL PRACTICES	227
Lucija Sokanovic	FRAUD IN ECONOMIC BUSINESS OPERATIONS IN CROATIA: PRACTICAL PROBLEMS AND LEGAL SOLUTIONS	235

Miro Gardas, Ana Gavran	CONFISCATION OF THE PROPERTY OF THE JEWS IN OSIJEK AFTER WORLD WAR II	244
Ivana Kunda	JURISDICTION AND APPLICABLE LAW IN CROWDFUNDING.....	253
Ivana Markovinovic Zunko	IMPLEMENTATION OF THE ODR (ONLINE DISPUTE RESOLUTION) PLATFORM ACCORDING TO THE REGULATION (EU) NO 524/2013 ON ONLINE DISPUTE RESOLUTION FOR CONSUMER DISPUTES	264
Dejan Bodul	BANKRUPTCY POLICY, STATE ATTITUDE TOWARDS BANKRUPTCY AND STATE INTERVENTIONISM	273
Maja Proso	CIVIL PROTECTION OF THE HUMAN RIGHT TO A SAFE AND HEALTHY ENVIRONMENT.....	282
Dunja Duic	EU GLOBAL STRATEGY ON FOREIGN AND SECURITY POLICY AND THE ROLE OF HIGH REPRESENTATIVE OF THE UNION FOR FOREIGN AFFAIRS AND SECURITY.....	289
Zeljka Primorac	EFFECTIVE STRATEGIES FOR DETECTING FRAUDULENT CLAIMS IN MOTOR THIRD PARTY LIABILITY INSURANCE	299
Mara Barun	LEGAL EFFECTS OF THE APPLICATION OF EU DIRECTIVE 2015/2302 ON PACKAGE TRAVEL AND LINKED TRAVEL ARRANGEMENTS	309
Dinka Sago	CROSS – BORDER PRACTICE OF LAW	319
Dominika Bochanczyk - Kupka	THE MEASURES OF INTELLECTUAL PROPERTY RIGHTS PROTECTION.....	329
Biljana Cincurak Erceg	EUROPEAN AIMS AND CROATIAN LEGAL SOLUTIONS FOR THE PROTECTION OF THE ADRIATIC SEA FROM POLLUTION.....	336
Blanka Ivancic - Kacer	CROATIAN LEGISLATION AND PRACTICE - THE EFFECTS ON INVESTMENT PROCESSES	347
Aleksandra Vasilj	IMPLEMENTATION OF THE RAILWAY SYSTEM OF THE REPUBLIC OF CROATIA IN THE EU RAILWAY SYSTEM.....	354

Damir Primorac	ACTUAL QUESTIONS REGARDING THE CRIMINAL OFFENCE OF ABUSE OF TRUST IN BUSINESS ACTIVITY	363
----------------	--	-----

Anton Petricevic	THE PROTECTION OF MENTAL HEALTH IN THE WORKPLACE	372
------------------	--	-----

Ana Radina	FOSTER CARE AS THE FORM OF ALTERNATIVE CARE FOR CHILDREN.....	380
------------	---	-----

Aleksandar Erceg	IS ABSENCE OF REGULATION AND FRANCHISING LAW OBSTACLE FOR FRANCHISING EXPANSION IN CROATIA – COMPARISON WITH OTHER COUNTRIES	392
------------------	--	-----

Economic and Social Development

Anetta Wasniewska, Katarzyna Olszewska	DETERMINANTS OF THE DEMAND FOR HIGHER EDUCATION SERVICES IN SELECTED EU COUNTRIES	403
--	---	-----

Abdelatif Kerzabi	PUBLIC EXPENDITURE AND ECONOMIC CRISIS IN ALGERIA	413
-------------------	---	-----

Agata Mesjasz-Lech	SECTOR VARIATION IN THE USE OF CRM SYSTEMS FOR ENTERPRISE LOGISTICS.....	420
--------------------	--	-----

Agnieszka Leszczynska	CONCEPTUALIZATION OF GREEN HUMAN RESOURCE MANAGEMENT	431
-----------------------	--	-----

Aneta Włodarczyk	FACTORS AFFECTING ROAD TRANSPORT CARBON DIOXIDE EMISSIONS IN THE VISEGRAD GROUP: A PANEL COINTEGRATION APPROACH	442
------------------	---	-----

Daniela Majercakova, Lucia Kocisova	IMPACT INVESTING – OPPORTUNITY FOR CREATIVE INVESTMENT.....	452
-------------------------------------	---	-----

Dunja Skalamera – Alilovic, Ivan Rubinic	THE TAX SYSTEM AS A GENERATOR OF ECONOMIC INEQUALITY IN CROATIA	459
--	---	-----

Nikolaeva Ekaterina, Pletnev Dmitri	ANALYSIS OF THE PRACTICE OF LEADERS OF SUCCESS IN THE RUSSIAN MEDIUM-SIZED BUSINESSES: AGRICULTURE VS INDUSTRIAL PRODUCTION	478
Aleksandra Grobelna, Anna Tokarz - Kocik	“WORK–LIFE BALANCE” AND ITS IMPORTANCE FOR THE WORK PROCESS IN THE HOSPITALITY INDUSTRY. A PERSPECTIVE OF GENERATION Y EMPLOYEES.....	489
Eva Rievajova, Roman Klimko	THE LABOUR MARKET IN THE SLOVAK REPUBLIC – STRUCTURAL PROBLEMS	498
Victor Barhatov, Irina Belova	INFRASTRUCTURE OF STATE SUPPORT OF SMALL AND MEDIUM-SIZED BUSINESS IN RUSSIA	508
Izabela Konieczna	IMPLEMENTED ACTIVITIES IN THE SPHERE OF DISTRIBUTION – AN EXAMPLE OF DAIRY COOPERATIVES FROM SWIETOKRZYSKIE PROVINCE	518
Flavia Guerra	GOVERNANCE CHALLENGES AND SOLUTIONS FOR OFFSHORE RENEWABLE ENERGY	529
Florije Miftari	FOREIGN DIRECT INVESTMENTS AND FISCAL STIMULATION IN BALLKANS: EVIDENCE FROM ALBANIA, KOSOVO AND MACEDONIA	541
Joanna Kizielewicz, Katarzyna Skrzyszewska	THE ROLE OF NON-GOVERNMENTAL ORGANIZATIONS IN THE FIELD OF SUSTAINABLE DEVELOPMENT OF CRUISE SHIP TOURISM	549
Gabor Batho	THE IMPORTANCE OF THE HISTORICAL ASPECT IN PUBLIC ADMINISTRATION REFORMS ON THE EXAMPLES OF HUNGARY	558
Katarzyna Czerewacz - Filipowicz	NEW ECONOMIC DIMENSION OF THE EURASIAN ECONOMIC UNION.....	567
Katarzyna Skrzyszewska, Ivona Milic Beran	IS IGNORANCE OF POTENTIAL CAREER PATHS A DISINCENTIVE FOR STARTING A CAREER IN THE MARITIME SECTORS?	577
Peter Sika	THE RELATIONSHIP OF THE MINIMUM WAGE AND UNEMPLOYMENT IN THE SLOVAK REPUBLIC	587

Luka Mladineo, Toni Susak	DETERMINANTS OF EFFECTIVE TAX RATE.....	597
M. Ozan Saray	THE INFLUENCE OF HIGHER EDUCATION ON PRODUCTIVITY: AN ANALYSIS OF TURKEY AND THE EUROPEAN UNION COUNTRIES.....	607
Kosjenka Dumancic	POSTED WORKERS IN THE LIGHT OF THE PRINCIPLE “SAME PAY FOR THE SAME WORK AT THE SAME PLACE”	616
Maria Piotrowska	THE ELECTORAL EFFECTS OF HOUSEHOLD ECONOMIC SECURITY IN POLAND.....	624
Brigita Krizanec, Damir Dobrinic	CONSUMER PERCEPTION OF VIRAL MARKETING – EXAMPLE OF CROATIAN MARKET	634
Valentina Vuckovic, Martina Basarac Sertic, Ruzica Simic Banovic	RELAXED BUSINESS REGULATIONS AS A PUSH FACTOR FOR THE ENTREPRENEURIAL ACTIVITY IN THE EUROPEAN UNION?	642
Verheyen Wouter	E-COMMERCE DELIVERIES 2.0: TOWARDS A SUSTAINABLE E-COMMERCE.....	653
Milaim Berisha	CONCESSION PRACTICES OF PUBLIC ENTERPRISES IN KOSOVO	662
Jelena Vidovic, Jasenka Bubic	SMEs IN EU AND EMPLOYMENT – IS THERE A CONNECTION?	669
Vlasta Roska	REINVESTED PROFITS AS THE ENGINE OF GROWTH OF COMPANIES ON THE STOCK EXCHANGE IN CROATIA	679
Wioletta Nowak	THE EUROPEAN UNION'S TRADE WITH AFRICA AND LATIN AMERICA	689
Yulia Bystraya, Svetlana Stash, Tatiana Makarenaya	ENTERPRISE ARCHITECTURE: THE CONFLICTS RESOLUTION INSTRUMENT OF BUSINESS MANAGEMENT	697
Natasa Vrh	WHAT DRIVES THE DIFFERENCE IN DOMESTIC VALUE ADDED OF EU EXPORTS?	704

Miroslaw Przygoda	TURKEY AS THE MOST IMPORTANT FACTOR IN STABILISING THE REGION	714
Robert Svetlacic, Dinko Primorac, Goran Kozina	SUSTAINABLE DEVELOPMENT AS A STRATEGIC GUIDING PRINCIPLE.....	732
Tatiana-Camelia Dogaru	THE EFFECT OF PUBLIC ADMINISTRATION REFORMS UNDER THE POST-NEW PUBLIC MANAGEMENT PARADIGM.....	743
Tatiana Leshchenko, Irina Sokolova, Liubov Teplova	THE INEVITABILITY OF THE ALIENATION OF COMMUNICATION IN THE ERA OF GLOBALISATION	753
Tinatin Akhvlediani	IMPACT OF ICT CAPITAL SERVICES ON PRODUCTIVITY GROWTH ACROSS CENTRAL AND EASTERN EUROPEAN COUNTIRES – WHERE HAVE ALL DIGITAL BENEFITS GONE?	762
Davor Mance, Mario Pecaric	RELATIONSHIP BETWEEN PROPERTY RIGHTS ENFORCEMENT AND CORRUPTION – PANEL ANALYSIS OF EU COUNTRIES	771
Jan Kowalik	ASSUMPTIONS OF TRANSPORT POLICY IN POLAND IN THE SUSTAINABLE DEVELOPMENT ASPECT	779
Ibrahim Yasar Gok	RESERVE OPTION MECHANISM: THE NEW MONETARY POLICY TOOL OF CBRT AND ITS EFFECT ON FX RATE VOLATILITY.....	789
Dubravka Pekanov Starcevic, Josipa Mijoc, Matea Culjak	CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE: THE CASE OF CROATIAN COMPANIES	796
Candida Bussoli	TRADE CREDIT FINANCING: SUBSTITUTION AND MATCHING EFFECT FOR ITALIAN SMEs.....	806
Arianit Jakupi, Hasan Jakupi, Indrit Baholli	ANTIBIOTIC CONSUMPTION IN A TURBULENT ENVIRONMENT	809
Izabela Konieczna	THE VALIDITY OF THE FEATURES OF THE OFFER FOR CLIENTS IN THE SPHERE OF SALES MARKETING – THE ASSESSMENT OF DAIRY COOPERATIVES FROM ŚWIĘTOKRZYSKIE PROVINCE.....	817

Jarmila Vidova	INVESTMENTS FOR THE EFFICIENT USE OF RAW MATERIALS	
.....		827
Jasenska Bubic, Toni Susak	DISTINCTIVE FEATURES OF COMPANIES WITH OPTIMAL CAPITAL STRUCTURE.....	834

The Legal Challenges of Modern World

CRIMINAL JUSTICE ASPECTS OF CAUSING FALSE BANKRUPTCY

Damir Primorac

Faculty of Law of the University of Mostar
damir.primorac@primorac-partners.com

Maja Buhovac

PhD candidate
Faculty of Law of the University of Mostar, Bosnia and
Herzegovina majabuhovac@yahoo.com.hr

ABSTRACT

Regulating of bankruptcy criminal offenses is based on a fact that there is a high dark number conditioned by structure of the very perpetrators. The bankruptcy criminal offenses are classic delicta propria and the perpetrators are either the responsible persons within a legal person or the debtors - individuals over which the bankruptcy proceedings may be instituted based on provisions of the Bankruptcy Act. However, in case of criminal offense of false bankruptcy the problem appears at the determining of a circle of persons being responsible for commitment of that offense, which is contributed to by the interpretation of a legal system for this criminal offense. The bankruptcy as a legally defined procedure that is conducted over the debtor's estate for the purpose of making a settlement to creditors indicates at the importance of the protection of creditors but also of adjudicated bankrupts as well as the protection of general public interests with the goal to prevent the commitment of bankruptcy criminal offenses. The aim of false bankruptcy regulating is to point out to the responsibility of persons which appear before and during the bankruptcy proceedings since the commitment of this offense requires a direct intention as a severe aspect of guilt. The determination of criminal responsibility of perpetrator is based, inter alia, on basic principles of obligatory commercial relations, principle of due care and diligence of a prudent businessman and principle of good faith. A specific feature of this criminal offense is that the causing of false bankruptcy is most often carried out over the corporate entities which were successfully running their business until the moment of committing the respective offense. The criminal offenses, committed in a privatisation process of public property, are committed very often but they are rarely prosecuted. For this reason the aim of this paper is to indicate at the importance of consistent implementation of legal provisions in the work of bankruptcy estate managers and registrars in bankruptcy, execution of the control of business activities of corporate entities and timely actions to be taken by the competent prosecutor's office in cases when the bankruptcy proceedings are suspended due to the lacking bankruptcy estate. Proving the direct intention of responsible persons is very difficult in practice, relativizing the determination of their criminal responsibility. With the aim of preventing the commitment of bankruptcy criminal offenses it is very important to have a concept of Actio Pauliana which is used for refuting the debtor's legal activities which impair the estate of the adjudicated bankrupt and violate the principle of equality of creditors.

Keywords: *criminal responsibility, false bankruptcy, Actio Pauliana, bankruptcy, bankruptcy criminal offenses.*

1. INTRODUCTION

Radical changes in political and economic system have brought to the series of changes in the economy and in a position of corporate entities, whereas a special importance has been placed with the privatisation as a part of entire transition process (Stanojević, Hamidžović, p. 677). In

criminal legislation of B&H the bankruptcy criminal offenses are differently positioned. So, in the Criminal Code of the Federation of Bosnia and Herzegovina (in the text hereinafter: the CC FB&H) the bankruptcy criminal offenses are described in chapter XXII Criminal Offenses against Economy, Business Operations and Safety of Payment System, i.e.: Art. 243. Causing Bankruptcy, Art. 244. False Bankruptcy, Art. 245. Abuse in Bankruptcy Proceedings and Art. 246. Damaging Creditors. Related criminal offenses from this chapter are the following: Art. 242. Business Mismanagement, Art. 247. Abusing Power in Business Operations and Art. 248. Abuse in Privatisation Process. In the same way these offenses are regulated in the Criminal Code of Brčko District of B&H. In the Criminal Code of the Republic of Srpska, the bankruptcy criminal offenses are described in chapter XXIV Criminal Offenses against Economy and Payment System, i.e.: Art. 258. Abuse of False Bankruptcy, Art. 259. Causing Bankruptcy by Mismanagement, Art. 261. Abuse in Bankruptcy Proceedings or in Forced Settlement Procedure and the Art. 262. Damaging or Favouring the Creditors. In the Republic of Croatia the bankruptcy criminal offenses are described in chapter XXIV of the Criminal Code (in the text hereinafter: CC of RC) under the title: Criminal Offenses against Economy: Art. 249. Causing Bankruptcy, Art. 250. Favouring the Creditors, Art. 251. Bribe Accepting and Giving in the Bankruptcy Proceedings. A group protection facility of these criminal offenses is economic system and economic performance. A state has a special interest to ensure a criminal justice protection in this field with regard to the expansion and existence of a series of conditions acting as criminogenic factors for committing these offenses. In a former state (SFRY) these offenses did not exist because the bankruptcy was regulated in a way that beside the settlement to creditors and the termination of the existence of adjudicated bankrupt, an organisation of associated labour was deleted with the termination of the bankruptcy proceedings from the register of corporate organisations (Velimirović, 1980, p. 281). The conditions that are favourable to the corruption appear in cases when the public property is impaired by accumulated liabilities with the aim of incorrect presentation of value of that property during the sale process together with a concurrent providing for a privileged position for individual legal entities, which is most often provided by responsible persons of companies, corporate entities to be privatised. For this reason, it is justified to sanction such conduct and to prescribe it as a criminal offense. A benefit from harsh punishment of bankruptcy criminal offenses is double: the economic turnover would exclude and mark the unfair participants which disturb the stability and increase the market risk (and therefore also the money price), whereas the bringing of businessmen under discipline would increase the outlook for successful restructurings in the bankruptcy after the timely instituting of bankruptcy (Sajter, 2008, p. 70). The bankruptcy proceedings are conditioned by historical development of a company and a state, depending on national culture and geographical position of certain corporate entity. Those differences have conditioned the existence of a codification in this field. The most important one is the European Convention on Certain International Aspects of Bankruptcy of 5 June 1990), which was adopted by the member states of the Council of Europe. This Convention codified the basic principles and rules of conducting the bankruptcy proceedings, which aimed at having a better functioning of internal market of the European Union. The Convention defined certain terms, among which there is also the term „insolvency proceedings“ as a type of general execution over the estate of adjudicated bankrupt, encompassing the procedure of disposal, taking away, collecting and division of the estate of adjudicated bankrupt on the territory of the European Union to his/her creditors. This Convention is applied to all types of bankruptcy proceedings. In criminal legislation a key importance is given to the Criminal Law Convention on Corruption of the Council of Europe, which prescribes some forms of criminal conduct that are present also in bankruptcy criminal offenses.

Cesare Beccaria also states that it is about severe forms of criminal conduct: „It is, however, necessary to distinguish between the fraudulent and the honest bankrupt. The fraudulent bankrupt should be punished in the same manner with him who adulterates the coin; for, to falsify a piece of coin, which is a pledge of the mutual obligations between citizens, is not a greater crime than to violate the obligations themselves. But the bankrupt who, after a strict examination, has proved before proper judges, that either the fraud or losses of others, or misfortunes unavoidable by human prudence, have stripped him of his substance, upon what barbarous pretence is he thrown into prison, and thus deprived of the only remaining good, the melancholy enjoyment of mere liberty?” (Beccaria, 1984, p. 119)

2. IMPORTANCE OF A CONCEPT OF BANKRUPTCY

The bankruptcy is a legally defined procedure that is conducted over the property of the debtors for the purpose of settlement to creditors. In addition, the goal of the bankruptcy is to enable the business entities with poor business results to participate further in economic performance (market competition) in a way to prevent the generating of business losses, resp. in doing so to disable the damage to be inflicted towards the business entities, which they have been running their business with. With the instituting of bankruptcy proceedings it is endeavoured to protect creditors from insolvent debtor but also to protect insolvent debtor from early settlement to his/her creditors (Rizvanović, 2013, p. 179). What connects this concept from criminal justice aspect and criminal law is a control of business activities of corporate entities which is prescribed as a liability in the Article 69., par. 3. of the Bankruptcy Proceedings Act of the

FB&H (in the text hereinafter: BPA FB&H) which envisages as follows: „Prior to the starting of bankruptcy proceedings it is necessary to carry out the control of business activities as well as the control of implemented privatisation for the companies that have been privatised or that have been under the privatisation process“. Having in mind the phases of bankruptcy proceedings, a role of an interim bankruptcy estate manager is prominent in a phase of a previous procedure, who is obliged to insure the estate of adjudicated bankrupt because if there is no estate, then there is no responsibility either. The interim bankruptcy estate manager is also obliged according to the Art. 16., par. 2. of the BPA FB&H to investigate whether the estate of adjudicated bankrupt shall cover the costs of the proceedings and whether there is a reason for starting the bankruptcy proceedings and to submit a report to the court about his/her findings. We may find a connection with criminal law also in the Art. 48., par. 4. of the BPA FB&H which regulates that the copy of a decision on starting the bankruptcy proceedings is to be delivered to the competent prosecutor's office also in the case when the bankruptcy proceedings are suspended due to the lacking bankruptcy estate. The importance of the bankruptcy is reflected also by introduction of a concept of reorganisation, i.e. rehabilitation of adjudicated bankrupt instead of the concept of forced settlement in the bankruptcy proceedings aiming at business continuation (under special supervision) (Rizvanović, 2013, p.187-193). As it is also pointed out by a renowned law expert in the field of bankruptcy law, the reorganisation has a functional priority over bankruptcy (Dika, 1998, p. 6).

2.1. Bankruptcy reasons and bankruptcy estate

According to our law, the bankruptcy reasons are the insolvency (inability to pay) of adjudicated bankrupt and the threatening insolvency. According to the comparative law, an excessive indebtedness may also be the reason for instituting the bankruptcy proceedings. The insolvency (Latin: insolvent- the one who is without means of payment) is the actual and durable inability to settle the matured cash liabilities. According to our law, it is believed that the adjudicated bankrupt is insolvent if he/she has not been able for incessant duration of 30

days (in the Republic of Croatia (in the text hereinafter: RC) for more than 60 days) to pay the matured cash liabilities to all creditors. For the purpose of comparison, in the USA and in Great Britain the debtor does not have to be insolvent to have the bankruptcy proceedings started (Sajter, 2007, p.41). In B&H (both state-entities) the insolvency is a general and main reason for instituting the bankruptcy proceedings. The threatening (expected, forthcoming) insolvency of the adjudicated bankrupt exists if the adjudicated bankrupt shall not be able, as anticipated, to settle the receivables to their entirety at the time of their maturity towards all creditors within a legally defined time period. In the RC the threatening inability to pay exists if the adjudicated bankrupt shall not be able, as anticipated, to meet his/her existing liabilities to their entirety at the time of their maturity. In criminal proceedings the court shall examine for the sake of determining the features of criminal offense of false bankruptcy (in the RC causing of bankruptcy) the debtor's matured liabilities as well as the volume and the time of maturity of the liabilities not yet matured (Pavlović, 2013, p. 645). A situation, when the debtor's property is not enough for debt settlement, is determined as the excessive indebtedness. In the sense of structure, the excessive indebtedness represents a relation in which the assets are lower than the liabilities. The excessive indebtedness exists as the bankruptcy reason in the Bankruptcy Act in the RC, while in B&H it is regulated in Brčko District (Rizvanović, 2013, p. 183-184). Pursuant to the Art. 7., par. 2. of the Bankruptcy Act of the RC it shall not be deemed that the debtor is excessively indebted if it may be reasonably assumed - according to the case circumstances (development programme, available sources of funds, type of property, obtained insurance, etc.) - that the debtor – legal person shall duly meet by business continuation their liabilities upon maturity and if the person, who is a solidary accountable for the company's liabilities, is a member of the company – natural person over whose property no bankruptcy proceedings have been started or instituted. So, the current excessive indebtedness is relevant only if there is a danger from the forthcoming insolvency. Such determination of the excessive indebtedness becomes clearer if we take into account the structure of corporations in the RC. It is difficult to get the accurate data, but for example in Austria more than 95% of companies is made of the limited liabilities companies, and when it comes to the stock capital - more than 90% of the companies complies with the amount of legally defined minimum. It would be unrealistic to assume that we have a different situation and the structure of corporations is dominated by the limited liabilities companies with minimum stock capital in B&H of BAM 1,000, and in the RC – HRK 20,000. The most of those companies in both countries have no real estate whatsoever in their ownership, or valuable equipment, so their property is equal to the amount of stock capital. Consequently, the most of those companies would have to go quickly in bankruptcy because it would be very quickly and easily that due to the small stock capital they reach a degree when their assets do not cover the matured liabilities, resp. they would reach the excessive indebtedness (Majstorović, 2007, p. 647).

The bankruptcy estate is an exceptionally important element of the bankruptcy proceedings, on which element their course and outcome depends – instituting, termination or reorganisation. The bankruptcy estate is made of the entire assets which belong to the adjudicated bankrupt at the moment of starting the bankruptcy proceedings as well as the assets which are acquired by the debtor during the bankruptcy proceedings. Out of the bankruptcy estate, which is made of movable and immovable items (capital assets: buildings and other edifices, land, equipment, machines, inventory..) and of property rights, the payments are made to the creditors which have at the time of the opening of the bankruptcy proceedings a grounded property claim towards the adjudicated bankrupt, as well as to the creditors who have acquired during the bankruptcy proceedings the right to claim by estate. However, before the settlement to creditors from the bankruptcy estate, the costs of proceedings are to be settled. Legal effects of opening

the bankruptcy proceedings occur *ex lege* as of the day when the decision on opening the bankruptcy proceedings is placed on a notice board at the competent court. Substantive law effects are the following: transfer of rights of management and disposal over property to the bankruptcy estate manager, dissolution of property community, firm of adjudicated bankrupt, invoices, employment contracts and termination of employment, prohibition of post and obligation of adjudicated bankrupt to cooperate and inform, effects to the personal responsibility of the company members and to the legal affairs. Procedural law effects are as follows: attraction of the competition in civil procedure, termination or take-over of litigation, prohibition of execution or settlement. Exceptionally, legal effects may occur even before the opening of the bankruptcy proceedings provided that the conditions are met for the *Actio Pauliana*.

3. REGULATION OF CRIMINAL OFFENSE OF FALSE BANKRUPTCY IN CRIMINAL LEGISLATION OF B&H AND RC

Criminal Code of the Federation of B&H in the chapter XXII. *Criminal offenses against economy, business and safety of payment system* Art. 244. prescribes the criminal offense of false bankruptcy. A legal description of the offense reads as follows: (1) Whoever, with an aim of avoiding payment of his obligations, by seemingly or actually diminishing his property, causes bankruptcy in a manner that he:

- a) seemingly or below a market value sells, conceals, transfers for free or destroys entire or portion of his property;
- b) makes sham contracts of a debt or acknowledges false claims;
- c) conceals, destroys, changes or keeps statutory business books, documents or files in a such manner that the actual financial condition cannot be established; or records the financial condition so as to give grounds for the institution of bankruptcy proceedings, by making fake documents or in some other way; shall be punished by imprisonment for a term between one and eight years.

(2) If, by the criminal offense referred to in paragraph 1 of this Article, serious consequences to a creditor are caused, the perpetrator shall be punished by imprisonment for a term between one and ten years.

The commitment of the offense is alternatively defined: as seemingly or actual impairment of one's property. Both of those types of commitment are undertaken with the goal to avoid the payment of one's liabilities. This is an important subjective feature of this criminal offense because if the perpetrator does not act with a certain goal, this criminal offense shall not exist either (Tomić, 2007, p. 174). The property impairment is carried out in a legally prescribed manner, i.e. in a way that he/she conceals, seemingly or below a market value sells, transfers for free or destroys entire or portion of his/her property. In case of concealment, the property becomes physically unavailable to creditors, whereas in case of seemingly sale such property ceases to be used in legal terms as a possible coverage with regard to the settlement to creditors. If it is about the sale below the market value, then the property is decreased and the buyer, if there was an intention on his/her side, may be also a co-perpetrator. This type is performed most often by concluding a contract on sale of entire or portion of the property, or by selling such property below its market value as well as by transfer for free.

The second way of committing the offense is to conclude a sham contract on debt or acknowledgement of false claims, which increases the liabilities of the company, other corporate entity or entrepreneur, so that they become insolvent, which causes the bankruptcy. Consequently, by concluding the sham contract it is acted in *fraudem legis agere* with the goal of deceiving the creditors. The third way of committing the offense is related to the business

books. The law states the concealment of business books, their destroying, or change performed in such manner that the actual financial condition cannot be established; or records the financial condition so as to give grounds for instituting the bankruptcy proceedings, by making fake documents or in some other way. The completion of the offense requires that the bankruptcy has been caused by the afore-mentioned activities, performed by responsible person, and if no consequence has occurred, then there shall be an attempt of criminal offense which is to be punished. Another, severe type of this criminal offense (par. 2) exists when due to the first type of this criminal offense a severe consequence occur for the creditor. The consequence of the offense consists of the causing of bankruptcy, whereby it is the false bankruptcy because, in fact, it is about the corporate entities which were successfully running their business until the moment of committing some of the above-mentioned activities. Croatian criminal legislation regulates in a similar way this criminal offense. It is described in chapter XXIV of the CC RC under the title Criminal Offenses against Economy, Article 249. Causing Bankruptcy. The legal description of the offense reads as follows:

(1) Whoever causes an excessive indebtedness or inability to pay in economic performance, either in a developed or threatening situation of excessive indebtedness or inability to pay, by doing the following activities: 1. seemingly transfers the property or transfers it for free to the company which he/she has founded alone or with somebody else, or seemingly sells in some other way entire or portion of the property which would make the bankruptcy estate, or encumbers it with no adequate counter-performance, transfers it for free, conceals, damages, destroys it or makes it unusable; 2. concludes a sham contract or acknowledges the false claim; 3. fails to keep trade or business books which he/she is required to keep pursuant to law, or conceals, destroys, damages, changes them, or keeps them, or makes an annual financial statement in such a manner that it is not possible to determine his/her income scale, or it is significantly aggravated to determine it; 4. opposite to the duly and prudent administering, impairs the property which would make the bankruptcy estate, or conceals the income scale, shall be punished by imprisonment for six months to five years.

(2) Whoever commits a criminal offense referred to in paragraph 1 of this Article by negligence shall be punished by imprisonment not exceeding three years.

(3) If, by the criminal offense referred to in paragraph 1 of this Article, a significant damage is caused, the perpetrator shall be punished by imprisonment for one to ten years.

(4) If, by the criminal offense referred to in paragraph 2 of this Article, serious consequences referred to in paragraph 3 of this Article are caused, the perpetrator shall be punished by imprisonment for six months to five years.

(5) If settlement is made to creditors before a verdict is reached, the perpetrator may be released from punishment.

(6) The criminal offense referred to in this Article shall exist only if the perpetrator has suspended his/her payments, or if the bankruptcy proceedings have been instituted against him/her, or against a person whom he/she has represented.

It may be seen in the legal description of criminal offense of causing bankruptcy (Art. 249. CC RC) that in the activities, regulated in a similar manner in the criminal offense of false bankruptcy (Art. 244. CC FB&H), the perpetrator of this criminal offense in the RC is punished with an expansion as compared to the regulations in Bosnia and Herzegovina. It refers to the conduct with good faith, resp. conduct with due care and diligence of a prudent businessman of all participants before and during the bankruptcy proceedings. Consequently, with the very failure to act according to these principles of obligatory commercial relations it may be determined that there is the responsibility of the perpetrator of this criminal offense. A difference compared to the regulation of this offense in the CC FB&H lies also with the

envisaged punishment for negligence as well as the possibility for being released from the punishment in case when creditors settle their debts before the verdict is reached.

3.1. Perpetrator of criminal offense of false bankruptcy

It may be concluded based on legal provisions in both countries that the perpetrator of this criminal offense may be any person; however, with regard to the nature of the offense it shall be, as a rule, that person which is able pursuant to his/her position within some legal person to make decisions related to the disposal of the property of that legal person (Tomić, 2007, p. 174).

Being guided by the provisions of the BPA FB&H (Bankruptcy Act of the RC) in process of determining the criminal responsibility for false bankruptcy, first of all the adjudicated bankrupt appears as the responsible person who acts with a direct intention (*dolus directus*) as conscious and willing realisation of criminal offense (Bačić, 1998, p. 229). An interim bankruptcy estate manager may appear as the perpetrator by acting opposite to the principle of good faith, who has failed to perform the due control of business activities. The bankruptcy estate manager, who is appointed by a registrar in bankruptcy after the conditions have been met for starting the bankruptcy proceedings, may be also responsible for this offense because he/she has known, as a representative of the adjudicated bankrupt, or must have known that the adjudicated bankrupt had caused the false bankruptcy with his/her activities being specified in the legal description of this criminal offense. His/her responsibility is envisaged also in the Art. 26., par. 1. of the

BPA FB&H. With regard to the wide legal provision that the perpetrator is „Whoever, with an aim ...“, it remains possible that such circle of persons may be even wider than it is stated. In particular, having in mind the concept of *Actio Pauliana* according to the bankruptcy law, the actively identified persons for filing such action are the bankruptcy estate manager and the creditor who may refute with that action the activities of the adjudicated bankrupt being committed prior to the instituting of the bankruptcy proceedings, which have contributed by their action to the impairment of the property of the adjudicated bankrupt. It is not rarely to happen that the debtor, whose liabilities towards the creditor have matured, wants to defeat the settlement of those liabilities in a way that he/she alienates or impairs his/her property by various legal activities. So, a figure of the perpetrator has been extended to any person that has participated in the commitment of the offense. Such third person is accountable if he/she undertakes certain activities towards the property of the debtor for the account or with the consent of the debtor but to the detriment of the creditor (Pavlović, 2013, p. 645). When it comes to the direct intention, the perpetrator acts with the direct intention when he/she is aware of the features of the criminal offense and when he/she wants to commit it, or when he/she is sure in its commitment. The intention at false bankruptcy is multiple; it encompasses the awareness to its strongest degree which is marked as „knowledge“ about avoiding to pay one's liabilities and which is related to the awareness that the property is seemingly or actually impaired, then the awareness about undertaking some of the afore-stated types of the commitment of offense as well as the awareness about the fact that all of that is done with a certain goal, which is to cause the false bankruptcy. In case of the bankruptcy criminal offenses, which should be also valid for the false bankruptcy, the perpetrator is actually the person who has been registered with the companies register as the responsible person. Consequently, it is beyond dispute that such person acts with the direct intention in case of this criminal offense. In general, the bankruptcy criminal offenses may be committed by their nature solely by responsible persons. In accordance with the Art. 2., par. 6. of the CC FB&H „A responsible person means a person in a business enterprise or other legal person who, in the line of duty or on the basis of specific authorisation, has been entrusted with a portfolio related to the implementation of law or regulations passed on the basis of law, or by-laws of a business

enterprise or other legal person in managing and administrating the property, or is related to managing a productive or other economic process or supervision of such process“. However, the CC of B&H and the Act on Legal Persons' Responsibility for Criminal Offenses (in the text hereinafter: ALPRCO) of the RC prescribe the responsibility also of legal persons under bankruptcy because they may continue with their activities, which means that even in that phase they may commit criminal offenses. Therefore, it is envisaged in the Art.7., par. 3. of the ALPRCO of the RC that the legal person shall be punished also for the criminal offenses being committed before the instituting of the bankruptcy proceedings or during the bankruptcy proceedings. Since the bodies of the company cease to act in the bankruptcy, a term of the responsible person shall be narrowed, whereby it shall refer, as a rule, only to the bankruptcy estate manager (Novoselec, Bojanić, 2013, p. 504-505).

3.1.2. Position of the bankruptcy criminal offenses in some European criminal legislations

Legal regulations of bankruptcies in the European Union are not standardised and there are different traditions and tendencies in this field. So, for example, Great Britain and France have essentially different bankruptcy laws. France places a focus onto protection of a debtor, while Great Britain places it onto protection of a creditor, whereas Germany is somehow by inclination of law closer to Great Britain. Such differences are reflected also in the regulating of the bankruptcy criminal offenses. Slovenian CC puts these offenses among economic criminal offenses, Italy places them in criminal offenses of debtor, Czech Republic and Austria in criminal offenses against property, Sweden in criminal offenses against creditors, whereas Germany has formulated for those offenses a special chapter of the bankruptcy criminal offenses (*Insolvenzstraftaten*) and France has also done the similar (*Banquerouts*); moreover, for such offenses the CC of the State of New York has a special chapter of criminal offenses of fraud to the detriment of creditors (*Frauds on Creditors*), and the Polish CC has included them into criminal offenses in economic performance (Pavlović, 2013, p. 643-644).

4. CASE LAW

In our case law a very small number of cases appear that are related at all to the bankruptcy criminal offenses. For that part, which is both prosecuted and sanctioned, it is evident that the punishments are at the borderline of a legally prescribed minimum, which is unacceptable while having in mind the damage which is inflicted by these offenses to the third parties and the society. Likewise, the criminal proceedings are instituted against very small percentage of perpetrators of these offenses. With regard to the high number of open bankruptcy proceedings as in B&H so in the RC as well, and on the other hand with regard to the very small number of criminal proceedings against these criminal offenses, a disproportion may be seen that results in the non-existence of the control, transparency and supervision over the work of the bankruptcy estate managers and registrars in bankruptcy. So, for example, based on the provisions of the CC of the RC there were 7 persons in Croatia sentenced in 2006 for bankruptcy criminal offenses, and in that same year there were 1209 bankruptcies started (Novoselec, 2007, p. 418). On the other hand, Novoselec states that in Germany it is suspected of criminal background in 80% of bankruptcy proceedings and it may be reasonably considered that such percentage is not lower in B&H and RC either. In B&H there is one and only indictment for this criminal offense, the verdict of which is expected to become a *modus operandi* for future cases (B&H Prosecutor's Office; S12K010279 12 Ko). Pavlović (2004, p. 90) warns about this widely spread passiveness and he states that there is a ...“wide social hypocrisy about the need for compliance with ethical and moral norms without taking any activities whatsoever in doing so in order to reduce the number of bankruptcies, to call to criminal account of the perpetrators

of criminal offenses and to undertake the activities on detecting the conditions for occurrence of the bankruptcy criminal offenses“. Concerning the supervision over the work of the bankruptcy estate managers, the changes made in the Bankruptcy Act abolished a panel of judges and all the activities of the bankruptcy court are performed by a judge, an individual – a registrar in bankruptcy. Since the judge has the biggest power in the bankruptcy process (i.e. the widest authorisations) as compared to all the parties in the process, it is logically concluded that he/she also bears the biggest responsibility for in-/efficient outcome of individual proceedings. However, it has been proved that the countries with higher level of court authorisations in bankruptcy proceedings had a higher level of corruption, regardless of whether it is about the developed or underdeveloped countries (Group of authors, 2004, p. 78). However, there are also positive examples of case law. It is the case with the decision of a Supreme Court of the RC, I KŽ-1063/04 of 16 March 2006, where the first-instance court properly determined that the accused had committed the criminal offense of causing bankruptcy (in B&H it is the offense of false bankruptcy) by selling the stocks of goods below an acquisition value, by concluding a false contract on clearance of receivables and liabilities, and in this way he/she abused his/her position as the responsible person of the company. A big deficiency in B&H compared to the RC is the non-existence of the commercial courts which would be efficiently dealing with these problems. Separate, independent and specialised commercial judiciary exists besides Croatia also in the following countries: France, Belgium, Luxembourg, Russian Federation, Switzerland (only in some cantons), Austria (only for the area of Vienna), Denmark (for the area of Copenhagen), Czech Republic (at second-instance matters in Prague, Brno and Ostrava) and in Ireland (Barbić, 2007). Nevertheless, Croatia is not in an enviable position either when it comes to the embezzlements of the bankruptcy estate managers and registrars in bankruptcy. So, for example, Knot and Vychodil (2006) state that the Czech Bankruptcy Act protects creditors very poorly in practice due to the inefficient implementation of the Act in the judiciary, resulting from the essential problem of the lack of competences of judges and to the certain degree also the corruption among the Czech judges. Furthermore, according to the legal provision that the decision on instituting the bankruptcy proceedings is to be submitted also to the competent prosecutor's office in case when the bankruptcy proceedings are suspended due to the lacking bankruptcy estate, the default and failure to act equally call to account for the effects of these criminal offenses. Besides, at this criminal offense an issue arises also related to the concurrence with other criminal offenses from the chapter of criminal offenses against economy exactly because of the activities, by means of which this offense may be committed. However, if we take the criminal offense of official document forgery and the criminal offense of false bankruptcy being committed by concluding the sham contract, there shall be no concurrence of these two offenses because already with the commitment of the criminal offense of false bankruptcy, this other offense is also realised.

5. CONCLUSION

Regulating the bankruptcy criminal offenses, a legislator indicates at the importance of the protection of creditors but also of adjudicated bankrupts from punishable conducts of the responsible persons before and during the bankruptcy proceedings. The criminal offenses on the occasion of bankruptcy are the result of a bad privatisation model that has been continued through the concept of bankruptcy. In this view, the concept of *Actio Pauliana* is insufficiently used and it represents a type of prevention for bankruptcy criminal offenses. With the goal to prevent and stop the commitment of the bankruptcy criminal offenses it is important to implement the BPA B&H consistently. A practical problem with determining the criminal responsibility of the responsible persons for false bankruptcy is related to the obligation to prove

the direct intention of the responsible person, which includes the elements of awareness about the avoiding to pay one's own liabilities that is related to the awareness that the property is seemingly or actually impaired, then the awareness about undertaking some of the aforementioned types of committing the offense, as well as the awareness that all of that is done with the certain goal, which is to cause the false bankruptcy. On the other hand, the legal description of the concept of criminal offense of false bankruptcy is inconsistent with other bankruptcy and related criminal offenses with regard to the determination of the responsible person, which does not represent a good solution. Therefore, the legal description of this article should be changed and instead of a general wording: „Whoever, with an aim ...“, the following article should be put: „responsible person in a legal person who aims at ...“. Having in mind the prescribed punishments for these criminal offenses, it may be seen that it is about a very severe types of delinquency, which the responsible persons should be warned about for the purpose of having a specialised and general prevention of their commitment.

LITERATURE:

1. Bačić, F. (1998). *Kazneno pravo: opći dio* – Criminal Law: General Part (5th modified and expanded edition). Zagreb: Informator
2. Beccaria, C. (1984). *O zločinima i kaznama* – On Crimes and Punishments, Split: Logos
3. Barbić, J. (2007). *Trgovačko sudstvo u Hrvatskoj* – Commercial Judiciary in Croatia (accessed on 17 May 2016) http://www.vtsrh.hr/index.php?page=history&article_id=54&lang=hr
4. Dika, M. (1998). *Insolventijsko pravo* – Insolvency Law, Zagreb: Faculty of Law of the University of Zagreb
5. European Convention on Certain International Aspect of Bankruptcy of 5 June 1990
6. Group of authors, *Doing Business in 2004: Understanding Regulation* (A co-publication of World Bank), (2004), Washington: The International Finance Corporation and Oxford University Press, World Bank
7. Knot, O., Vychodil, O. (2006). *Czech Bankruptcy Procedures: Ex- post Efficiency View*, Working Papers IES 2006/03, Charles University Prague, Faculty of Social Sciences, Institute of Economic Studies (accessed on: 16 May 2016) https://ideas.repec.org/p/fau/wpaper/wp2006_03.html
8. Majstorović, D. (2007). *Stečajna kaznena djela* – Bankruptcy Criminal Offenses, Zagreb: *Hrvatski ljetopis za kazneno pravo i praksu vol. 14, br 2/2007* (Croatian Chronicle for Criminal Law and Practice, vol. 14, no. 2/2007)
9. Novoselec, P. (2007). *Aktualni problemi hrvatskog gospodarskog kaznenog prava* – Current Problems in Croatian Economic Criminal Law, Zagreb: *Hrvatski ljetopis za kazneno pravo i praksu vol. 14, br 2/2007* (Croatian Chronicle for Criminal Law and Practice, vol. 14, no. 2/2007) Zagreb
10. Novoselec, P., Bojanić, I. (2013). *Opći dio kaznenog prava* – General Part of Criminal Law (4th changed edition), Zagreb: Faculty of Law of the University of Zagreb
11. Pavlović, Š. (2004). *Insolventijska kaznena djela: aktualna pitanja kaznenog zakonodavstva 2004* – Insolvency Criminal Offenses: Current Issues in Criminal Legislation 2004; Zagreb: Inženjerski biro (Engineer Bureau)
12. Pavlović, Š. (2013). *Kazneni zakon (drugo izmijenjeno, dopunjeno i prošireno izdanje)* – Criminal Code (2nd changed, amended and expanded edition), Rijeka: Libertin Publishing
13. Petrović, B., Meško, G. (2008). *Kriminologija* - Criminology (2nd changed and amended edition), Sarajevo: Faculty of Law of the University of Sarajevo

14. Rizvanović, E. (2013). *Poslovno pravo: osnivanje, natjecanje, prestanak poslovnih subjekata* – Business Law: Foundation, Competition, Dissolution of Business Entities (1st edition), Sarajevo: Privredna štampa d.o.o. Sarajevo
15. Sajter, D. (2008). Economic Aspects of Bankruptcy and Restructuring in Bankruptcy: (doctoral dissertation). Osijek: Faculty of Economics of Osijek, Juraj Strossmayer University of Osijek, accessed on 16 May 2016) from http://oliver.efos.hr/~dsajter/PDF/Sajter_Disertacija.pdf
16. Stanojević, P., Hamidžović, Dž. (2010), *Krivična dela- prouzrokovanje stečaja i prouzrokovanje lažnog stečaja: kao aktuelna krivična dela protiv privrede u postkriznom periodu* - Criminal Offenses – Causing Bankruptcy and Causing False Bankruptcy: as Current Criminal Offenses against Economy in Post-crisis Period, in "*Anali međunarodne konferencije mladih lidera*" (Annals of International Conference of Young Leaders) International Science Society for Promotion and Enhancement of Scientific Sciences - AKROASIS
17. Tomić, Z. (2007). *Krivično pravo II: posebni dio* - Criminal Law II: Special Part (2nd changed and amended edition), Sarajevo: Faculty of Law of the University of Sarajevo
18. Velimirović, M. (1980). *Privredno pravo: organizacije udruženog rada* – Commercial Law: Organisations of Associated Labour (2nd edition), Sarajevo: IGKRO „SVJETLOST“, Sarajevo
19. Criminal Code of the Republic of Croatia (OG 125/11, 144/12, 56/15, 61/15)
20. Criminal Code of the FB&H (OG of the Federation of B&H 36/03, 37/03, 21/04, 69/04, 18/05, 42/10)
21. *Code penal Francais* (accessed on 20 May 2016)
<https://www.legifrance.gouv.fr/affichCode.do?cidTexte=LEGITEXT000006070719>
22. European Convention on Certain International Aspect of Bankruptcy of 5 June 1990, (accessed on 21 May 2016)
<https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=090000168007b3d0>
23. Bankruptcy Proceedings Act of the FB&H (Official Gazette of the Federation of B&H 29/03, 33/04, 47/06)
24. Bankruptcy Act of the Republic of Croatia (OG 71/15)
25. Act on Responsibility of Legal Persons for Criminal Offenses of the Republic of Croatia (OG 151/03, 110/07, 45/11, 143/12)
26. *Kazenski zakonik Slovenia* (Uradni list RS, št. 95/04, 55/08 – KZ-1)
27. *Codice penale Italia*, <http://www.anvu.it/wp-content/uploads/2016/03/codice-penale-navigabile-4-marzo-2016.pdf> (accessed on 28 May 2016)
28. Act on Confirmation of Criminal Law Convention on Corruption, http://narodne-novine.nn.hr/clanci/međunarodni/2000_10_11_103.html (accessed on 1 June 2016)

APPLICABLE LAW FOR CONSUMER CONTRACTS ACCORDING TO THE REGULATION (EC) NO 593/2008 ON THE LAW APPLICABLE TO CONTRACTUAL OBLIGATIONS (ROME I)

Ivana Markovinovic Zunko

Law Firm Vedriš & Partners Ltd, Croatia

ivana.markovinovic@vedris-partners.hr

ABSTRACT

Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations, known as Rome I provides harmonised conflict of laws rules based on widely recognized international private law principles such as freedom of choice with the aim to ensure uniformity within EU and to eliminate uncertainty with regard to the applicable law. The position of the consumers as the weaker party in the contractual relation results with the implementation of various safe-guarding mechanisms in both national and international legislations. In cross-border transactions the position of the consumers is considered even more sensitive and the need for their protection results with numerous special provisions. Such provisions in Rome I are contained in the Article 6 that provides definition of the consumer contract (and also the exemptions) and establishes the rules for determination of the law that should be applied thereon. The main principle is that consumers should be protected by such rules of the country of their habitual residence that cannot be derogated from by agreement. Such solution still enables the parties to choose the governing law for their agreement, but provides the minimum of the protection to the consumers by not depriving them from the protection of their local rules they supposed to be familiar with. The aim of this paper is to analyse whether such solution is well balanced and well harmonized with the other EU instruments adopted with the purpose to ensure protection of the consumers, particularly in the field of the increasingly present on-line commerce.

Keywords: applicable law, consumers, habitual residence, protection.

1. INTRODUCTION

Ever since of the first EU acts, protection of consumers has been defined as one of the goals that should be achieved in order to enable functioning of internal market and free movement of goods and services. Work of European authorities in this respect has been quite productive and today protection of the consumer is one of the most regulated area. Besides the acts that deals exclusively with this subject, protection of the consumers is also included in the provisions of the acts dealing with the general substantive or procedural matters.

One of them is Rome I Regulation that deals with conflict-of-laws issues in contractual nature. This paper will try to provide some introductory remarks with regard to protection of consumers in general and than to give an overview of the specific aspect of consumer protection as set out in the Rome I Regulation.

The special provisions on consumers are contained in the Article 6 of the Rome I which provides a definition of the consumer contract; establish the general rule which represents the derogation from the generally accepted conflict-of-laws rule based on freedom of choice and sets out the exclusions for certain types of contracts. The paper deals with the context and interpretation of those provisions in order to enable assessment whether this instrument is eligible to contribute to the proclaimed protection of consumers.

2. CONSUMER PROTECTION IN THE EU LEGISLATION

2.1. Historical development

The Charter of Fundamental Rights and the European treaties since the Single European Act guarantee a high level of consumer protection in the EU. It is also a general objective defined in Article 12 of the Treaty on the Functioning of the EU explicitly stating that consumer protection requirements shall be taken into account in defining and implementing other Union policies and activities. Formally, the protection on EU level started with the Council Resolution of 14 April 1975 on a preliminary programme of the European Economic Community for a consumer protection and information policy, where the five fundamental consumer rights: the right to protection of health and safety, the right to protection of economic interests, the right to claim for damages, the right to an education, and the right to legal representation (or the right otherwise to be heard) have been defined. During following decades the consumer protection became one of the most regulated areas covering various aspects of consumer interest (product safety, labelling, digital market, data protection etc.) which resulted with legally binding tools containing around 90 directives and few regulations as well as supplementary tools such as market studies and awareness-raising campaigns.

2.2. Present status

As already mentioned, the legal instrument mostly in the field of EU consumer protection has been the directive which does not apply directly, but requires transposition into the national laws. Such procedure resulted with certain inconsistency and probably this is one of the reasons for the general assessment that the consumer protection has not yet reached an adequate level and that further work is needed. It has been established that full harmonization of some key regulatory aspects should considerably increase legal certainty for both consumers and traders and such harmonization should eliminate the barriers stemming from the fragmentation of the rules, namely that establishing uniform rules at Union level is necessary for the consumer protection.

It should be pointed out that respective directives mainly deal with specific issues, while only few of them have more general scope such as Directive 2006/114/EC concerning misleading and comparative advertising, Directive 2011/83/EU on consumer rights or Directive 2013/11/EU on alternative dispute resolution for consumer disputes.

Although the consumer protection has so far won some great battles such as lowering of roaming charges, there are many open consumer's protection related issues left (such as data protection or impact of Transatlantic Trade and Investment Partnership) and the status of the present level of protection is considered as not fully realized. This creates an obstacle for development of the internal market. For example, cross-border potential of distance selling, which should be one of the main tangible results of the internal market, is not fully exploited due to the number of factors including the different national consumer protection rules imposed upon the industry.

2.3. Future challenges

As the European consumer legislation has been recognized as crucial in order to overcome obstacles to the development of the internal market, it is considered to be a crucial part of the European Commission's strategic planning, as stated in the documents Europe 2020 Strategy for smart, sustainable and inclusive growth or Digital Agenda. In this respect, presently there are two main measures: the European Consumer Agenda- the new strategy for EU consumer policy and the Consumer programme 2014-20 as the financial framework complementing the

mentioned strategy that foresees a budget of €188.8 million (corresponding to around €0.05 per consumer per year), that defined following aims: improving consumer safety; enhancing knowledge; improving implementation, stepping up enforcement and securing redress as well as aligning rights and key policies to economic and societal challenges.

One of the most demanding in constant need to respond to the technological developments resulting with completely new phenomena such as shift from consumer to more sophisticated users – prosumers – who are not simply using but also forming the content.

3. ROME I REGULATION IN GENERAL

One of the most important EU documents - The Amsterdam Treaty (Treaty of Amsterdam Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts,) in the field of judicial co-operation in civil matters (Article 61(c) TEC), and specific measures promote the compatibility of the rules applicable in Member States concerning the conflict of laws and of jurisdiction (Article 65 (b) TEC). Based on those provision, the Council and the European Parliament have enacted numerous regulations in the field of private international law. Regulation Rome I was adopted on 17 June 2008 and it entered into force on December 17, 2009.

As stated in the preamble of the Rome I, the proper functioning of the internal market creates a need, in order to improve predictability of the outcome of litigation, of certainty as to the law applicable and the free movement of judgements, for the conflict-of-law rules in the Member States to designate the same national law irrespective of the country of the court in which an action is brought.

The work of the EU aimed at establishing the uniform rules in this area has long history. The great achievement is Convention 80/934/ECC on the law applicable to contractual obligations opened for signature in Rome on 19 June 1980, known as Rome Convention, but as it was only Community private law instrument, namely pure international treaty, it was proposed in 2003 by the European Commission that it should be converted into Community regulation which is form that ensures it direct application and requires no measures for transposal into national laws. To the large extent the new regulation has replicated the provisions of the Convention – most importantly the prevailing principle – freedom of choice.

Rome I is a part of of the Community Private International Law System the and as stated in its preamble should be consistent with Brussels I (Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters) and Rome II (Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to noncontractual obligations. It should be mentioned that on December 20, 2010 Council Regulation (EU) Regulation no 1259/2010 implementing enhanced cooperation in the area of law applicable to divorce and legal separation was passed – known as Rome III – so it is very well said that this overwhelming but fragmentary work of art resembles the unfinished Sagrada Familia in Barcelona, with its entangled yet incomplete towers (Boele-Woelki, 2010, p. 17).

4. DEFINITION OF THE CONSUMER CONTRACT

Article 6 Rome I sets up a definition of the consumer contract in line with the Convention, but also recognizes some contemporary demands in reality of on-line transactions and introduces new elements.

4.1. Consumer – natural person

Article 6 Rome I sets up a definition of the consumer contract – it is a contract concluded by a natural person for a purpose which can be regarded as being outside his trade or profession (the consumer) with another person acting in the exercise of his trade or profession (the professional). According to the wording of the Article 6 Paragraph 1 a consumer is natural person – this might seem obvious, but it should be pointed out that the protection of the legal person might be justified in certain cases – e.g. when the legal persons act on non-profit basis (e.g. non-profit governmental organizations).

4.2. Acting out of the professional domain

The following condition is that such person needs to act out of its professional domain. The same condition is contained in the Bruxelles I and in the Vienna Convention. In this respect, it should be pointed out that if a natural person, though acting for a private purpose, holds himself out as a professional, the good faith of the other party is protected and the case will not be governed by Article 6. On the other hand, person with which the consumer enters into agreement must be professional. Although quite clear, the rule still leaves the space for certain question – e.g. what is to be done in case that the agreement is concluded for both private and professional needs (e.g. purchase of the computer which will serve both for work and for private usage) – some are of opinion that consumers status should be prevailing, other feels that specific rules on consumer protection should only exceptionally be applied.

4.3. Conditions on professional's side

The Rome I sets out 2 more conditions to be fulfilled on the professional's side. He needs to pursue his commercial or professional activities in the country where the consumer has his habitual residence, or by any means, direct such activities to that country or to several countries including that country, and the contract falls within the scope of such activities. The rule covers two different situations – the example for the first one is the situation where the professional has the subsidiary in the country of the habitual residence of the consumer, while in the second situation there is no subsidiary but somehow the activities are related to that country. Such solution is fully in line with the introductory provision.

Clearly, the second situation can lead to various doubts. Originally, the concept of directed activities has been inserted in the Regulation Bruxelles I in order to adjust the law to the development of the communication technologies and distant commerce (particularly e-commerce) – the consequence of this rule is protection of the consumer that buy goods on-line through specialized web-sites of the professionals. It should be pointed out that introductory provision point out that it is not sufficient for an undertaking to target its activities at the Member State of the consumers residence, or at a number of Member States including that member State; a contract must also be concluded within the framework of its activities and also that the mere fact that the Internet site is accessible is not sufficient, but that this site solicits the conclusion of distance contracts and that a contract has actually been concluded at a distance, whereby the language or currency which a website uses does not constitute a relevant factor.

However, it should be pointed out that the concept is quite vague – if a professional creates a web-page that the consumer can access in the country of his habitual residence due to the Internet transnational nature, it is not clear whether this act itself can be considered as directing the professional/s business or the additional elements are required.

4.4. Protection of the passive consumers

The stated provisions protect only passive consumers – i.e. those cases where it is not the consumer who goes to the market of the professional but the professional who goes or directs his activities to the market of the consumer, so the key element is «targeted activity criterion.

The scope of application of this rule is defined by a material element, as it only applies to consumer contracts, and by a territorial element, as it only protects the so-called “passive or sedentary consumers”. In this respect it should be pointed out that Article 6 of the Regulation results in a paradoxical difference of treatment between consumers - passive consumers are protected by the rule, while active or mobile consumers are not, and accordingly they are treated as if they were professionals, i.e., they are subject to general rules of Rome I, as is any

other professional (Garcimartín Alférez, 2008, 70-71).

5. GENERAL CONFLICT-OF-LAWS RULE FOR THE CONSUMERS

The Convention had stipulated that the choice of law cannot deprive the consumer of the protection afforded to him by the mandatory rules of the law of the country in which he has his habitual residence. The solution adopted in the Rome I starts from the different position – it stipulates that consumer contracts shall be governed by the law of the country where the consumer has his habitual residence and then enters the possibility of choosing the applicable law.

5.1. Application of the consumer’s habitual residence law

The concept of habitual residence is defined in Article 19 Rome I but only for the companies and other bodies and for the natural persons acting in the course of their business activity – in such case that would be their principal place of business (even if they live in another country). The definition is not applicable on consumer contracts so the autonomous concept is required – in order to ensure the protection of the consumer it must be the place where the consumer factually, and not only formally resides. The rule is specific expression of the principle of the most favorable law which purpose is to ensure protection of the consumer as presumably the weaker party of the contract.

5.2. Freedom of choice

Despite of the above mentioned rule on the application of the law of consumer’s residence, the parties may choose the law applicable to a contract which fulfils the general conditions as stipulated in Article 3 Rome I. So, although the Rome I has adopted different concept than the Convention, the result is the same - the main rule is still *lex autonomiae*, which has been recognized in the historical development of the international private law as the law that in the greatest extent corresponds with the need of the contractual parties and that should be cornerstone of the system of conflict-of-law rules in matters of contractual obligations as emphasised in the Preamble (11). According to the general conditions, stipulated in the Article 3 of the Rome I, choice of law can be made expressly or clearly demonstrated by terms of the contract or the circumstances of the case. The latter formulation clearly leaves quite room for the various interpretation, but in general some situations have been broadly accepted (e.g. language of contract together with specific institutions from certain law system). It should be also mentioned that Rome I allows subjection of various parts of the agreement to the different laws and that the law can be changed any time – the parties may at any time agree to subject the contract to a law other than that which previously governed it.

The Article 6 sets up specific restriction – such a choice may not, however have the result of depriving the consumer of the protection afforded to him by provisions that cannot be derogated

from by agreement by virtue of the law which, in the absence of choice, would have been applicable, namely the law of the country where the consumer has his habitual residence.

It should be also pointed out that the rule on closer connection as contained in the Article 4 and provision on protection of employees as of Article 8 Rome I, according to which if clear from all the circumstances that the contract is manifestly more closely connected with a country other than the country of the applicable law (so called escape clause) shall not apply for the consumer contracts. It should be also pointed out that in case that the parties have not made a valid choice of law, also the law of the consumer's habitual residence would apply. However, in reality such exclusive protection by application of the consumer's law does not necessarily guarantee higher protection – e.g. in case of consumers who live in countries with low consumer protection (Ragno, 2009, p. 154)

5.3. Weak points of the Rome I solution

The adopted solution for consumer contracts in Rome I is a certain compromise and as every compromise it is doubtful whether aimed interests are indeed preserved – on the one hand the choice of law is enabled, on the other hand the consumers are protected by the application of the law they are familiar with as the minimum standard. In practice, this means that the judge should firstly establish whether the parties have validly chosen the law to be applied and after that it should be checked whether the chosen law deprives the consumer of the protection of the mandatory provision of the country of his habitual residence namely the laws should be compared. It can happen that in some aspect the chosen law is favourable and in the other the law of the country of consumer's habitual residence – the Regulation does not offer solution for this situation and scholars are not united when it comes to dilemma whether to adopt mixed-approach or to decide for single law to be applied. Furthermore, it is not clear whether this should be done by the court *ex officio* or only upon consumer's request – taking into consideration general nature of consumer protection rules, it seems more likely that *ex officio* approach should be taken.

5.3. Other possibilities

With respect to the freedom of choice, it should be mentioned that the first official proposal of the Rome I did not envisage this possibility (unlike the Convention), namely the only applicable law for consumer contracts, was the law of the consumer's habitual residence and that there are still some opinions that abolishing party autonomy would be a better choice instead of adhering to it formally while threatening to its substance, not only from the perspective of the consumer but also from the professional's as double set of mandatory rules could have quite discouraging effect (Volker, 2011, p. 251). On the other hand, there are also opinions that maybe unrestricted freedom of choice or even only merchant's law, as in the United States - apparently such approach results with increased consummation of goods and services at lower cost.

6. SPECIFIC EXCLUSIONS FROM THE GENERAL RULE

Unlike the Convention that established special protection only for certain consumer contract, namely those the object of which is the supply of goods or services or a contract for the provision of credit for that object, Rome I Regulation covers all types of the consumer contracts, except those explicitly excluded by the provisions of the Article 6 Paragraph 4 and contracts of carriage and insurance contracts as regulated by the Article 5 and Article 7 of the Rome I Regulation. This represents significant extension of the protection as now various forms of agreements are covered by the protection umbrella (e.g. financial instruments not connected to

the supply of goods or services; contracts from intellectual property domain, contracts related to immovable properties etc.). The exclusions are the following:

6.1. Contracts of services supplied to the consumers out of his country

The first exception, taken from the Convention, defined in the Article 6 Paragraph 4 under letter a) refers to a contract for the supply of services where the services are to be supplied to the consumer exclusively in a country other than that in which he has his habitual residence (e.g. language course or similar tourist service abroad). The purpose of the rule is to protect the service providers in the situation where it should not be expected that consumer should count on the application of their law. However, it is not quite clear why the rule refers to services only and it is also noted that sometimes it would be difficult to define place where the service is offered, as for example in case of online services (Ragno, 2009, p.140). As to the law that should be applied instead of the Article 6, it should be pointed out that general application of Article 3, i.e. *lex autonomiae* or Article 4 of the Rome I Regulation could lead to deprivation of the reasonable protection of the consumer – as it was noted it is somehow a paradox that in the case of a consumer contract for the provision of a language course in Switzerland, the consumer is considered as if he were a professional and, therefore, the parties have absolute freedom to choose the applicable law without the protection afforded by Swiss

Law. (Garcimartín Alférez, 2008, p. 72).

6.2. Contracts of carriage except package travel contracts

The following exclusion under letter b), also taken from the Convention, refers to all the contracts of carriage (separately regulated by Article 5 of the Rome I) other than a contract relating to package travel within the meaning of Council Directive 90/314/EEC of 13 June 1990 on package travel, holidays and package tours. This exception is justified by great number of the specific regulation in the field of transport, but probably it is just designed for the powerful transport industry. The specific exception made for package travel could also lead to paradox, as based on this rule for example the consumer who consumes the package travel service offered by the tour operator operating outside the country of consumer's residence is protected by the special rule of the Article 6, while such consumer who would consume only accommodation is not (Ragno, 2009, pp.141-142)

6.3. Right in rem or tenancy of immovable property

The exclusion of letter c) refers to a contract relating to a right in rem in immovable property (e.g. mortgage) or a tenancy of immovable property other than a contract relating to the use of immovable properties on a time-share basis within the meaning of Directive 94/47/EC. The Convention had excluded the application with regard to immovable properties in general, but as this was abandoned, the specific restriction is included. The reason is the generally accepted principle «*lex rei loci*» for the real estates.

6.4. Financial and similar instruments

Pursuant to the the stipulation under letter (d) the rules of Article 6 shall not apply to the rights and obligations which constitute a financial instrument and rights and obligations constituting the terms and conditions governing the issuance or offer to the public and public take-over bids of transferable securities, and the subscription and redemption of units in collective investments undertaking in so far as these activities do not constitute provision of financial service.

This provision seems quite complex and clearly requires understanding of the capital market and financial instruments, but for better understanding the stipulations from the Preamble (28)

stating that it is important to ensure that rights and obligations which constitute a financial instrument are not covered by the general rule applicable to consumer contracts, as that could lead to different laws being applicable to each instrument issued changing their nature and preventing their fungible trading and offering while there is a need to ensure uniformity in terms and conditions of an issuance or offer. However, it should be pointed out that Article 6 Rome I does apply to financial services (such as investment services provided by professional to a consumer), namely that the marketing or the direct selling of the financial instruments is not covered by the exclusion, as stated in the Preamble (26).

6.5. Contract concluded within a multilateral system

The last exception under letter e) refers to a contract concluded within the type of system falling within the scope of Article 4(I)(h) namely a contract concluded within a multilateral system which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments. This exclusion is justified same as the previous - by need of applying a single law. It should be mentioned that on practical level this exclusion shall not be of significance, as such agreements are mostly concluded between the professionals.

7. CONCLUSION

With around 90 directives in force, protection of the consumers is highly regulated area. However, it seems that a development of the internal market has not yet achieved its full potential and that one of the main reason is the fact that the consumers do not trust that their position is safe enough to enter in the cross-border transaction without any fear, particularly without the fear that in case that something goes wrong they would be able to have the justice done before the court. Potential application of the foreign law, involvement of the foreign lawyers, competence of the foreign courts – those are factors that seems to complicate (and too expensive) to handle and apparently consumers in too many cases rather choose to stay on the safe side, on their local market. For decades EU legislation aims to find appropriate solutions to remove those obstacles to the development of the internal market and full realization of the free movement of goods by adopting various regulations and other instruments that suppose to make participation of all the parties involved in the process of cross-border transaction easier. One of the crucial questions that arises in this context is which law is applicable to the agreement between the parties in situations involving a conflict of laws. The great achievement in this regard was Rome Convention that set up the main rules for the establishment of the governing law in such cases with respecting the freedom of choice as the most important principle in the context of the contractual relations. However, it was recognized that the effective protection of the weaker parties in the contracts such as employees or consumers requires certain derogation of that principle so the Convention set up special rules for such categories, whereby the stipulation that they cannot be deprived of the rules of the country of their habitual residence has the central place. As the Rome Convention was simply international convention, it was necessary to transform it in the Union instrument so the Convention was replaced with the Rome I regulation that came to force in December 2008. The rules of the Rome I follow the rules previously contained in the Convention but they are modernized in the certain extent, including the provisions on the consumers. The general rule – freedom of choice with the restriction with regard to the application of the law of the country of the habitual residence of the consumer as the minimum standard remain substantively the same, although the concept is changed. The definition of the consumer is now structured to protect only so - called passive consumer, namely the consumers are protected by the application of the laws of their habitual residence so long as the professional undertakes commercial activities in the

consumer's home country. The Rome I also introduced some additional exclusions for certain types of the agreement as now the rule covers all types of contracts. Although the provisions of the Article 6 of the Rome I regulation on consumer's protection seem clear enough, the contemporary environment with Internet as constantly growing media, new technologies and new form of communication, leaves much room for the interpretation. Certain uncertainty arises from the relation between Rome I as the regulation which is directly in force in all the Member States (except Denmark that never to opt-in) and other sources of law, particularly from the reach field of the consumer protection. The assessment whether the provisions of the Rome I do contribute to the protection of the consumers is not easy to be made and the scholars seems to have very different opinion on this matter. There are opinions that restrictions of the freedom with regard to the choice of law in reality do not guarantee any protection, while there are also opinions that this model should serve as example how to ensure protection. The trend in the EU development is unification of the rules as the idea is that the common law applicable and maybe what should be expected is the same law in all the EU countries. In the meantime, it is only positive to have the instrument that deals with the conflict-of-laws issue and which does recognize the need for protection of the consumers as the weaker party in the agreement. Any work on the consumer issues should be taken as on-going process due to the constant changes of the its environment and the Rome should not be exemption.

LITERATURE:

1. Kunda, I., Gonçalves de Melo Marinho , C.M. (2010), *Practical Handbook on Europe Private International Law*. Deutsche Stiftung für Internationale Rechtliche Zusammenarbeit E.V.
2. Boele-Woelki, K. (2010). For better or for worse: the Europeanization of international divorce law. *Yearbook of Private International Law*, Volume 12 (2010) (p. 1-26), Sellier European Law Publishers.
3. Bisping, C. (2013). The common European sales law, consumer protection and overriding mandatory provisions in private international law. *International and Comparative Law Quarterly*, (p. 463-483). doi:10.1017/S0020589313000055.
4. Healy, J.J. (2009), Consumer Protection Choice of Law: European Lessons for the United States, 19 *Duke Journal of Comparative & International Law* (p.535-558), Retrieved from: <http://scholarship.law.duke.edu/djcil/vol19/iss3/7>
5. Puljko, V., Nuić, K. (2007). Collision law consumer protection in Croatia and Europe. *Split Faculty of Law Journal*, 44(2), (p.241-253). Retrieved 01.08.2016. <http://hrcak.srce.hr/31440>
6. Twigg-Flesner, C. (2011). 'Good-Bye Harmonisation by Directives, Hello Cross-Border only Regulation?' – A way forward for EU Consumer Contract Law. *European Review of Contract Law*. Volume 7, Issue 2 (p.235–256), ISSN (Online) 1614-9939, ISSN (Print) 1614-9920, DOI: 10.1515/ercl.2011.235
7. van Bochove, L.M. (2014). Overriding Mandatory Rules as a Vehicle for Weaker Party Protection in European Private International Law. *Erasmus Law Review*, 3, (2014) (p.147-156).
8. Volker, B. (2011). Rome I Regulation a—Mostly—Unified Private International Law of Contractual Relationships within—Most—of the European Union. *Journal of Law and Commerce*, Vol.29 (2) (p.233-272). University of Pittsburgh.
9. Garcimartín Alférez , F. J. (2008). The Rome I Regulation: Much ado about nothing?. *The European Legal Forum* (E) 2-2008 (p.61 – 80). IPR Verlag GmbH München

10. Ragno, Francesca (2009). The Law Applicable to Consumer Contracts under the Rome I Regulation. In Ferrari, F., Leible, S. (ed), The Law Applicable to Contractual Obligations in Europe (p. 129-170). Publisher Munich: Sellier European Law Publishers.
11. Gunelius, S. 03.07.2010. The Shift from CONsumers to PROsumers. Forbes. Retrieved 02.08.2016. from <http://www.forbes.com/sites/work-in-progress/2010/07/03/the-shift-from-consumers-to-prosumers/#674aeb35543f>

LEGAL ASPECTS OF PACKAGE TRAVEL CONTRACTS

Dario Klasic

*Attorney-at-law; Doctoral Candidate, Institute of Air and Space Law, Faculty of Law,
University of Cologne (Institut für Luft- und Weltraumrecht, Rechtswissenschaftliche
Fakultät, Universität zu Köln), Albertus-Magnus-Platz, Cologne, Germany
dklasic@smail.uni-koeln.de*

ABSTRACT

In the last decades the inclusive tour holiday business in Croatia and the EU has shown a significant growth. Since the adoption of Directive 90/314/EEC, back in 1990, the market has also undergone considerable changes. In arranging the various components that make up a package holiday, a tour operator enters into contracts with airlines, coach companies, hoteliers and others since it is them who actually provide the transport and accommodation which feature in the package. However, tour operators are responsible for all the elements of the package and primary liability for anything which goes wrong rests with them. In other words, the tour operators face strict liability for any of the services, facilities or goods to be supplied as component parts of the package and are not able to mount a defence on the basis that the services, facilities or goods were supplied by others over whom they had no control.

The new Package Travel Directive (EU) 2015/2302 adopted in November 2015 repeals the old Directive (EEC) 90/314 and aims at enhancing transparency and increasing legal certainty for travellers and tour operators alike. Having previously worked for two major Croatian tour operators with a considerable practical experience on this subject, in the following article the author will focus attention on the legal aspects of those involved in travel industry and packaged travel, be they tour operators, travel agents or travellers themselves.

Keywords: Directive (EU) 2015/2302, Liability, Package holidays, Tour operators.

1. INTRODUCTION

Tourism plays an important role in the economy of not only Croatia, but also the European Union as a whole, and package travel, package holidays and package tours ('packages') represent a significant proportion of the travel market.

Since the adoption of Directive (EEC) 90/314¹, back in 1990, the market has undergone considerable changes. In addition to traditional distribution channels, the Internet has become an increasingly important medium through which travel services are now offered and sold. It should be also noted that nowadays travel services are not only combined in the form of traditional pre-arranged packages, but are often combined in a customised way. Many of those combinations of travel services were either in a legal 'grey zone' or were just not covered by Directive (EEC) 90/314.

The new Directive (EU) 2015/2302² adopted in November 2015 repeals Directive (EEC) 90/314 and aims at taking the above mentioned developments into account, all to enhance transparency, and to increase legal certainty for travellers and tour operators alike.

¹ Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours. *Official Journal L 158* (23.06.1990).

² Directive (EU) 2015/2302 of the European Parliament and of the Council of 25 November 2015 on package travel and linked travel arrangements, amending Regulation (EC) 2006/2004 and Directive 2011/83/EU of the European Parliament and of the Council and repealing Council Directive 90/314/EEC. *Official Journal L 326* (11.12.2015).

In the following chapters I shall examine how the law is applied to protect the travellers and how it affect tour operators.

1.1. Package Holidays Defined

Package holidays, traditionally, are holidays the elements of which are packaged together to form a whole which is sold at an inclusive price. The creator of the package is the tour operator who makes arrangements for transport companies, hotels etc. to provide the travel, accommodation, meals and other items which together constitute a particular holiday.

People normally think of package holidays as involving a flight to some sunny destination, a comfortable hotel by the sea and a few excursions. However, the range of package holidays is truly astonishing: ski holidays, cruises, bus/coach holidays, sporting and adventure holidays, pilgrimages etc.

A tour operator normally sets out in a brochure or their website the package holidays which he is offering for a particular season. As well as containing the basic factual information regarding each holiday, and items such as the operator's booking conditions, the brochures and websites normally also contain a selection of photographs and descriptions that potential traveller's dreams are made of.

It should be noted that tailor made package holidays have also become increasingly popular in the last years. These are holidays where the tour operator describes the constituent parts but leaves it to the travellers to ask for constituents to be packaged into a whole which best satisfies their requirements.

Many of the large travel companies are both tour operators and travel agents but proper consideration must always be given to the capacity in which such a company acts on a particular occasion. It should be noted that today there are only a handful of tour operators in Croatia and most of them sell their holidays through travel agents. Their role is totally different from that of the tour operator and awareness of this is essential to a proper understanding of the legal responsibilities of each. It is certainly the tour operator who arranges the various facilities and services which make up the package holiday, and hence attracts the higher level of responsibility. In Croatia, travellers most often deal exclusively with travel agents.

2. THE REGULATORY FRAMEWORK AND THE LEGAL BACKGROUND

The first EC Directive on Package Travel, Package Holidays and Package Tours (EEC) 90/314 was adopted on June 13, 1990. It was a result of the EC's general aim to complete the internal market and harmonise laws, as the EC identified the tourist sector as an essential part of the internal market.

As there are still disparities in the rules protecting travellers in different EU Member States and in order to enable travellers and tour operators to benefit fully from the internal market it was necessary to further approximate the laws of the EU Member States relating to packages and linked travel arrangements. The new Directive entered into force on December 31, 2015. Furthermore, the Member States have to transpose it by January 1, 2018 and it will be applicable from July 1, 2018³.

³ Revision of the Package Travel Directive. (2015). *Package Travel, Revision of the Package Travel Directive*. Retrieved 15.05.2016 from http://ec.europa.eu/consumers/consumer_rights/travel/package/index_en.htm.

In Croatia, the 'packages' are regulatorily covered by the Obligations Act⁴, namely articles 881 through 908. The Act defines a package as „the pre-arranged combination of at least two of the following components when sold at an inclusive price and when the service covers a period of more than 24 hours or includes overnight accommodation: transport, accommodation or other tourist services“⁵.

2.1. Tour Operator's Pre-contract and Pre-departure Responsibilities

Obligations Act, article 882 stipulates that no organiser should supply to a traveller any descriptive matter concerning a package, the price of a package or any other condition applying to the holiday contract which contains any misleading information.

If a tour operator breaches the above mentioned regulation, it will be liable to compensate the traveller for any loss which he suffers in consequence. This can include compensation for disappointment as well as direct financial loss. However, except in respect of disappointment, there is no need for a holiday maker to demonstrate reliance upon the information. He only has to show that, as a result of the misleading information, he suffered loss.

In Croatia, it is a common practice for tour operators and travel agents to produce leaflets and brochures which describe package holidays available. Those materials fully oblige tour operators and no organiser should make available a brochure to a possible consumer unless it indicates in a legible, comprehensive and accurate manner the price and adequate information about the 'package'.

There is no requirement for package holidays to be sold through the medium of a brochure or a leaflet, but, where one is used, it certainly must contain the information specified in article 882: the holiday price; the destination; the means, characteristics and categories of transport used; the type of accommodation, its location, category or degree of comfort in accordance with the local regulatory classification; the meals which are included in the package; the itinerary; general information about passport and visa requirements which apply for Croatian citizens and health formalities required for the journey and the stay; either the monetary amount or the percentage of the price which is to be paid on account and the timetable for payment of the balance; whether a minimum number of persons is required for the package to take place and, if so, the deadline for informing the traveller in the event of cancellation.

It has been noted that Croatian tour operators face a number of difficulties in deciding the extent of the above information. In my view, a common-sense approach should be adopted in deciding what should be included in particular promotional materials. A newspaper advertisement, display in a travel agent's window or a 1-2 page leaflet should certainly be regarded as a promotional material, although some of those cannot include all of the above information. However, to avoid the risk of dispute, tour operators and travel agents should aim at including the above listed information or at least statements in all advertising material that the particular advertisement does not give a full description.

2.1.1 Call Centre / Phone Bookings

Phone bookings have lately become increasingly popular. Frequently, the consumer will when he makes a telephone booking be in possession of a brochure or promotional material in which most or possibly all the terms of the contract are set out. Where this is the case, the tour organiser or travel agent may need to do no more than draw attention to these facts. Where this is not the

⁴ Obligations Act (2005), *Zakon o obveznim odnosima* (NN 35/05, 41/08, 125/11, 78/15).

⁵ *Ibid.*, Article 908.

case, I consider that the tour organiser or travel agent would discharge his responsibilities only if he ensures that the customer has been given, so far as is relevant, all of the above mentioned information together with any special terms and conditions the tour organiser or travel agent may impose.

It should be noted that Croatian contract law provides that the latest that booking conditions can be incorporated into a contract is at the time of making the contract. Failure to incorporate the conditions into the contract will result in them being inapplicable. For example, should anything go wrong during a holiday, the tour operator will not be entitled to rely on any post-contract attempt to limit or exclude the liability.

2.2.2 Pre-departure Information

In accordance with Obligations Act, article 886, the tour operator should supply the following information to the traveller in writing or some other appropriate form in good time before the holiday is due to start: the times and places of intermediate stops and transport connections and particulars of the place to be occupied by the traveller (for example cabin on ship, sleeper compartment on train or class of air travel); the name, address and telephone number of the tour operator's representative in the locality where the traveller is about to stay, or if there is no such representative, an agency in that locality on whose assistance a traveller in difficulty would be able to call, or if there is no such representative or agency, a telephone number or information which will enable the traveller to contact the tour operator during the stay.

2.2.3 Transfer of Bookings

Article 889 creates a significant right for travellers to transfer their bookings. It is done so by implying into the Act a term that where the traveller is prevented from proceeding with the package, he may transfer his booking to a person who satisfies all the conditions applicable to the package, provided that the he/she gives reasonable notice to the tour operator of his intention to transfer the contract, ahead the date when departure is due to take place.

The right to transfer a booking applies only where the traveller is prevented from taking his holiday. Although the article does not clearly stipulate, this will obviously cover sickness or accidents suffered by him or his close family. It could probably be interpreted as covering some work-related reasons which make it desirable for him not to go, as well as the insistence of an employer. A mere change of mind would certainly not suffice.

The transferee must be someone who meets any requirements stipulated for people taking the relevant holiday.

In accordance with article 889 (2), when a transfer takes place, both the transferor and the transferee are jointly and severally liable to the tour operator for the holiday price, or the unpaid balance, and also for any additional costs incurred by the tour operator as a result of the transfer. It is not clear whether the latter is limited to the operator's administrative costs of arranging the transfer or whether it also includes cancellation charges imposed by suppliers. Particularly where air transport is on a scheduled airline, the airline may well impose 100 per cent cancellation charges and demand the price of replacement ticket. In my view, any additional costs such as these could be charged by the tour operator, provided that the operator's booking conditions make it clear that they may arise. For the holiday maker to be able to transfer, reasonable notice must be given. The tour operator may have to contact a considerable number of suppliers to obtain new tickets, change names in hotel rooming lists etc. Accordingly, it would be reasonable for an operator to stipulate that no request for transfer can be made within a certain number of days of the departure date (e.g. 14). Again, this must be made clear in

booking conditions. In practice, this right may prove to be rarely exercised by Croatian holiday makers. Particularly where illness is involved, the holiday maker is unlikely to devote efforts to transferring the ticket. On the assumption that he has insurance, he is much more likely to rely on that. This will, of course, enable tour operators to levy cancellation charges where a consumer cancels without putting forward a transferee, while the traveller recovers either whole or significant amount of the paid price. Any such charges will also need to be clearly provided for in the holiday contract.

2.2.4 Surcharges

In contract law there is no objection to a supplier or arranger of future services reserving the right to increase the price of the services to reflect supervening increases in costs. Historically this is something which tour operators have occasionally done, though it looks that the no surcharge guarantees are fashionable at the moment. According to article 900, holiday maker is under no obligation to accept a surcharge caused by alterations which the tour operator makes to a holiday should those exceed 10 per cent of the contracted price and it should be noted that the contracted price cannot be increased within 20 days of departure.

2.2.5 Cancellation or Alteration by the Tour Organiser

Holidays are often booked many months before their departure date. There is always the possibility of some supervening event, such as the closing of a hotel or a political unrest, which necessitates an alteration to, or possibly even the cancellation of a holiday. There is also a possibility of such a change even after the holiday has commenced. Where the organiser is constrained before departure to alter significantly an essential term of the contract, such as the price, he should notify the consumer as quickly as possible. The consumer must notify the organiser or the agent as soon as possible of his decision which may be to withdraw from the contract without penalty or to accept the variation of it which specifies the alterations made and their impact on the price. Croatian Obligations Act does not impose a limit on the amount of a surcharge, but if an increase is a significant one, it will enable the consumer to withdraw from the contract without penalty.

When a consumer withdraws from a holiday contract or where the organiser for any reason other than the fault of consumer cancels the holiday before the agreed departure date, the consumer should have the following implied contractual rights:

- to take a substitute package of equivalent or superior quality if the organiser is able to offer him such a substitute
- to take a substitute package of lower quality if the organiser is able to offer him one and to recover from the organiser the difference in price between that of the package purchased and substitute package
- to have repaid to him as soon as possible all the moneys paid by him under the contract.

The consumer would not be entitled to compensation if the holiday is cancelled because the number of persons who agree to take it is less than the minimum required and the consumer is informed of the cancellation, in writing, within the period indicated in the description of the package or if the holiday is cancelled by reasons of unusual and unforeseeable circumstances beyond the control of the organiser, the consequences of which could not have been avoided even if all due care had been exercised.

2.2.5.1 Post-departure Changes

In case where, after departure, a significant proportion of the services contracted for are not provided, or the organiser becomes aware that he will be unable to procure a significant proportion of them, according to Obligations Act, article 903, the first is that the organiser should make suitable alternative arrangements, at no extra cost to the traveller for the continuation of the package and should, where appropriate, compensate him/her for the difference between the services to be supplied under the contract and those actually supplied. The second applies where it is impossible to make suitable alternative arrangements, or they are rejected by the consumer for good reasons. In such cases the organiser must, where appropriate, provide the consumer with equivalent transport back to the place of departure or to another place which the consumer has agreed. In addition, the organiser must, where appropriate, compensate the consumer. In my opinion, it might well be appropriate for no compensation to be paid where the problem is caused by a genuine *vis major* event such as an earthquake.

2.2. Tour Operator's Post-departure Responsibilities

A feature of the package holiday is that (in most cases) the tour operator does not himself provide the flights, accommodation, meals, etc. which go to make up the holidays advertised in his marketing materials. But it is he who makes the arrangements which enable the holiday to be sold as package, and it is he who enters into contracts with the airlines, hotels etc. involved in the package. Usually the holiday maker has no contractual link with hotels and so is not even in a position to make breach of contract claims against them. Here we come to a source of interesting questions about the tour operator's contractual responsibilities to his customers. Are tour agents responsible in damages for every accident suffered by travellers through the negligence of airlines which he employed, or for every bowl of boiling soup which hotel waiters accidentally dropped on the laps of his customers? Or are they only liable if they, according to Obligations Act, article 889, made a good choice, namely a failure to choose good hotels, airlines etc.?

I would find it wholly unreasonable to saddle a tour operator with an obligation to ensure the safety of all components of the package over none of which he had any control at all. However, the aim of the first EC Directive was that the tour operator would be responsible for all the elements of the package and that primary liability for anything which went wrong would rest with him. In other words, the tour operator should face strict liability for any of the services, facilities or goods to be supplied as component parts of the package and would not be able to mount a defence on the basis that the services, facilities or goods were supplied by others over whom he had no control. The Obligations Act confirms the previous in article 889.

The tour operator is thus liable to the traveller for any damage caused to him by any failure to perform the contract or improper performance of it unless the failure or improper performance is due neither to the fault of the tour operator nor that of another supplier of services because:

- it is attributable to the consumer
- it is attributable to a third party unconnected with the provision of the services contracted for, and is unforeseeable or unavoidable
- it is due to unusual and unforeseeable circumstances beyond the control of the tour operator, the consequences of which could not have been avoided even if all due care had been exercised or an event which neither the tour operator nor the supplier of services, even if all due care had been exercised, could foresee or forestall.

2.2.1 The Consumer's Communication Obligation⁶

The traveller needs to communicate at the earliest opportunity in writing or any other appropriate form, to the supplier of the services concerned any failure which he perceives at the place where the services concerned are supplied. The same needs to be communicated to the tour operator within 8 days of finishing the journey.

3. DAMAGES

The holiday may be disrupted by events beyond the control of tour operator: flights may be delayed by bad weather or industrial action by airport staff, or independent hoteliers may have overbooked their hotels. To what extent should the operator be held responsible for the holiday-makers' loss of enjoyment when such things happen?⁷

This chapter assumes liability and examines the extent to which holiday makers will be able to recover damages.

The Croatian regulator defines the meaning of damages⁸ as that sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been if he had not sustained the wrong for which he is now getting the compensation. For damages to be recoverable for breach of contract, there must be a causal connection between the defendant's breach of contract and the plaintiff's loss, and the particular loss must be within the contemplation of the parties. The first question to be considered is whether or not the defendant's breach caused the plaintiff's loss, in respect of which two alternative situations must be borne in mind:

- the defendant's breach⁹ directly caused the plaintiff's loss
- the defendant's breach indirectly caused the plaintiff's loss, i.e. a new intervening event occurs pursuant to the defendant's breach and causes the plaintiff's loss.

3.1 Claims

A holiday maker who is dissatisfied with any aspect of his holiday and who fails to obtain satisfaction from the tour operator concerned, must decide whether to pursue matters further and, if so, how.

As previously argued, the holiday maker's contract for a package holiday is with the tour operator who arranges it and, *prima facie*, any liability for defects in the holiday will attach to the tour operator. Thus, a dissatisfied holiday maker should address his complaints to the tour operator, either directly or through the travel agent with whom the booking was made. Also, a traveller may have a claim against a travel agent if the agent misrepresented the facilities available, failed to process the booking satisfactorily or gave unsatisfactory advice.

Should the travel agent not inform the traveller of the actual tour operator, the dissatisfied traveller could start the proceeding against the travel agent, which shall be considered as the tour organiser in this particular instance.

In Croatia, generally speaking, holiday claims in respect of which court proceedings are issued are brought in the county courts.

⁶ *Ibid.*, Article 898.

⁷ Keenan, D., Riches S. (2005). *Business Law*, Harlow: Pearson Longman, p. 444.

⁸ Obligations Act (2005), *Zakon o obveznim odnosima* (NN 35/05, 41/08, 125/11, 78/15), Article 1085.

⁹ E.g. false and misleading statements. Tour operators and travel agents are often accused by customers of making false or misleading statements, e.g. regarding the facilities available on a package holiday.

4. FINANCIAL PROTECTION¹⁰ FOR HOLIDAY MAKERS

It is a feature of package holiday contracts that the customer pays money to the tour operator long before the holiday begins. Usually he/she pays a deposit at the time when he books his holiday and then pays the balance of his holiday price before the departure. If he books shortly within departure, the traveller will normally be required to pay the full price when he makes the booking. This pattern of payment gives rise to special problems in cases where a tour operator ceases trading. Before he does so, he will, in the normal course of events, have received large sums of money paid by customers whose holidays have not commenced. He may have used some of this money to make advance payments to airlines and hotels, or to pay his other trade creditors. In any event, if the tour operator is insolvent, there is little chance of customers whose holidays have not commenced receiving a full refund in the course of its liquidation. There is also the problem of holiday makers who are stranded abroad at the time of cessation of trading. In some cases, especially where the operator has paid the relevant hotels and airlines in advance, the holiday may continue as planned. Hitherto, protection and assistance for holiday makers in the event of the insolvency of their tour operator needs to be provided by requiring tour operators to make arrangements to protect and assist their customers in the event of tour operator's insolvency. In accordance with Obligations Act, article 893, these arrangements must take form of bonding, insurance or bank guarantee. In theory the Act ensures that purchasers of package holidays will receive a full refund if their tour operator goes bust before the start of their holiday and will be repatriated if it does so during their holiday. However, this will depend upon tour operators making the required arrangements and doing so by reference to correct projections of their turnover. In Croatia, in this circumstances we rely only on honesty and reliability of all tour operators and the ability of relevant officers to make sufficient checks and ensure that tour operators maintain the required level of protection.

5. REVISION OF THE PACKAGE TRAVEL DIRECTIVE

As previously mentioned, on November 25, 2015 the new Directive on Package Travel (EU) 2015/2302 was adopted, bringing the EU legislation up to date with the developments in the travel market, which has changed dramatically since the original adoption of the old Package Travel Directive. The new Directive entered into force on December 31, 20 days after its publication. Furthermore, Croatia and the other EU Member States have to transpose it by January 1, 2018 and it will be applicable from July 1, 2018. As increased use of the Internet to research and book travel means it is now more common for travellers to book their flights, hotels etc. separately, rather than as a package, the new rules will extend protection of the 1990 Package Travel Directive to cover not only traditional package holidays, but also give clear protection to travellers who book other forms of combined travel, e.g. a self-chosen combination on a website of a flight plus hotel or car rental. There will always be protection where travel services are advertised as a package or where they are offered at a total or inclusive price. Based on the above, it must be noted that the new Directive broadens the concept of

‘package’ and now will apply to three different sorts of travel combinations:

- *pre-arranged packages* - ready-made holidays from a tour operator made up of at least two elements: transport, accommodation or other services, e.g. car rental;
- *customised packages* - selection of components by the traveller and bought from a single business online or offline;

¹⁰

E.g. the arrangements for security for money paid over and for the repatriation of the consumer in the event of insolvency.

- *linked travel arrangements* - if the consumer, after having booked one travel service on one website, is invited to book another service through a targeted link or similar, the new rules offer some protection– provided that the second booking is made within 24 hours.

As well as travellers, the new Directive will affect all travel organisers and retailers of travel services.

5.1. Benefits for Consumers

The new Directive reinforces the following rights:

- New information requirements for travellers: traders must include understandable information on the package and the protection travellers benefit from under package holiday rules.
- More predictable prices: establishment of an 8% cap for possible price increases by the trader, beyond which the traveller has the right to cancel their holiday free of charge.
- Stronger cancellation rights: free cancellation before departure in case of natural disasters, war, or other serious situations at the destination. Package travellers will also be able to cancel their holiday for any reason by paying a reasonable cancellation fee (in addition to the right to transfer the package to another traveller).
- Clear identification of the liable party: the organiser of the package in all EU Member States has to deal with the problem if something goes wrong. In addition Member States may decide that also the retailer (travel agent) is fully liable.
- Clear liability for booking errors: traders will be made explicitly liable for booking errors in relation to packages and linked travel arrangements.
- Clarification on essential consumer rights: the organiser is required to assist travellers in difficulty, for example where health assistance is needed.
- Guarantees of money-back and repatriation: if the package organiser goes bankrupt; these guarantees will under certain conditions be extended to linked travel arrangements.

5.2. Benefits for Businesses

The new Directive will certainly reduce the administrative burden on businesses and bring down compliance costs for traders. The main advantages for market operators consist in:

- A level playing field: the same rules will apply for businesses across the EU selling competing travel products. The new harmonized approach will result in easier cross-border transactions and increase legal certainty.
- Mutual recognition of insolvency protection: insolvency schemes will be recognised across the EU. To that effect, a structured cooperation mechanism between the Member States will be put in place.

6. CONCLUSION

As argued above, several legal issues arise when considering travel agents' business. Some of them certainly limit the potential of tour operators, extending their liability further ensuring that travellers in Croatia and the EU enjoy a significant level of legislative protection. However, some of the old rules need to be brought into the digital age, a change is essential, and it is certain, that the new Travel Package Directive will meet the needs of the consumers and the businesses, in Croatia, and the EU as a whole. With the new rules, consumers shall certainly enjoy even more protection and greater rights. On the other hand, one of the most important

benefits of the new Directive will be the boost to the economy due to clearer and harmonised regulation which will allow businesses to expand. A lot has been done in the field of passenger rights, however, there is more to be done in the future.

LITERATURE:

1. Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours. Official Journal L 158 (23.06.1990).
2. Council Directive (EU) 2015/2302 of the European Parliament and of the Council of 25 November 2015 on package travel and linked travel arrangements, amending Regulation (EC) 2006/2004 and Directive 2011/83/EU of the European Parliament and of the Council and repealing Council Directive 90/314/EEC. Official Journal L 326 (11.12.2015).
3. Keenan, D., Riches S. (2005). Business Law, Harlow: Pearson Longman.
4. Obligations Act (2005), Zakon o obveznim odnosima (NN 35/05, 41/08, 125/11, 78/15).
5. Revision of the Package Travel Directive. (2015). Package Travel, Revision of the Package Travel Directive. Retrieved 15.05.2016 from http://ec.europa.eu/consumers/consumer_rights
6. /travel/package/index_en.htm.

FAIR AND EQUITABLE TREATMENT STANDARD IN INVESTMENT TREATIES AND GENERAL INTERNATIONAL LAW

Davor Muhvic

*Faculty of Law Osijek, J.J. Strossmayer University of Osijek,
Croatia dmuhvic@pravos.hr*

ABSTRACT

Fair and equitable treatment (FET) standard is a common part of contemporary bilateral investment treaties, as well as other international investment agreements. Indeed, in the last two decades the practice of investment treaty arbitration has revealed FET standard as the most important standard for foreign investors' international legal protection. This paper analyzes the relationship of this in principle treaty standard with general international law. Investment treaties generally do not provide a definition of FET standard and they are not uniform with regard its association with general international law. This has placed a lot of burden on investment arbitration tribunals who interpret this standard by taking into account the text and context of particular investment treaty.

The paper gives an overview of relevant literature and practice of investment arbitration tribunals in considering two main questions. Firstly, the author considers whether the FET standard as such represents the existing general customary international law in the form of the long time acknowledged minimum standard of treatment of aliens. Secondly, the author considers whether the very large number of contemporary investment treaties, accompanied by the constantly growing arbitration practice with regard to FET standard has some sort of a rebound effect on general customary international law. The main conclusion of the paper is that the mutual influence of relevant customary and treaty law, as well as FET standard's more objective and clearer nature than the minimum standard says a lot about the potency of this standard to confirm its place in general international law.

Keywords: *fair and equitable treatment standard, general (customary) international law, investment treaties, minimum standard of treatment of aliens.*

1. INTRODUCTION

In the last two decades the growing practice of investment treaty arbitration has revealed the so-called "fair and equitable treatment" (hereinafter: FET) standard as the most important investment treaty standard for foreign investors' international legal protection. This standard which is commonly found in today around 3.000 bilateral investment treaties (hereinafter: BITs) (See *UNCTAD World Investment Report 2015*, 2015, p. 106) is the most recognizable one by foreign investors, mainly transnational (multinational) corporations, as in most cases they base their claims on it and the largest number of successful claims is won on the basis of its violations (Dolzer, Schreuer, 2012, p. 130). The investment treaties however do not generally provide for definition or the elaboration of the content of the FET standard. Consequently, one of the main problems in clarifying this standard by arbitral tribunals is determining whether it is based on the relevant rules of general international law or whether it represents a separate treaty standard with its own meaning and scope. The purpose of this article is thus to analyze the relationship of this in principle treaty standard with general international law.

In the first part of the paper (Section 2) it is given an overview of the FET standard as it is found in BITs as well as in other international instruments. This overview will include the question of the nature of the FET standard as a legal standard and the question of its definition and content provided mostly by various arbitral tribunals. In the second part (Section 3) it will be questioned

whether the FET standard, as in principle a treaty standard, as a matter of fact represents the existing general international law. In this context a special emphasis will be placed on the long time acknowledged minimum standard of treatment of aliens as part of general customary international law. The third part of the paper (Section 4) will investigate connections between FET standard and general international law the other way around. The main question in this regard is whether the very large number of investment treaties accompanied by the constantly growing arbitration practice with regard to FET standard has some sort of a rebound effect on general customary international law. In the end, the author shall offer some conclusions (Section 5).

2. FET STANDARD AS PROVIDED BY INVESTMENT TREATIES

As it is already mentioned, the FET standard is a common component of contemporary BITs as well as other international investment agreements (IIAs; such as NAFTA from 1992 (Art. 1105(1)) and the Energy Charter Treaty from 1994 (Art. 10(1))). The standard can be traced back even to earlier "treaties on friendship, commerce and navigation" in whose conclusion especially prominent were the United States of America (Dolzer, Schreuer, 2012, p. 130). Apart from the investment treaties it can be found in texts of some other international instruments, among other the Convention Establishing the MIGA from 1985 (Art. 12(d)) and the World Bank Guidelines on the Treatment of Foreign Direct Investment from 1992 (Section III., para. 2.). Despite the appearance of the FET standard in earlier international documents it was not until around the year 2000 when arbitral tribunals started to define it more precisely and to elaborate on its content (Dolzer, Schreuer, 2012, p. 130).

It is firstly important to emphasize that regardless the terminological similarity the *fair and equitable* standard needs to be differentiated from situations when international judicial or arbitral bodies are authorized to solve the dispute between parties *ex aequo et bono* (See e.g. Art. 38(2) of the Statute of the International Court of Justice from 1945 and Art 42(3) of the ICSID Convention from 1965; See more on this: Andrassy, Bakotić, Seršić, Vukas, 2010, p. 32-34). Unlike making a judicial or arbitral decision *ex aequo et bono*, the FET standard is not an extra-legal concept (Cf. Angelet, 2012, p. 1094; Dolzer, Schreuer, 2012, p. 134). In *Mondev v. United States* Award from 2002 the Arbitral Tribunal has emphasized that in the application of the FET standard on the particular case, "[i]t may not simply adopt its own idiosyncratic standard of what is "fair" or "equitable", without reference to established sources of law" (para.

119). FET standard is thus a legal standard. The concept of legal standard is well known in general theory of law. Visković for example defines legal standards as very abstract terms which express a broad array of forms of some types of behaviour which the law-makers cannot or consider inopportune to elaborate precisely. Therefore they leave to the addressees of this norms to give them concrete meanings themselves according to the particularities of the case in question, such meanings which in particular situation an average reasonable person would give to those norms (Visković, 2006, p. 251).

The fact that investment treaties generally do not provide a definition of FET standard has placed a lot of burden on arbitral tribunals to interpret and clarify its meaning. Sometimes the arbitral tribunals lean towards providing an abstract definition of the FET standard. The Arbitral Tribunal in *Genin v. Estonia* Award from 2001 has for example concluded that acts in violation of the FET standard "would include acts showing a wilful neglect of duty, an insufficiency of action falling far below international standards, or even subjective bad faith" (para. 367.). Due to their abstractness, this and other definitions (See e.g. *Tecmed S.A. v. Mexico*, 2003, para. 154) do not help much in fully understanding the FET standard. The other arbitral tribunals have adopted a different approach. They tend to recognize some typical situations in which this

standard is violated. This situations include, for example: situations of coercion and harassment of foreign investors by host state organs (See e.g. *Pope & Talbot v. Canada*, 2001, para. 181; *Tecmed S.A. v. Mexico*, 2003, para. 163; *Desert Line Projects v. Yemen*, 2008, para. 179), situations of denial of justice (See e.g. *Loewen v. United States*, 2003, paras. 132, 137; *Tecmed S.A. v. Mexico*, 2003, para. 162), situations of host state actions conducted in bad faith towards foreign investors (See e.g. *Saluka Investments BV v. Czech Republic*, 2006, para. 307; *Chemtura Corp. v. Canada*, 2010, para. 145), situations of host state failure to comply with contractual obligations by using their sovereign authority (See e.g. *Bayindir v. Pakistan*, 2009, paras. 180, 377; *Duke Energy v. Ecuador*, 2008, para. 345) and situations of misleading the foreign investors' legitimate expectations by changing the relevant regulations (See e.g. *Occidental Co. v. Ecuador*, 2004, paras. 183-186; *Eureko B.V. v. Poland*, 2005, paras. 231-234).

Dolzer and Schreuer offer an interesting parallel between the FET standard in international investment law and a general clause of good faith provided by civil codes in Continental European countries. According to these authors, the purpose of the FET standard would be to serve as a kind of a comprehensive principle which fills the gaps not covered by other more specified investment treaty standards and which also gives contribution to their better understanding (Dolzer, Schreuer, 2012, p. 132). However, no matter the some degree of interaction and overlaps with other investment treaty standards (Dolzer, Schreuer, 2012, p. 133), the prevalent view seems to be that the FET standard is an autonomous standard and not merely the sum of all other investment treaty standards (See e.g. *Azurix Corp. v. Argentina*, 2006, para. 408; *El Paso Energy v. Argentina*, 2011, paras. 228-231; *CME Czech Republic v. Czech Republic*, 2001, para. 611).

For the purpose of this paper it is very important to emphasize that the FET standard denominated as such originated from (mainly bilateral) treaties and not from general international law (Cf. Angelet, 2012, p. 1095). Arbitral tribunals are primarily concerned with claims of violations of this standard as it is found in particular investment treaty concluded between the host state and the home state of the investor which brought the claim. As the provisions which provide for FET standard in investment treaties are formulated in different variations this has significant consequences for the interpretation of the FET standard in general (Cf. Dolzer, Schreuer, 2012, p. 132). Naturally, the provisions of every particular treaty must be interpreted according to the general rules of international law on the interpretation of treaties, as envisaged in articles 31-33 of the Vienna Convention on the Law of Treaties from 1969. According to the general rule of interpretation "[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose" (Art. 31(1)). In this paper it is especially worth noting the provision of the Art. 31(3(c)) of the Vienna Convention on the Law of Treaties according to which when interpreting the text of a treaty:

“There shall be taken into account, together with the context: [...]

(c) Any relevant rules of international law applicable in the relations between the parties.”

The phrase "any relevant rules of international law applicable in the relations between the parties" naturally includes any relevant rules of general international law. Bearing this in mind, in the next sections it will be examined the relations of the FET standard with the relevant rules of general international law.

3. FET STANDARD AS A REFLECTION OF GENERAL INTERNATIONAL LAW?

It has been said that when interpreting the treaty provision one must take into account any relevant rules of general international law which are applicable between the parties. According to this, when interpreting the investment treaty provisions providing for FET standard it is necessary to determine which are the relevant rules of general international law in this regard. These are the rules covered by the so-called “minimum standard of treatment of aliens” (See Dickerson, 2012, p. 235). The minimum standard of treatment was formed in contradistinction to the so-called “Calvo doctrine” of Latin American states of the second part of the 19th century, according to which the aliens have the same level and means of protection as the nationals of some country. During the first half of the 20th century it has prevailed the concept according to which there exists a standard established by (customary) international law according to which aliens have to be treated no matter the possible lower standards which are enjoyed by the nationals of the state in question. The precise content of the minimum standard is however unclear. It is in this regard frequently quoted the passage of the Decision of Mexico/U.S.A. General Claims Commission from 1926 in the *Neer* case which demands a very high threshold for demonstrating the violation of the minimum standard:

“the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.” (p. 61-62)

According to Dickerson, the minimum standard included in the first place the right to be free from denial of justice, the right to protection of life and against bodily harm but also the right to recognition of juridical personality and various procedural rights which are enjoyed by natural and legal persons alike. Because of the significant evolution of international human rights law that, at least for natural persons, covered most of this rights for aliens and nationals alike, the main area of application of the minimum standard today are property rights (Dickerson, 2012, p. 237). There are various deliberations about the relationship of the FET standard and general international law in the literature. Some authors consider the FET standard a reflection of general international law, while others do not. According to Surya P. Subedi for example the FET standard “is deeply rooted in customary international law” (Subedi, 2008, p.

63). Orakhelashvili on the other hand does not consider it a part of general international law saying that there is no sufficient “evidence pointing to the customary status of this notion” and that “its inherent indeterminacy [...] makes it impossible to infer its acceptance as part of general international law” (Orakhelashvili, 2008, p. 105). In the heart of this debate is actually the question whether the FET standard is capable of providing a higher, more protective standard of protection to foreign investors than the traditional notion of minimum standard of treatment (See Sornarajah, 2010, p. 349, Subedi, 2008, p. 65). There is also the third group of authors which consider this contradistinction between investment treaties' FET standard and traditional notion of minimum standard of treatment flawed because of failing to take into account the evolving nature of customary international law (See Douglas, 2009, p. 88; Orrego Vicuña, 2012, p. 197). This question will be expounded in more detail in the Section 4. It has already been said that provisions containing FET standard are not uniformly formulated in various investment treaties. Investment treaties are not uniform neither with regard to relation of FET standard with general international law. Some investment treaties thus provide for FET standard without references to general international law whatsoever while others provide such references. For example, the German Model BIT from 2008 in Art. 2(2) provides that “[e]ach Contracting State shall in its territory in every case accord investments by investors of the other Contracting State *fair and equitable treatment* as well as full protection under this Treaty”

(emphasis added) not containing any reference to general international law. On the other hand, the French Model BIT from 2006 for example in Art. 3(1) provides that "[e]ither Contracting Party shall extend *fair and equitable treatment in accordance with the principles of International Law*" (emphasis added). The special kind of the latter type of investment treaties are those which define FET standard as integral element of the minimum standard of treatment of aliens as provided by general customary international law. The best known example of these investment treaties is the North American Free Trade Agreement (NAFTA) from 1992. In the Art. 1105 of this treaty which is titled "Minimum Standard of Treatment" in para. 1 it is provided that "[e]ach Party shall accord to investments of investors of another Party *treatment in accordance with international law, including fair and equitable treatment* and full protection and security" (emphasis added). Three State Parties of NAFTA (Canada, Mexico and United States of America) have subsequently agreed on the interpretation of the aforementioned provision stating that "Article 1105(1) prescribes *the customary international law minimum standard of treatment of aliens* as the minimum standard of treatment to be afforded to investments of investors of another Party" (emphasis added) and that "[t]he concepts of 'fair and equitable treatment' and 'full protection and security' *do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens*" (emphasis added; NAFTA Notes of Certain Chapter 11 Provisions", 2001). Therefore, in the context of NAFTA, FET standard does not give higher level of protection to foreign investors than that which they already enjoy according to the relevant rules of general international law. According to this interpretation the FET standard thus merely represents the existing general international law. This interpretation of FET standard has since 2001 been generally accepted by the NAFTA arbitral tribunals (See e.g. *Mondev v. United States*, 2002, para. 100, *Loewen v. United States*, 2003, paras. 124-128 and *Thunderbird v. Mexico*, 2006, paras. 192-193), but also seems to have made a significant impact even on a broader practice of NAFTA State Parties beyond that legal regime (See Art. 5 of the 2012 US Model BIT and Art. 5 of the 2004 Canada Model BIT). In any case, the NAFTA legal regime is specific because of the explicit connections of FET standard and general international law in the same treaty provision (and its subsequent official interpretation). One needs to be very careful while trying to bring deliberations regarding the FET standard in NAFTA regime to a broader debate on FET standard and general international law (for the useful comparison between "the two lines of jurisprudence" of NAFTA and "non-NAFTA" tribunals regarding FET standard see Dolzer, von Walter, 2007, p. 99). Therefore it is important to see how the arbitral tribunals which had to rule on treaty provisions with no explicit references to general international law declared on this matter. Naturally, every investment treaty arbitral tribunal has to interpret FET standard by taking into account the text and the context of the particular investment treaty in which this standard is found. The findings of arbitral tribunals in this regard are far from uniform. Some tribunals have concluded that FET standard goes beyond the minimum standard of treatment of aliens (See e.g. *Tecmed S.A. v. Mexico*, 2003, paras. 155-156; *Bayindir v. Pakistan*, 2009, para. 164), while others considered that their content is the same (See e.g. *Occidental Co. v. Ecuador*, 2004, paras. 188-190; *CMS v. Argentina*, 2005, paras. 282-284). Other arbitral tribunals have, on the other hand, called into question this whole debate. According to them, because of the rather vague character of both the minimum standard of treatment and the FET standard their distinction is of no great relevance when applying them to the facts of a particular case (See e.g. *Saluka Investments BV v. Czech Republic*, 2006, para. 291; *El Paso Energy v. Argentina*, 2011, para. 335). So it seems there is no consensus in sight about the question whether the FET standard merely represents the traditional minimum standard of treatment of general international law or it provides the higher (treaty) standard of protection of foreign investors.

But, it is very likely that the resolution of this controversy lies not in the question of impact of traditional general customary international law on the contemporary treaty law but instead in the reversed impact of investment treaty law on general international law. This argument will be shown in the next section.

4. THE REBOUND EFFECT OF FET STANDARD ON GENERAL INTERNATIONAL LAW

In the previous section it has been considered the question of connections between the FET standard and the relevant rules of general customary international law, primarily the question of influence of customary law on creating and designing of the FET standard. In this section the connections between FET standard and customary law shall be analyzed the other way around. Namely, it will be explored whether the very large number of contemporary (mostly bilateral) investment treaties, accompanied by the constantly growing arbitration practice with regard to FET standard has some sort of a rebound effect on (re)shaping or changing of the relevant rules of general customary international law.

As it was already stated in the previous section, there are authors who in discussing the FET standard emphasize the evolving nature of the customary international law. Douglas for example pointed to "the sterility of the debate as to whether the fair and equitable standard of treatment is the same as the minimum standard of treatment for aliens in general international law" as customary international law is not "in a petrified state as existed in 1926 when *Neer v Mexico* was decided" (footnote omitted; Douglas, 2009, p. 86, 88). Similar argument is put by Orrego Vicuña. According to him, since the minimum standard is today broader "there is no need to explore further the question of fair and equitable treatment as an autonomous standard under international law, as had become occasionally when the restrictive view of the customary rule standard appeared to prevail" (Orrego Vicuña, 2012, p. 197). Schwebel sees this evolution of rules of general international law concerning foreign investment as a direct result of enormous and growing number of in their content very similar investment treaties (Schwebel, 2004, pp. 27 *et seq.*). This kind of reasoning has also been adopted by some arbitral tribunals.

The Arbitral Tribunal in *Chemtura Corp. v. Canada* has grappled with the question of defining the FET standard as envisaged in the Art. 1105 of NAFTA which, as it was already stated, is explicitly restricted to the relevant rules of general international law. In the Award from 2010 this Arbitral Tribunal has stated:

"the Tribunal notes that it is not disputed that the scope of Article 1105 of NAFTA must be determined by reference to customary international law. Such determination cannot overlook the evolution of customary international law, nor the impact of BITs on this evolution. [...] In determining the standard of treatment set by Article 1105 of NAFTA, the Tribunal has taken into account the evolution of international customary law as a result *inter alia* of the conclusion of numerous BITs providing for fair and equitable treatment." (para. 121, 136)

So, according to this Tribunal the relevant rules of general customary international law regarding the treatment of the alien in general and foreign investor in particular do not necessarily stand still in time but are capable of evolution along with the change of economic, social, political and other circumstances. Additionally, the Tribunal has taken for granted that *inter alia* "the conclusion of numerous BITs providing for fair and equitable treatment" has already had some impact on customary international law.

Even more progressive view on this question enunciated the Arbitral Tribunal in *Merrill & Ring Forestry v. Canada* in the Award from the same year. This Arbitral Tribunal has stated the following:

"A requirement that aliens be treated fairly and equitably in relation to business, trade and investment is the outcome of this changing reality and as such it has become sufficiently part of widespread and consistent practice so as to demonstrate that it is reflected today in customary international law as *opinio juris*. In the end, the name assigned to the standard does not really matter. What matters is that the standard protects against all such acts or behavior that might infringe a sense of fairness, equity and reasonableness." (para. 210)

This Arbitral Tribunal has basically said that the FET standard as it is widely accepted in investment treaties has today become part of general customary international law. It goes on to explain that the name we assign to it (FET standard or minimum standard of treatment) does not have much relevance. Foreign investors are protected from every act "that might infringe a sense of fairness, equity and reasonableness" and this has to be determined according to the facts of every particular case. This last argument actually points to the more objective and clearer nature of the FET standard in comparison to the minimum standard of treatment. As F.A. Mann exposed in a slightly different context way back in 1981:

"A tribunal would not be concerned with a minimum, maximum or average standard. It will have to decide whether in all circumstances the conduct in issue is fair and equitable or unfair and unequitable." (referenced by Dolzer, Schreuer, 2012, p. 135).

This argument could be critical in the following development regarding the question of the confirmation of the place of the FET standard in general international law.

5. CONCLUSION

The problem of determining the relationship of the FET standard envisaged by investment treaties and the minimum standard of treatment of general international law is a direct consequence of the ambiguity of both notions. This ambiguity has proven to be a great burden for investment treaty arbitral tribunals. It seems however that the discourse about the question whether the FET standard represents the traditional notion of minimum standard of treatment of aliens or more protective separate treaty standard is being gradually replaced by the discourse about the question of a reversed impact of investment treaties' FET standard on general international law. Be that as it may, the mutual influence of relevant customary and treaty law, as well as FET standard's more objective and clearer nature says a lot about the potency of this standard to confirm its place in general international law.

LITERATURE:

1. Andrassy, J., Bakotić, B., Seršić, M., Vukas, B. (2010). *Međunarodno pravo*, 1. dio [International Law, Part 1] (2nd edn.). Zagreb: Školska knjiga.
2. Angelet, N. (2012). Fair and Equitable Treatment. In R. Wolfrum, R. (ed.), *Max Planck Encyclopedia of Public International Law*, Vol. III (p. 1094). Oxford: Oxford University Press.
3. *Azurix Corp. v. Argentina* (2006). ICSID Case No. ARB/01/12, Award, 14 July 2006. Retrieved 28.07.2016 from https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC507_En&caseId=C5.

4. *Bayindir v. Pakistan* (2009). ICSID Case No. ARB/03/29, Award, 27 August 2009. Retrieved 28.07.2016 from <http://www.italaw.com/sites/default/files/case-documents/ita0075.pdf>.
5. Canada Model BIT (2004). Retrieved 28.07.2016 from <http://www.italaw.com/documents/Canadian2004-FIPA-model-en.pdf>.
6. *Chemtura Corp. v. Canada* (2010). NAFTA Arbitration (UNCITRAL Rules), Award, 2 August 2010. Retrieved 28.07.2016 from http://www.italaw.com/sites/default/files/case-documents/ita0149_0.pdf.
7. *CME Czech Republic v. Czech Republic* (2001). UNCITRAL Arbitration Proceedings, Partial Award, 13 September 2001. Retrieved 28.07.2016 from <http://www.italaw.com/sites/default/files/case-documents/ita0178.pdf>.
8. *CMS v. Argentina* (2005). ICSID Case No. ARB/01/8, Award, 12 May 2005. Retrieved 28.07.2016 from https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC504_En&caseId=C4.
9. Convention Establishing the MIGA (1985). Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) of 11 October 1985, *United Nations Treaty Series*, Vol. 1508, p. 100.
10. *Desert Line Projects v. Yemen* (2008). ICSID Case No. ARB/05/17, Award, 6 February 2008. Retrieved 28.07.2016 from https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC791_En&caseId=C62.
11. Dickerson, H. (2012). Minimum Standards. In R. Wolfrum, R. (ed.), *Max Planck Encyclopedia of Public International Law*, Vol. VII (p. 235). Oxford: Oxford University Press.
12. Dolzer, R., Schreuer, C. (2012). *Principles of International Investment Law* (2nd edn.). Oxford: Oxford University Press.
13. Dolzer, R., von Walter, A. (2007). Fair and Equitable Treatment – Lines of Jurisprudence on Customary Law. In F. Ortino, L. Liberti, A. Sheppard, H. Warner (eds.), *Investment Treaty Law: Current Issues II: Nationality and Investment Treaty Claims/Fair and Equitable Treatment in Investment Treaty Law* (p. 99). London: British Institute of International and Comparative Law.
14. Douglas, Z. (2009). *The International Law of Investment Claims*. Cambridge: Cambridge University Press.
15. *Duke Energy v. Ecuador* (2008). ICSID Case No. ARB/04/19, Award, 18 August 2008. Retrieved 28.07.2016 from https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1611_En&caseId=C44.
16. *El Paso Energy v. Argentina* (2011). ICSID Case No. ARB/03/15, Award, 31 October 2011. Retrieved 28.07.2016 from <http://www.italaw.com/sites/default/files/case-documents/ita0270.pdf>.

17. Energy Charter Treaty (1994). Energy Charter Treaty of 17 December 1994, *United Nations Treaty Series*, Vol. 2080, p. 3.
18. *Eureko B.V. v. Poland* (2005). Ad hoc Arbitration, Partial Award, 19 August 2005. Retrieved 28.07.2016 from http://www.italaw.com/sites/default/files/case-documents/ita0308_0.pdf.
19. French Model BIT (2006). Retrieved 28.07.2016 from <http://www.italaw.com/documents/ModelTreatyFrance2006.pdf>
20. *Genin v. Estonia* (2001). ICSID Case No. ARB/99/2, Award, 25 June 2001. Retrieved 28.07.2016 from https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC592_En&caseId=C178.
21. German Model BIT (2008). Retrieved 28.07.2016 from <http://www.italaw.com/sites/default/files/archive/ita1025.pdf>.
22. ICSID Convention (1965). Convention on the Settlement of Investment Disputes between States and Nationals of other States of 18 March 1965, *United Nations Treaty Series*, Vol. 575, p. 159.
23. *Loewen v. United States* (2003). ICSID Case No. ARB(AF)/98/3, Award, 26 June 2003, *International Legal Materials*, Vol. 42 (2003), p. 811.
24. *Merrill & Ring Forestry v. Canada* (2010). NAFTA Arbitration (UNCITRAL Rules; ICSID Administered Case), Award, 31 March 2010. Retrieved 28.07.2016 from <http://www.italaw.com/sites/default/files/case-documents/ita0504.pdf>.
25. *Mondev v. United States* (2002). ICSID Case No. ARB(AF)/99/2, Award, 11 October 2002, *International Legal Materials*, Vol. 42 (2003), p. 85.
26. NAFTA (1992). North American Free Trade Agreement of 17 December 1992, *International Legal Materials*, Vol. 32 (1993), p. 289, 605.
27. NAFTA Notes of Certain Chapter 11 Provisions (2001). *NAFTA Free Trade Commission, NAFTA Notes of Certain Chapter 11 Provisions*, 31 July 2001. Retrieved 28.07.2016 from http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp.
28. *Neer case* (1926). *L.F.H. Neer and Pauline Neer (U.S.A.) v. Mexico*, Mexico/ U.S.A. General Claims Commission, Decision, 15 October 1926, *Reports of International Arbitral Awards*, Vol. 4, 1951, p. 60.
29. *Occidental Co. v. Ecuador* (2004). LCIA Case No. UN 3467, Final Award, 1 July 2004. Retrieved 28.07.2016 from <http://www.italaw.com/sites/default/files/case-documents/ita0571.pdf>.
30. Orakhelashvili, A. (2008). The Normative Basis of "Fair and Equitable Treatment": General International Law on Foreign Investment?. *Archiv des Völkerrechts*, Vol. 46, No. 1 (p. 74).
31. Orrego Vicuña, F. (2012). Customary International Law in Action: From the International Minimum Standard to Fair and Equitable Treatment. In H.P. Hestermeyer et al. (eds.), *Coexistence, Cooperation and Solidarity: Liber Amicorum Rüdiger Wolfrum*, Vol. I (p. 181). Leiden; Boston: Martinus Nijhoff Publishers.

32. *Pope & Talbot v. Canada* (2001). NAFTA Arbitration, Award on the Merits of Phase 2, 10 April 2001. Retrieved 28.07.2016 from <http://italaw.com/sites/default/files/case-documents/ita0678.pdf>.
33. *Saluka Investments BV v. Czech Republic* (2006). Arbitral Tribunal (Registry: P.C.A.), Partial Award, 17 March 2006. Retrieved 28.07.2016 from http://www.pca-cpa.org/showpage.asp?pag_id=1149.
34. Schwebel, S.M. (2004). The Influence of Bilateral Investment Treaties on Customary International Law. *American Society of International Law Proceedings*, vol. 98 (p. 27).
35. Sornarajah, M. (2010). *The International Law on Foreign Investment* (3rd edn.). Cambridge: Cambridge University Press.
36. Statute of the International Court of Justice (1945). *Charter of the United Nations and the Statute of the International Court of Justice of 26 June 1945*. Retrieved 28.07.2016 from <https://treaties.un.org/doc/Publication/CTC/uncharter-all-lang.pdf>.
37. Subedi, S.P. (2008). *International Investment Law: Reconciling Policy and Principle*. Oxford; Portland: Hart Publishing.
38. *Tecmed S.A. v. Mexico* (2003). ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003. Retrieved 28.07.2016 from https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC4872_En&caseId=C3785.
39. *Thunderbird v. Mexico* (2006). NAFTA Arbitration (UNCITRAL Rules), Award, 26 January 2006. Retrieved 28.07.2016 from <http://www.italaw.com/sites/default/files/case-documents/ita0431.pdf>.
40. *UNCTAD World Investment Report 2015: Reforming International Investment Governance* (2015). New York; Geneva: United Nations.
41. US Model BIT (2012). Retrieved 28.07.2016 from <http://www.italaw.com/sites/default/files/archive/ita1028.pdf>.
42. Vienna Convention on the Law of Treaties (1969). Vienna Convention on the Law of Treaties of 23 May 1969, *United Nations Treaty Series*, Vol. 1155, p. 331.
43. Visković, N. (2006). *Teorija države i prava* [Theory of State and Law] (2nd edn.). Zagreb: CDO Birotehnika.
44. World Bank Guidelines on the Treatment of Foreign Direct Investment (1992). *Legal Framework for the Treatment of Foreign Investment, Vol. 2: Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment*. Washington: The World Bank

LEX CONTRACTUS AND OVERRIDING MANDATORY RULES. WHAT CAN WE LEARN FROM THE CJEU CASE LAW?

Ines Medic

Faculty of Law, University of Split
Domovinskog rata 8, 21 000 Split,
Croatia ines.medic@pravst.hr

ABSTRACT

It is generally well known that party autonomy represents a cornerstone in cross-border commercial transactions. Up to now it has become „the unquestioned primary tool to determine the applicable law in contracts“. It runs counter most of legal theories in private international law and as such does not fit well within traditional methods of private international law, which consider the question of the applicable law in terms of a conflict between the states. Some even consider it a new paradigm of private international law, a „parallel word of private transnational ordering“, since in private international law realm due to party autonomy it is the state law that is subordinate to the contract. In order to strike the balance between the party autonomy and state regulatory interests there are also some limitations to party autonomy, one of them being overriding mandatory rules. Overriding mandatory rules are dealt with in Art. 9 of the Rome I Regulation and with respect to earlier Art. 7 of the Rome Convention entail a number of modifications, some of which are either unclear or disputed.

The CJEU case law on this matter is scarce and not entirely clear but it still offers an important guidance on how to interpret and apply those rules. The aim of this article is to clarify the concept of overriding mandatory rules in European context as well as in the CJEU case law.

Keywords: CJEU case law, overriding mandatory rules, party autonomy.

1. INTRODUCTION

Traditional private international law methods evolve around the idea that conflicts of laws are battles between the states. It is explained as the consequence of the attempt to transfer the concepts from international law to conflict of laws (Lehmann, 2008, p. 400). Though it might not be the most appropriate approach to international disputes between private parties it has resulted in number of methods with one common denominator – bypassing the importance of the individual (Lehmann, 2008, p. 403-413; Sajko, 2009, pp. 359-376). To the central question of conflicts theory – how to determine the applicable law – all of these methods (traditional and some newer ones) answered in similar way, by giving the priority to the state and its interests. Party autonomy appeared relatively late. It developed throughout 20th century (Muir Watt, 2010, p. 256), after being strongly opposed by Joseph H. Beale, the author of the First Restatement of Conflict of Laws (Lehmann, 2008, p. 390). However, due to Dumoulin, Mancini, Anzilotti and Bagge it gradually raised to a general principle (Klasiček, 2006, pp. 690-691; Nygh, 1999, p. 3; Sajko, 2009, pp. 146-147). Up to now party autonomy has become „the unquestioned primary tool to determine the applicable law in contracts“ (Michaels, 2013, p. 2). Today, it represents a cornerstone in cross-border commercial transactions even though its theoretical justification remains dubious. It runs counter most of legal theories in private international law and as such does not fit well within traditional methods of private international law, which consider the question of the applicable law in terms of a conflict between the states. Thus, some even consider it a new paradigm of private international law, a „parallel word of private transnational ordering“ (Muir Watt, 2010, pp. 253-254), since in private international law realm due to party autonomy it is the state law that is subordinate to the contract.

In order to strike the balance between the party autonomy and state regulatory interests there are also some limitations to party autonomy, one of them being overriding mandatory rules. Interestingly enough, their development can be traced back to von Savigny, otherwise known as proponent of multilateral approach, who also allowed for the so-called „strictly positive mandatory rules“, which could never be displaced by foreign law as they carried forward vital policies of the State (Wojewoda, 2000, p. 185). Due to growing liberalization of human relations, those rules went unnoticed until 1940's and the elaboration of *Sonderstatut* doctrine by Wengler and Zweigert (Mann, 1978; referenced by Wojewoda, 2000, p. 186). With the famous Dutch *Alnati* case, in 1966, a new stage in the evolution of choice of law in Europe has begun. An essential feature of overriding mandatory rules is that they can be applied regardless of a choice of law made by the parties or even the objectively applicable law. The difficulty with regard to identification of these rules lies in the fact that they hardly ever contain the expressly stated intention of their creator as to their international relevance, so it must be inferred from the surrounding circumstances (Kunda, 2007, p. 220). Thus, categorisation of a certain rule as „overriding“ will always depend upon the views of whatever court decides the case (Buxbaum, 2008, p. 22). Courts do not treat this issue in a uniform manner. It is however possible to define certain limits to respect, and guidelines to follow, by the court (Pauknerová, 2010, p. 34). Another problem is that many of these rules are part of public law. For a long time foreign public rules were not applicable in private international law relations (Wojewoda, 2000, p. 195) but the „public law taboo“ as „the most limiting view“ is gradually being defeated (Baumbax, 2007, p. 25; Muir Watt, 2003, p. 2). There are three different laws whose mandatory rules may be imposed onto the contract: rules of *lex fori*, rules of *lex contractus* and the rules of a third country with a connection to the contract. While the application of mandatory rules of the law of the forum is generally accepted, there are some controversies about the other two types of rules. However, the most contentious seem to be the application of the rules of a third country (Chong, 2006, p. 27). For some authors these restrictions affect legal certainty, a very relevant aim of choice of law (Symeonides, 2010, pp. 513,536; von Wilmski, 1998, p. 4) because the parties cannot be sure that the law they have chosen will be applied (Schwarze, 2015, p. 89). Final determination of applicable law becomes complex due to „heterogeneity, unpredictability and the general difficulty in their application“ (Sánchez Lorenzo, 2010, p. 76). In this article, which is primarily focused on the Rome I Regulation, the Author will briefly present the framework of party autonomy under the Regulation (Part 2), as a starting point of this analysis. Then the Author will examine the concept of domestic (internally) mandatory rules and its distinction from overriding (internationally) mandatory rules (Part 3). Part 4 will examine the evolving practice of The Court of Justice of the European Union and its implications. Finally, in Part 5 the Author will attempt to outline her views with regard to the further development of the concept.

2. PARTY AUTONOMY AND ROME I

Party autonomy has been and will remain the fundamental principle in European private international law in matters of contractual obligations (Heiss, 2009, p.1), since it is regarded as essential for the proper functioning of the internal market (von Wilmski, 1998). Within the internal market, it is the Rome I Regulation that establishes a uniform regime of conflict-of-laws rules applicable to contractual obligations. Regulation maintains party autonomy as a general principle. Consequently, parties to a contractual relationship linked to more than one legal system are free to determine the law applicable to their contract by an agreement (Art. 3(1)). At first sight without any restrictions. Their choice even substitutes mandatory rules of the objectively applicable law by the rules of chosen system. They may refer to any law, as long as it is „the law“ in technical sense. Application of non-state body of law as a conflictual choice

was rejected but, according to Recital 13, remains possible within the limits of mandatory provisions of the state-law applicable to the contract. Parties may choose any law even if it has no objective connection to the contract (Garcimartín Alférez, 2008, p. 66).

Normally, choice is agreed upon expressly but there is also a possibility of a tacit choice (where it can be „clearly demonstrated by the terms of the contract or the circumstances of the case“).

Most often, the chosen law will be applicable to the entire contract but there is also a possibility of *dépeçage*. It is not so frequently used since it might produce unwanted outcome in case these choices turn to be mutually exclusive or inconsistent (Wojewoda, 2000, p. 206). Still it is imaginable that a very complex contract (e.g. international construction contract) might be better served by splitting choice-of-law to certain parts of contract (Carducci, 2013).

Most usually, choice-of-law is stipulated in original contract but parties may at any time agree to submit the contract to a different law. Any subsequent change does not affect formal validity of the contract nor can adversely affect the rights of third parties (Art. 3(2)).

Party autonomy provided in paras. 1-2 of Art. 3 is not absolute and can be displaced in certain circumstances, as will be shown *infra*.

3. MANDATORY RULES AND ROME I

Rome I Regulation differentiates between internally mandatory rules („rules which cannot be derogated from by agreement“) and internationally mandatory rules („overriding mandatory rules“) but within the former category Art. 3(3) refers to provisions which are mandatory within the framework of a certain country while Art. 3(4) refers to the EU legal order. They apply *a priori* and restrict the application of a chosen law.

The role of Art. 3(3) is to secure the application of mandatory rules of a Member State when „all relevant elements“ (other than choice of law) point to that Member State. Thus, in such cases application of a chosen law will be restricted by the internally mandatory rules of that state. The Regulation does not clarify what „all relevant elements“ means but it can be inferred from Rec. 15 that choice of court is also excluded. So, irrespective of the „tandem“ (choice of law accompanied by the choice of court)(Berends, 2014, p. 77), if „all relevant elements“ point to one Member State application of a chosen law will be restricted by the internally mandatory rules of that state (Harris, 2009, p. 336). This exception is introduced in order to prevent parties from internationalising a domestic case merely by choosing a foreign law (Garcimartín Alférez, 2008, p. 64).

Since most of the European contract law has its origin in the directives (Siehr, 2014, p. 809), which apply between the parties of the contract upon their transposition by national legislators, new Art. 3(4) does not come as a surprise. According to this article, contracts with „all relevant elements at the time of choice ... located in one or more Member States“ require application of European mandatory law („rules that cannot be derogated from by an agreement“), even if the chosen law is the law of the third country. Obviously, there is an obligation to extend the application of mandatory rules (irrespective of its overriding character) of directives against the eventual content of the applicable law (Sánchez Lorenzo, 2010, p. 74). According to Art. 3(4) of Rome I Regulation, this mandatory law should be applied „where appropriate as implemented in the Member State of the forum“. Thus, the protection should include level of protection established by the Member State of the forum. It is rather unexpected solution since contracts covered by this article are exclusively connected to Member States and in the absence of a choice of law by the parties, law of the Member State will be applicable. It remains unclear whether it means that national transpositions of directive law are considered equivalent to each other, in which case the application of *lex fori* is the most practical solution (Mankowski, 2009; referenced by Heiss, 2009, p. 5) or it just slipped unnoticed.

In any case, the rationale behind the paras. (3) and (4) of Art. 3 are the same – if mandatory rules of national law must not be substituted by the rules of a chosen law, mandatory Community rules must not be substituted by the chosen law of a third country (Heiss, 2009, p. 4).

Opposite, Art. 9(1) of the Rome I Regulation provides the elements for clear identification of internationally mandatory rules, i.e. overriding mandatory rules. In order for a rule to be classified as overriding mandatory rule it has to cumulatively fulfill the interest and the overriding criteria (Kunda, 2007, pp. 217-219). Definition itself is drawn from the *Arblade* case, and refers to „provisions the respect for which is regarded as a crucial by a country for safeguarding its public interests, such as political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation“. With regard to their effectuation,

Art. 9(2) imposes no restriction to the application of the overriding mandatory rules of the forum while, according to Art. 9(3), application of foreign overriding mandatory rules may be brought into play only if it is „the law of the country where the obligations arising out of contract have to be or have been performed“.

According to some authors, although this new formulation limits the scope of this provision to a narrower level (Dickinson, 2007, p. 53. *et seq*), it is not without deficiencies (Wang, 2011, p. 170), since it is not clear whether it deals with a legal or less predictable factual notion of the place of performance (Freitag, 2004, p. 114). So, the question is how to determine „the place of performance“? Whether its determination should depend on *lex contractus* or on the law of the third state whose mandatory rules should to be applied, *lex loci solutionis*? How to interpret the „unlawfulness“ of the performance? In the narrowest sense – which suggests only criminal consequences, in the intermediate sense – which also includes civil unlawfulness or in the widest sense – which includes a simple nullity of inefficacy of contract (Sánchez Lorenzo, 2010, p. 85)? Is it still possible to give effect also to mandatory provisions of law other than the law of the place of performance since they may be relevant in the enforcement of judicial decision in the country having issued such mandatory rules (Pauknerová, 2010, pp. 40-41; Sánchez Lorenzo, 2010, pp. 85-86)? As it will be shown *infra*, some of the questions have been, at least partially, cleared by the CJEU case law.

4. CJEU RULINGS

There is no need to go into the details with regard to the *Arblade* (Joined Cases C-369/96 and C-376/96 [1999] ECR I-8453) since its main contribution to this question can be explained simply. It created a missing piece of the definition of overriding mandatory rules (Rec. 30) but connecting it exclusively with the strictly governmental interests the CJEU restrained the definition to the „interventionist“ rules (Bonomi, 2003, p. 48), which caused some confusion with respect to later rulings.

Next case was *Ingmar v. Eaton* (Case C-381/98 [2000] ECR I-9305). In 1989, an agent - Ingmar GB Ltd., a company established in the United Kingdom, and a principal - Eaton Leonard Technologies Inc., a company established in California, concluded a contract under which Ingmar was appointed as Eaton's commercial agent in the United Kingdom. The parties had elected the law of California to govern their contract. Chosen law did not provide for indemnity or compensation after the termination of the contract.

In 1996, after the termination of the contract, Ingmar instituted proceedings before the High Court of Justice of England and Wales seeking payment of commission and, pursuant to Art. 17 of the Council Directive 86/653/EC (European Agency Directive (EAD)), compensation for damage suffered as a result of the termination of its relations with Eaton. The High Court held that the Regulations did not apply, since the contract was governed by the law of the State of

California. Ingmar appealed against that judgment to the Court of Appeal which requested a preliminary ruling from the CJEU on the interpretation of the territorial scope of the EAD, which aims to harmonise the rules of the Member States pertaining to relationship between the commercial agents and their principals.

To the question whether or not Arts. 17 and 18 of the Directive must be applied in a situation where an agent is active on the territory of Member State, even though the principal is established in a non-Member State and the chosen law is that of a non-Member State CJEU answered affirmatively. According to the CJEU, Arts. 17 and 18 of the Directive, as implemented by an English law, have a mandatory nature (para. 22). The mandatory nature of the right to indemnity or compensation is confirmed by the fact that, under Art. 19 of the Directive, the parties may not derogate from them to the detriment of the commercial agent. Their purpose is to protect the minimum requirements formulated in a European harmonised set of rules or in the words of Court „to protect, for all commercial agents, freedom of establishment and the operation of undistorted competition in the internal market“ (para. 24). It is essential for the Community legal order that a principal established in a non-member country, whose commercial agent carries on his activity within the Community, cannot evade those provisions by the simple expedient of a choice-of-law clause. Therefore, the purpose served by the provisions in question requires that they be applied where the situation is closely connected with the Community, irrespective of the choice of law clause in the agency contract (para. 25).

Since, at the time of judgment, the UK was not the party nor the CJEU had the competence to interpret the provisions of the Rome Convention this case was not decided on the basis of the Convention although it was obviously inspired by it (para. 64 of the AG Léger). In any case, CJEU took a doubtful approach towards the relationship between the principle of party autonomy and the mandatory rules enacted in the Member State to implement a directive. It confirmed that, in principle, party autonomy prevails but also attributed a preferential status to rules originating from the EAD. Pointing mainly at the interests of the commercial agents and only sporadically to the smooth operation of the internal market it left to the interpretation whether it departed from its ruling in *Arblade* introducing as „overriding“ purely „protective“ rules or it is just another quality added to their original „interventionist“ function (de Boer, 2008, p.19; Kunda, 2007, p. 216). Many commentators claimed that it failed to prove the direct and strong connection between the protection of private interests and the interests of internal market. On top of that, many claimed that an approach which focuses exclusively on the needs of internal market could constitute a reason for the CJEU to characterise all the future Community mandatory rules as directly applicable in international cases, which would compromise the principle of party autonomy. Even more, it would nullify the principle that legal systems are equivalent: EU legislation on contracts would prevail, systematically, over the laws of the third countries (Verhagen, 2002, pp. 153-154).

Another case dealt with by the CJEU is *Unamar NV v Navigation Maritime Bulgare* (Case C-184/12 [2013] ECLI:EU:C:2013:663). In 2005 Unamar, a company incorporated in Belgium, and NMB, a company incorporated in Bulgaria, concluded a commercial agency agreement for the operation of NMB's container liner shipping service. The one-year agreement, according to which Unamar would act as an agent for NMB, provided that it was to be governed by Bulgarian law and that any potential dispute is to be determined by the arbitration chamber of the Chamber of Commerce and Industry in Sofia (Bulgaria). Agreement was renewed annually until the end of 2008 when the NMB informed Unamar that, because of financial difficulties, decided to terminate the agreement.

Unamar held that its commercial agency agreement was unlawfully terminated and brought proceedings before Antwerpen Commercial Court for various forms of compensation provided

under the European Agency Directive and the Belgian law. NMB raised a plea of inadmissibility due to arbitration clause but the Belgian court ruled that it was unfounded. With regard to applicable law Court ruled that Art. 27 of the Belgian law has to be applied as an overriding mandatory rule. Upon the appeal, the Antwerpen Court of Appeal upheld the appeal brought by NMB and declared the arbitration clause valid but took the view that Belgian Law on commercial agency contracts does not qualify as overriding mandatory rules (within the meaning of Art. 7 of the Rome Convention) and it ruled the inapplicability of Belgian law. Instead, since Bulgaria also implemented the European Agency Directive, establishing minimum standards for the protection of agents, Court held that Unamar is sufficiently protected by the chosen (Bulgarian) law despite the fact that Bulgarian law provides less protection than Belgian law.

Unamar brought an appeal to the Court of Cassation which, uncertain how to interpret the Rome Convention, stayed the proceedings and referred the question to the CJEU asking whether the Belgian provisions that offer wider protection than the minimum laid down by the Directive may be applied as overriding mandatory provisions of the forum (within the meaning of Art. 7(2) of the Rome Convention) even if the law applicable to the contract is the law of another Member State in which the minimum protection provided by the Directive has also been implemented.

Since the Court of Cassation submitted to the CJEU only the question of the applicable law, CJEU replied to that question only. CJEU first gave its opinion on the concept of overriding mandatory rules. It emphasised that its concept is in line with Art. 9(1) of the Rome I Regulation which, though not applicable to respective proceedings, for the sake of consistency has to be taken into account (para. 48). In its ruling the CJEU allowed the possibility of replacing the law of another Member State (chosen by the parties) which has perfectly validly implemented the Directive if the legislature of the State of the forum, when it was implementing the Directive, held that it was crucial to grant agents additional protection going beyond that required by the Directive - „to protect an interest judged to be essential by the Member State concerned“ (para.

50). So, the fact that Directive is correctly transposed is not in itself good enough reason to automatically bar the court in the State of forum from qualifying its own law as overriding mandatory provisions in the sense of Art. 7(2) of the Rome Convention or Art. 9(1) of the Rome I Regulation (van Bochove, 2014, p. 155). However, the court of the forum State has to be aware that the application of national rules shall not be detrimental to the primacy and uniform application of EU rules (para. 46) and („in order to secure full effect to the principle of the freedom of contract“) that the term „overriding mandatory rules“ must be interpreted strictly (para. 49).

Obviously, with this ruling the CJEU set the conditions which have to be fulfilled in order to allow a court of Member State to replace the chosen law of another Member State with its own national provisions which are based on the Directive but offer greater protection only when the legislature adopted these provisions to protect a fundamental interest. But, the CJEU has once again missed to explicitly address the issue of whether the rule aimed primarily at the protection of a weaker party could be viewed as an overriding mandatory rule (van Bochove, 2014, p.

150). Also, it did not provide an information on how to deal with „gold plating“ situations, as was the situation with Belgian law.

The last case submitted to the CJEU, still without a preliminary ruling, is *Nikiforidis* (Case C-135/15 [2015] ECLI:EU:C:2016:281). So far there is only an Opinion of the AG Szpunar, delivered on 20 April 2016 but it can also suggest the possible direction of the Court's ruling. The case concerns Nikiforidis, a teacher working in primary school located in Germany but managed by Greece. At the beginning of 2010, in connection with the debt crisis Greek

parliament passed the law aimed at reducing public spending which also affected the remuneration of Mr. Nikiforidis. He then brought an action before the German court against his employer (Greece), for payment of labour salary due for the period October 2010-December 2012.

Labour Court dismissed his petition on account of the immunity of the Greek state but the Second instance Labour Court annulled that decision and ruled in favor of Mr. Nikiforidis. Greece then filed a cassation to the German Federal Labour Court which confirmed the jurisdiction of German courts and found that the employment relationship is governed by German law under which a reduction of the fee requires an amendment of the (continuing) employment contract by mutual consent (*Änderungsvertrag*) or notification of change in termination condition, if notice is accepted (*Änderungskündigung*). Among other questions referred to the CJEU, German court also asked for the (first) ruling on Art. 9, especially its para. 3.

In its Opinion AG Szpunar first remarks (and latter repeats) that the interest of the doctrine over this issue by far exceeds its featuring in practice (paras. 1 and 78). Then he stresses the difference between mandatory and overriding mandatory provisions in EU law (paras. 65-74). With regard to the latter, he refers to the *Arblade* case (para. 71) as well as to the obligation of a Member State to make an assessment of „overriding“ nature of third country rules in each particular case (as confirmed in *Unamar*) (paras. 72-73). With regard to its effectuation, AG Szpunar is of the opinion that this assessment should be functional, in a way that it is understood as an opportunity for the courts to prescribe a solution that is both fair and recognizes the need to balance competing interests of the countries concerned. (paras. 74 and 88). He rejected the suggestion of restrictive application of Art. 9(3) stressing that it would create even greater disbalance due to the unlimited application of overriding mandatory rules of *lex fori* and strictly limited application of overriding mandatory rules of the third country, which is not in accordance with the purpose of Rome I (paras. 86-87). On the contrary, it has to be used as a tool to contribute to mutual trust between Member States in a broadest sense (para. 88).

According to AG's Opinion, „place of performance“ should not be understood too narrowly. He refuses the idea of parallelism between Art. 9(3) of the Rome I and Art. 5(1) of the Brussels I (Case C-386/05 *Color Drack* [2007] ECR I-3699) due to „completely different objectives of the two“ (para. 91). He suggests rather relaxed interpretation of Art. 9(3) since „its aim is not to establish a precise location“ but to identify the State in whose territory contractual obligation has to or have been performed. It should be understood, not only as a search for the place of the factual performance, but also as a search for attachment to a certain state and its legal system (para. 92). Consequently, it is necessary to look beyond „the characteristic performance“. In order to determine the conditions for the application of Art. 9(3), performance of any obligation arising from the contract may be taken into account (paras. 93-94). There is no obstacle, when it comes to certain contractual agreements, to establish a place of performance in more than one country (para. 95). In that spirit, AG Szpunar concluded that in this particular case, including the Greek State as a party to the employment contract, Greece as a place of performance should not be automatically rejected.

5. INSTEAD OF CONCLUSION

What, if any, can we learn from the CJEU case law?

With respect to party autonomy? In words of Muir Watt – that „the private interest paradigm which constitutes the foundations of the conflict of laws can no longer cope with the increasing interference of state policies in the field of transnational litigation“ (Muir Watt, 2003, p. 2).

And there is no way back. Choice of law has become an issue of political economy. Overriding mandatory rules are just a tool in providing an effective regulatory framework for it to operate. With respect to overriding mandatory rules? It is still work in progress. Undoubtedly, we got some answers but not all that we hoped for. Obviously, there is a double layer of mandatory rules – national and European (Erau, 2004, p. 265). There should be the difference between mandatory and overriding mandatory rules in European context also. Hence, we agree with some commentators that the only European rules that deserve the status of overriding mandatory rules are those that are primarily meant to protect European public interests (e.g. Art. 81 EC Treaty)(de Boer, 2008, p. 19; Verhagen, 2002, 148). And those rules only may be used to displace the law of the non-member state if the case is within the scope of EC rule at issue. In that respect, *Ingmar* failed on number of points. Question is, how would *Ingmar* be decided today? Depends on who you ask. According to some authors, if application of Art. 3(4) is not possible due to the fact that „all relevant elements are not located in one or more Member States“, there is Art. 9(2) which gives absolute priority to the forum's overriding mandatory rules over any other provisions. According to this provision, the application of European overriding mandatory rules will be possible as a *lex fori*. Since rules contained in directives generally appear as overriding mandatory rules in the sense of Art. 9 of the Rome I Regulation, they will be applied as implemented in *lex fori* (Sánchez Lorenzo, 2010, p. 77). In our view, by virtue of Art. 3(3) and 3(4) *Ingmar* should not be possible. First, rules contained in directives should not *per se* be considered overriding mandatory rules. Second, international agreements have always been treated more flexibly than domestic ones. Nothing really justifies imperative application of harmonised rules in relations *ad extra* (Erau, 2004, p. 283). All of the cases proved that overriding mandatory rules within the meaning of Art. 9(3) Rome I have to fulfill cumulatively „the interest“ and „the overriding“ criterion. Protection of private interests as such is not sufficient to give a norm overriding mandatory character. It has to aim at furthering a broader policy objective. Thus, they may be either „interventionist“ or „protective-interventionist“ rules but they may be deployed as overriding mandatory rules only if they „directly and intentionally serve a regulatory purpose“ (Renner, 2015, p. 252). Despite some opponent doctrinal views (Lüttringhaus, 2014, p. 150), *Unamar* seems to be benevolent toward „gold plating“, i.e. situation where the directive leaves at the discretion of the Member States to extend the scope of application of the provisions of the directive or gradually exceed the level of protection offered by the directive (Remien, 2011; referenced by van Bochove, 2014, p. 155), which was the case with Belgian law. It confirmed that there is a possibility to replace the chosen law of another Member State with gold plated national provisions but only „on the basis of a detailed assessment, that, in the course of that transposition, the legislature of the State of the forum held it to be crucial ... to protect an interest judged to be essential by the

Member State concerned“, as long as such increased protection does not violate the EC Treaty and the fundamental freedoms guaranteed by it (Heiss, 2009, p. 5). In short, it left a wide margin of appreciation to national courts and the door open for preferential approach. With regard to Art. 9(3) and missing answers, AG Szpunar's Opinion largely follows present doctrinal views (Hellner, 2009, pp. 465-466; Renner, 2015, p. 257). It remains to be seen to what extent it will be followed by the CJEU in its ruling.

LITERATURE:

1. Berends, A.J. (2014), *Why overriding mandatory provisions that protect financial stability deserve special treatment*, Netherlands International Law Review, 2014 (Vol. 61, No. 1), pp. 69.-106.

2. Bonomi, A. (2003), *Conversion of the Rome Convention on Contracts into an EC Instrument: Some Remarks on the Green Paper of the EC Community*, Yearbook of Private International Law, 2003 (Vol. 5), pp. 53-98.
3. Buxbaum, H.L. (2008), *Mandatory Rules in Civil Litigation: Status of the Doctrine Post-Globalization*, Articles by Maurer Faculty, Paper 292. Retrieved 23. 5. 2016. from <http://www.repository.law.indiana.edu/facpub/292>.
4. Carducci, G. (2013), *Major infrastructure projects in EU private international law: jurisdiction and conflict of laws*, Construction Law International, 2013 (Vol. 8, No. 3), pp. 14-21.
5. Chong, A. (2006), *The public policy and mandatory rules of third countries in international contracts*. In Beaumont, P. Harris, J. (eds.), Journal of Private International Law, 2006 (Vol. 2, No. 1), Oxford: Hart Publishing, pp. 27-70.
6. De Boer, T.M. (2008), *Unwelcome foreign law: public policy and other means to protect the fundamental values and public interests of the European Community*. Retrieved 13. 3. 2016. from <http://hdl.handle.net/11245/1.285248>.
7. Dickinson, A. (2007), *Third-Country Mandatory Rules in the Law Applicable to Contractual Obligations: So Long, Farewell, auf Wiedersehen, Adieu?*, Journal of Private International Law, 2007 (Vol. 3, No. 1), pp. 53-88.
8. Erauw, J. (2004), *Observations about mandatory rules imposed on transatlantic commercial relationships*, Huston Journal of International Law, 2004 (Vol. 26, No. 2), pp. 263-286.
9. Freitag, R. (2004), *Einfach und international zwingende Normen*. In Leible, S. (ed.), Das Grünbuch zum Internationalen Vertragsrecht: Beiträge zur Fortentwicklung des Europäischen Kollisionsrechts der vertraglichen Schuldverhältnisse, München, pp. 167-191.
10. Garcimartín Alférez, F.J. (2008), *The Rome I Regulation: Much ado about nothing?*, The European Legal Forum, 2008, Section I, pp. 61-120.
11. Harris, J. (2009), *Mandatory rules and Public Policy under the Rome I Regulation*. In Ferrari, F., Leible, S. (eds.), Rome I Regulation, The Law Applicable to Contractual Obligations in Europe, Munich: Sellier, European law publishers GmbH, pp. 269-342.
12. Heiss, H. (2009), *Party autonomy*. In Ferrari, F., Leible, S. (eds.), Rome I Regulation, The Law Applicable to Contractual Obligations, Munich: Sellier, European law publishers GmbH, pp. 1-16.
13. Hellner, M. (2009), *Third Country Overriding mandatory rules in the Rome I Regulation: Old wine in new bottles?*, Journal of Private International Law, 2009 (Vol. 5, No. 3), pp. 447-470.
14. Klasiček, D. (2006), *Autonomija u međunarodnom privatnom pravu – novije tendencije*, Zbornik PFZ, 2006 (Vol. 56, No. 2-3), pp. 687-715.
15. Kunda, I. (2007), *Defining Internationally Mandatory Rules in European Private International Law of Contracts*, Zeitschrift für Gemeinschaftsprivat Recht (GPR), 2007 (Vol. 4, No. 5), pp. 210-222.
16. Lehmann, M. (2008): *Liberating the Individual from Battles between the States: Justifying Party Autonomy in Conflict of Laws*, Vanderbilt Journal of Transnational Law, 2008, Vol. 41, pp. 381-434.
17. Lüttringhaus, J.D. (2014), *Eingriffsnormen in internationalen Unionsprivat- und Prozessrecht: Von Ingmar zu Unamar*, Praxis des Internationalen Privat und-Verfahrensrecht (IPRax), 2014 (No. 1), pp. 146-152.
18. Michaels, R. (2013): *Party Autonomy – A New Paradigm without a Foundation?*, Retrieved 25. 3. 2016. from http://www.pilaj.jp/data/2013_0602_Party_Autonomy.pdf.

19. Muir Watt, H. (2003): *Choice of law in integrated and interconnected markets: A Matter of Political Economy*, Electronic Journal of Comparative Law, 2003 (Vol. 7, No. 3). Retrieved 15. 4. 2016. from <http://www.ejcl.org/ejcl/73/art73-4.html> .
20. Muir Watt, H. (2010): „Party Autonomy“ in *International contracts: from makings of a myth to the requirements of global governance*, European Review of Contract Law, 2010 (Vol. 6, No. 3), pp. 250-283.
21. Nygh, P. (1999), *Autonomy in International Contracts*, Oxford: Clarendon Press.
22. Pauknerová, M. (2010), *Mandatory rules and public policy in international contract law*, ERA Forum, 2010 (Vol. 11, No. 1), pp. 29-43.
23. Remien, O. (2011), *Variationen zum Thema Eingriffsnormen nach Art. 9 Rom I-VO und Art. 16 Rom II-VO unter Berücksichtigung neuerer Rechtsprechung zu Art. 7 Römer Übereinkommen*. In Kronke, H. et. al (eds.), *Grenzen überwinden, Prinzipien bewahren: Festschrift für Bernd von Hoffmann*, Bielefeld: Verlag E. und W. Giesecking.
24. Renner, M. (2015), *Article 9. Overriding mandatory provisions*. In Gralf, P.C. (ed.), *Rome Regulations: Commentary*, Kluwer Law International BV, pp. 242-261.
25. Sajko, K. (2009), *Međunarodno privatno pravo*, Zagreb, Narodne novine.
26. Sánchez Lorenzo, S. (2010), *Choice of law and overriding mandatory rules in international contracts after Rome I*, Yearbook of Private International Law, 2010, (Vol. 12), pp. 67-91.
27. Schwartze, A. (2015): *New Trends in Parties' Options to Select the Applicable Law? The Hague Principles on Choice of Law in International Contracts in a Comparative Perspective*, University of St. Thomas Law Journal, 2015 (Vol. 12, No 1), pp. 87-99.
28. Siehr, K. (2014), *International contracts, party autonomy and mandatory rules*, Revue hellénique de droit international, 2014 (Vol. 67), pp. 801-828.
29. Symeonides, S.C. (2010), *Party Autonomy in Rome I and II From a Comparative Perspective*. In Boele-Woelki, K. et al. (eds.), *Convergence and Divergence in Private International Law – Liber Amicorum Kurt Siehr*, Zürich: Eleven International Publishing, pp. 513-550.
30. Van Bochove, L.M. (2014), *Overriding mandatory Rules as a Vehicle for Weaker Party Protection in European Private International Law*, European Law Review, 2014 (No. 3), pp. 147-156.
31. Verhagen, F.L.E. (2002), *The tension between party autonomy and European Union Law: some observations on Ingmar GB Ltd v Eaton Leonard Technologies Inc*, International and Comparative Law Quarterly, 2002 (Vol. 51, No. 1), pp. 135-154.
32. Von Wilmowsky, P. (1998), *EG-Vertrag und kollisionsrechtliche Rechtswahlfreiheit*, Rabels Zeitschrift für ausländisches und internationales Privatsrecht, 1998 (Vol. 62, No. 1), pp. 2-37.
33. Wang, L. (2011), *Mandatory Rules of the Rome I Regulation, Not „Old Wine in New Bottles“*, Canadian Social Science, 2011 (Vol. 7, No. 2), pp. 166-172.
34. Wojewoda, M. (2000), *Mandatory Rules in Private International Law*, Maastricht J. Eur. & Comp. L., 2000 (Vol. 7, No. 2), pp. 183-213.

CRIMINAL PROTECTION OF ENVIRONMENT - ORGANIZED CRIME AND EFFECTIVE REGRET

Ivan Vukusic

Law faculty, Ul. Domovinskog rata 8, Split,
Croatia ivan.vukusic@pravst.hr

ABSTRACT

This paper analyzes special criminal offences of environment endangering through national and international legislation. How social aspect is important in criminal law because of prevention of injury, legislator predicted provision of effective regret if person acts as individual perpetrator or as part of criminal organization. That is key reason why paper analyzes effective regret prescribed in Criminal Code of Croatia in Special part (Head protecting environment and Head protecting public order). Mostly, environment will be injured by act of individual, but nowadays, environment is valuable resource that enables to gain large profit and as such is aim of criminal organizations. Legislator punishes mostly stadium of environment endangering, so paper reflects nature of provisions against environment on possibility of effective regret (instrument of stopping injury of legal good (material completion of criminal offence against environment)). Paper analyzes also UN Palermo Convention and EU Framework Decision against organized crime, specially provisions about conspiracy (when exists no criminal organization) and criminal organization and on end their comparison with legislation of Croatia. De lege ferenda is noted that Framework Decision must incriminate conspiracy established for only one criminal offence, and not for only two or more, because one criminal offence can have characteristics of organized crime as well. Paper concludes that it is necessary to predict effective regret by more criminal offences of environment endangering because it represents best way of legal good protection. If person acts as part of criminal organization, it should be sufficient that content of effective regret presents certainly prevention of commission of criminal offence without disclosure of criminal organization because protection of legal good (environment) should have an advantage over punishment of perpetrator.

Keywords: Criminal Code, effective regret, environment, organized crime.

1. INTRODUCTION

Environmental protection has gained importance not only in national legislation but also on the international level. As Croatia is member of the European Union, and provisions in jurisdiction of the European Union are in accordance with international documents, we will analyze reflecting of the norms of EU law on the Croatian legislation. It is important to emphasize that concept of the environment must be understood in the broadest sense, and not limited in terms of older anthropocentric theory, on only so-called "human environment". Object of protection are also air, soil, water and sea, flora and fauna in the totality of their interaction so as cultural heritage as part of the environment created by man. Offenses against the environment are located in a special chapter in Special Part of Criminal Code in Croatia (further: CC). Criminal law is a subsidiary instrument for the protection of certain legal goods which is particularly evident when it comes to protecting the environment. If environment can not be protected through administrative and financial provisions or other branches of law, as ultima ratio appear instruments of criminal law. Mentioned is special visible through fragmentation of legal protection because criminal law protects environment only from the hardest form of threat or injury (Cvitanović in Novoselec et al., 2007, p. 269). Organized crime is significant because

"usual" crime shows in more dangerous form when committed as a realization of the plan of organized crime, and those activities of organized crime present harder form than individual or even "regular" joint action (Derenčinović, 2001., p. 72). There are different definitions of organized crime but common characteristics of it are joint planning and execution of criminal acts in order to achieve profit or power, on the basis of division of labor, for a long or indefinite period involves more than two participants using specialized trade skills, using violence or other means of intimidation in connection with politicians, media, public administration, justice or the economy. Since the main target of organized crime is only profit, and saving no legal good, environment is also particularly affected legal good. Transition from abstract to concrete danger, and then injury, is most obvious while analyzing legal good of environment because legislator in Art. 214 of the CC predicts material completion (serious consequences) of many crimes against the environment. How social aspect is important in criminal law to prevent injury of legal goods (material completion by criminal offences against environment), the legislator also foresees the possibility of effective regret with legal consequence of possibility of remit from punishment. This provision on one hand protects environment from severe consequences, because it has prime aim to protect legal goods, but also shows that legislator wants to affect mind of the offender. Theories about privileging offender who takes action of effective regret can be linked to theories about privileging voluntary abandonment (Vuletić, 2011, p. 5 - 31). Purpose of the privilege is reflected in the annulment of criminal intent because legal system must provide appropriate incentives that will motivate offender to withdraw. In this sense, the state opens to offender a back exit to escape from punishment. If the state refuses to give offender the opportunity to enjoy the privilege, it actually forces him to complete the work started, because if there is nothing he can get with withdraw, than with material completion of the initiated actions is nothing he can lose. Also, offenders remorse gives hope that he will not do evil deeds in the future. Acting creditably, offender deserves "mercy" and "to be spared" from the sentence. A relatively new concept, based on the principles of civil law was founded in 1987. by Herzberg. He sees privilege for withdraw in general legal principle that allows state to apply threat and that should not be activated if the offender with appropriately behavior fulfills his duty with correction of prior caused illegal condition. This author warns on cases in which offender alone reduces range of his unlawful conduct. Proper conduct of offender creates conflict between criminal justice, the principle of directed absolute prevention, and demand that state threat should weaken if it comes to compensation of previous behavior. It's up to legislator how to resolve this conflict. Some of the most important theories about the purpose of punishing are theory of specific and general deterrence and theory of balancing interests between the offender and the victim. Consequently, it is necessary to point out legal regulations of organized crime and environmental protection at European and national level. As the legislator in the Republic of Croatia prescribes punishment for an agreement to commit criminal offence (criminal offence that is subject of agreement must have possibility of punishing with imprisonment of more than three years) and criminal association (which may consist in organizing or conducting with criminal association), it was necessary to see and EU regulations because today's organized crime can be found everywhere where there is a tangible benefit, and environment as such is a valuable resource. For this reason, the paper refers primarily to specific offenses of environment endangering for which is provided "privilege" of possible effective regret.

2. TYPE OF CRIMINAL OFFENCES

Criminal offences by which effective regret is prescribed as possible are special criminal offences of environment endangering (Art. 194. of CC The Discharge of Pollutants from the

Vessel, Art. 195. of CC Endangering the Ozone Layer, Art. 196. of CC Endangering Environment with Waste, Art. 197. of CC Endangering the Environment with Facility, Art. 198. of CC Endangering the Environment with Radioactive Substances, Art. 199. of CC Endangering with Noise, Vibration or Non-ionizing Radiation and Art. 211. of CC Unlawful Exploitation of Mineral Resources). All mentioned criminal offences are *delictum communium* what means that everybody can be perpetrator (Novoselec, Bojanić, 2013, p. 136-137). They are also blanket criminal offences because their definition refers on legal acts beyond CC. It's completely reasonable because of complexity of this field of life and enormous procedural provisions about, for example, handling of hazardous substances. All this criminal offences can be committed with intent (because it's basic, regular and grave element of guilt) and negligence (that needs to be strictly prescribed in article of mentioned criminal offence). Exception is Art. 199. of CC which can be committed only with intent what is reasonable if You read definition of this article because it encompasses awareness about noise and vibration so negligent is hard to imagine (Vukušić, 2016, p. 587). Criminal offenses against environment in modern legislation are largely regulated as endangering crimes which do not require injury of a protected legal good (environment). For this criminal offenses is sufficient existence of risk of injury. In Croatia and Germany, legal theory talks about two groups of endangering criminal acts: concrete endangering and abstract endangering. By first (concrete endangerment), the court must find that there has been a threat to the protected object, the real danger of it's injury, while for the other (abstract endangering) is enough to prove offenders punishable endangering act. The key term is punishable act which is inherently dangerous and the punishment is prescribed when there has been no specific threat or injury (Kurtović Mišić, Krstulović Dragičević, 2014, p. 105). Austrian and German doctrine beyond these two categories also discusses transitional form of endangering criminal offenses - so-called- criminal offences of eligibility (Maršavelski, 2011, p. 292 - 293). It's legal description contains action that must be suitable for harming a protected legal object or that could lead to it's injury. This is actually a subclass of abstract endangering offenses because they don't have to perform a direct threat to the protected legal good. However, this type of offenses have similarities with abstract or concrete criminal offence of endangering. With abstract is when legal definition of criminal offence in the CC mentions possibility of performance effects (eg. "can lead to contamination",

"may endanger the quality", "is similar to lead to damage" or "suitable to cause damage"). The similarity with concrete is when legal description of criminal offence states that legal good is well compromised (e.g. "thereby jeopardizing" or "thereby endangers"). The offense under Art.

252. para. 1. of CC from 1997. provides punishment for management with waste in a way which endangers the quality of air, soil, water, watercourses or the sea within a wider area and to an extent which can worsen the conditions of life of humans or animals or endanger the existence of forests, plants and other vegetation. From the established facts is clear that in this case, the discharge of waste leads to a specific threat for plants and animal life (and even threat for human health, although it remained incompletely established in definition of this criminal offense), where the court must establish that the offender acted with intent because he was aware of it and agreed to it. In this case endangering was specifically created. Difficulty by distinguishing abstract and concrete danger with which in this case meets the court, and that is to some extent contributed because of the imperfect legal solution which prescribes the same penalty for both forms of threats, shows the good impact of the new regulation of criminal offense of

Environment Endangering with Waste in the new CC (Maršavelski, 2011, p. 294). It is reasonable to abandon the distinction of abstract and concrete danger as two forms of this crime, because in some cases is indeed difficult to determine when abstract danger becomes concrete.

Therefore, new CC prescribes only an abstract danger for special criminal offences of environment endangering in its pure form (without indicating danger). Exception is Art. 199.

3. EFFECTIVE REGRET

Accepting the dominant ecocentric model, prescribed environmental crimes are mostly fulfilled with creation of abstract danger caused with negligence, so legislator is trying to avoid sentencing wherever there is no special need for punishment and where it is beneficial for the environment. For this reason, Croatian legislator justified opening up the possibility of effective regret for crimes against the environment. It is necessary to distinguish completion of a criminal offense in the sense of accomplishment of definition of the criminal offense (formal completion) and the injury of legal goods (material completion) because after formal completion of the criminal offense, offender may achieve qualifying features and there is a possibility of involvement of other participants in the commission of an offense (Wessels, Beulke, 2010, p. 221). Criminal work is completed in a formal sense when it realized all its features and formal completion is in principle sufficient that the offense is considered complete (Kurtović Mišić, Krstulović Dragičević, 2014, p. 106). If repairment of state caused by the condition (formal completion) occurs in a timely manner, voluntarily and in full, then effective regret eliminates the consequences of the crime. Effective regret exists when offender after formal completion prevented material completion of criminal offence (Kurtović Mišić, Krstulović Dragičević, 2014, p. 154). It is necessary to see whether effective regret consists in preventing the material completion or attempt to prevent the material completion. CC by effective regret mostly demands prevention of material completion of a criminal offense and attempt to prevent material completion is not sufficient. Although, Croatian legislator considered sufficient for some crimes even act of attempt to prevent / eliminate consequences of acts. CC in Art. 102. (Terrorist Organization) and in Art. 328. (Criminal Association) requires prevention of the criminal offense or in the alternative, allows the application of effective regret on members of the association if they detected criminal association before in its composition or for it commits criminal offense. Risk of criminal offense material completion prevention, CC lays on competent authorities to who detection of the criminal association was reported. Theoretically, action of effective regret is not a reason to reduce the sentence, but to remiss of penalties. In the area of environmental crime is in many cases desirable and recommend to take effective regret to reduce the risk of a criminal conviction. Then relationship between the offender and victim will be primary only seen through civil proceedings. The provisions of effective regret are rarely applicated. Those provisions present more desire of the legislator than real practice and seek the attention of the possible offenders because protection of legal good is more important than criminal punishment of them. (Busch, Iburg, 2002, p. 33) It can therefore be concluded that effective regret exists when is caused necessary causal series which has final aim of preventing material completion (Kottmann, 2010, p. 4). Attempting to prevent material completion of criminal offence can occur in two forms. The first refers on the situation when offense is not materially completed regardless of the actions of the perpetrator ("noncausal effective regret"). Another form refers on the situation when the criminal offense despite effort of perpetrator to prevent material completion still was completed (failed effective regret). By environmental crimes material completion must be prevented in full. In Special Part of CC in the Head of environmental crimes, legislator predicted effective regret in Art. 213. so court has possibility of remission of punishment for the offender of a criminal offense under Art. 193., Art. 194., Art. 196., Art. 197., and Art. 198. of the CC who before the onset of severe consequences voluntarily eliminates danger or condition that he caused. Here legislator requires prevention of material completion so that attempt to prevent material completion has no legal

effect in terms of effective regret. According to the text of the CC, effective regret can be applied to crimes against environment that are committed with negligence as Art. 213. of the CC did not limit its application only on prescribed criminal offences that can be completed with intention. Taking into account the legal nature of specific offenses against the environment endangering which are in the paper analyzed and those offenses by which effective regret is prescribed, according to the Commentary of CC Working Group, it is prescribed only for criminal offences of abstract endangering (Turković et al., 2013, p. 269.). By criminal offences of abstract endangering exists time interval between endangerment and injury, or more precisely, of serious consequences, so the legislator has enabled to perpetrator effective regret at that time. Effective regret is by nature risky operation because criminal offence is already formally completed. In general, offender must personally take action of effective regret what requires Art. 213. of CC. An exception may be granted and active action of effective regret can be taken by third person but in the name of perpetrator (e.g. legal persons). Material completion (damages) must be entirely prevented as CC for crimes against environment requires removal of condition that offender caused so serious consequences from Art. 214 of the CC won't happen, since they represent material completion of the criminal offense. After their happening, effective regret isn't possible.

4. VOLUNTARY ABANDONMENT

The offense must not be formally completed in order to be possible to apply provisions of voluntary abandonment, so the voluntary abandonment represents reduction of criminal guilt and significantly annulment of criminal evil than effective regret. Only logical solution is to prescribe significant legal effects to the voluntary abandonment than to effective regret (Vuletić, 2011, p. 234). Voluntary abandonment was known in Roman law, because by some criminal offences was predicted remit of punishment. We need to take into account that Roman law didn't know General and Special part of CC and uncompleted crime usually wasn't punishable. Development of attempt and voluntary abandonment starts with glosators and postglosators. They formed term of attempt and institute of voluntary abandonment that wasn't punishable (Vuletić, 2011, p. 71). CC of Croatia prescribes possibility of remit of punishment if perpetrator acts with voluntary abandonment. Possibility of it, must be seen through definition of completed and uncompleted attempt, because first demands active prevention of consequence, and uncompleted attempt demands passivity of perpetrator. Voluntary abandonment of inappropriate attempt is possible till the perpetrator isn't aware of impossibility. If criminal offence is formally completed, voluntary abandonment isn't possible. In that case we need to analyze effective regret. Voluntary abandonment is prescribed in General part of CC and effective regret is prescribed in Special part of CC. Effective regret understands situation when perpetrator completed formally his criminal offence so there is possibility of preventing the consequence by stopping/or taking activity before material completion of criminal offense. This means that effective regret encompasses formal completion of criminal offense and perpetrator is trying to mitigate the damage caused. At voluntary abandonment caused damage is smaller and criminal offense is stopped in stadium of attempt. Thus, legally equation of these two institutes from the aspect of legal effects is questioned (Vukušić, 2016, p. 599). Preparatory actions against environment are described as completed crimes of abstract endangering, and because of it, special provision of effective regret are prescribed for these offences. When perpetrator commits preparatory action, some criminal offences are formally completed, so it was inevitable to prescribe effective regret for this criminal offences of environment endangering. After criminal offense is completed, act of a offender needs to be directed on reduction or elimination of consequences of committed

criminal offence. Time when perpetrator takes action of voluntary abandonment is earlier than when he takes action of effective regret. Effective regret has legal consequences *ex post*. Basic difference is that voluntary abandonment eliminates criminal characteristic of attempt and by effective regret criminal offence is formally completed.

5. ORGANIZED CRIME

Everything mentioned earlier refers on situation if perpetration isn't committed as part of organized crime. How environment is tangible benefit, criminal offences against environment can be committed as product of organized crime. Most important international documents on this topic are Convention on Transnational Organized Crime, so called Palermo Convention of UN from 2000. and EU Council Framework Decision 2008/841/JHA from 2008. on the fight against organized crime (Framework Decision). Their provisions are demanding to prescribe and to punish conspiracy to commit crime and establishment of criminal organization. (Kurtović Mišić, 2015). Framework Decision aims to establish harmonization of regulations between EU and UN documents, with particular emphasis on organized crime. (Mitsilegas, 2011, p. 5). It is often noted that Framework Decision because of mentioned regulation could lead to excessive criminalization (Mitsilegas, 2011, p. 5). According to Art. 2. of Framework Decision, punishable is conduct of any person consisting in an agreement on activity with one or more persons that should be pursued, which if carried out, would amount to the commission of offences referred to in Art. 1, even if that person does not take part in the actual execution of the activity (Fajardo, 2015, p. 12 – 15). Definition of criminal organization can be find in Art. 1 of Framework Decision and encompass structured association, established over a period of time, of more than two persons acting in concert with a view to committing offences which are punishable by deprivation of liberty or a detention order of a maximum of at least four years or more serious penalty, to obtain, directly or indirectly, a financial or other material benefit. The above mentioned shows that Framework Decision provides the possibility of punishing even if that person (perpetrator of conspiracy) does not take part in the actual execution of the activity. It would still be better if there is a technical difference in regulation, so if a person takes part in the conspiracy, and then commits a crime, there is no criminal liability for the conspiracy. However, terminology and those provisions used, enabled concurrence between agreement to commit criminal offense (conspiracy, preparatory action) and crime committed (which is the subject of the agreement), taking into account the different practices in the legal systems of the EU. Prescribing criminal agreement (conspiracy), as criminal offence *sui generis*, is covered punishment of action when there is no criminal organization, and criminal offense isn't committed. Institute of conspiracy is favorite for the plaintiff because of its vagueness, the inversion of the evidentiary burden to the detriment of the defendant and the exceptions to the principle of immediacy in the presentation of evidence in common law

(Bojanić, Derenčinović, Horvatić, Krapac, Seršić, 2011, p. 59 – 60). The difference of agreement to commit crime (conspiracy) according to the Framework Decision, in relation to participation in a criminal organization is that criminal organization exists if it was established for a long time. In addition, it is necessary participation of at least three people and the existence of certain structure. Aim of the Framework Decision is to establish a higher degree of harmonization and narrow criminalization of participation in a criminal organization and thereby establish legal certainty. In particular, Framework Decision wants to distinguish participation in a criminal organization which is organized by the hierarchy from other organizations that have no vertical structure and acting as a network (Mitsilegas, 2011, p. 14). Framework Decision refers on criminal offenses - plural, so it requires the existence of an agreement to commit not only one but two and more criminal offenses. However, EU state

legislation prescribes punishment of agreement to commit only one criminal offense (Vukušić, 2014, p. 53 – 108) and if there is agreement to commit more crimes, it represents a concurrence of several offenses of agreement or it presents criminal offense arising out of the same transaction (Art. 52 of CC of Croatia) if there is possibility of such legal construction. It is logical that Framework Decision demands conspiracy or execution of more crimes because it regulates action against organized crime, which typically involves committing more crimes. But one should not ignore that it is sometimes possible to establish an agreement for committing one serious offense, that will provide financial or material benefit to offenders for a long time, and such action should not be deprived from the characteristic of organized crime. Therefore, the solution of CC in Croatia when conspiracy or criminal association is possible if it was established for only one offense, more correct. Framework Decision seeks to criminalize conspiracy to commit offenses for which is prescribed a punishment of imprisonment for at least four years (De Moor, Vermeulen, 2010, p. 74). In legislation of Croatia, those criminal offenses are ones for which is prescribed a prison sentence longer than three years (Derenčinović, 2004., p. 31 – 32) This provision in CC is commendable because it prescribes punishment of agreement on criminal offense for which offender can be punished on prison sentence longer than three years. The special minimum of four years (according to Framework Decision) in prison in the CC of Republic of Croatia is not known. Punishing conspiracy, (Art. 327. of the CC) are covered offenses for which the special minimum is less than three years as indicated by their specific maximum exceeding three years, and are very dangerous. Thus formulated provision is adhered to the principle *poenalia sunt restringenda*. The question is whether the agreement must include the location, the time of commission and other modalities of the commission. The answer to this question depends on the fact whether these elements are a constituent part of the definition of criminal offense. If they are, then members of the agreement must be agreed and on these elements. But if such circumstances, which are part of the definition of the criminal offence, does not exist at the time of agreement, it is necessary to see if mutual agreement is dependent on this circumstances (Maljević, 2011, p. 177). In particular is noted that the agreement to commit (conspiracy) in international documents is established on the model of the common law tradition. From the foregoing it is evident that in Croatia exists criminalization only of those who agree to commit a criminal offense which requires that members of an agreement are co-perpetrators, and not participants, agreed to the offense. We believe that there is a striking lack which is reflected on conduct of more instigators who reach an agreement that will together encourage other person to commit the offense by which the agreement is punishable. Instigator of a criminal offense is often punished more severe than the main perpetrators because he is criminal creator of future commission of criminal offense so conspiracy to instigate potential perpetrator should be punished. According to Art. 328. par. 4. CC of Croatia, criminal association exists when it consists of at least three persons who have joined together with the common purpose of committing one or more criminal offenses for which person can be condemned on a prison sentence of three years or more, and that does not include an association that people make accidentally connected for directly committing one offense. Provision of Art. 328. para. 2. of CC provide criminalization of any form of participation in criminal association that will be legal characterized as perpetration. All mentioned criminal offences of environment endangering are covered with definition of criminal association so they can present organized crime. Every action that aims to gain profit within criminal organization will endanger environment and in accordance with definition of criminal offences in CC can be punished person/criminal organization that in their criminal action releases, places or drops the amount of substances or ionizing radiation into air, soil, subsoil, water or sea; or who discharges pollutants to the marine

facility in the sea or to the vessel in the inland waters; or who manufactures, imports, exports, places on the market or uses substances that deplete the ozone layer; or in one or more apparently related items makes unauthorized traffic management in an amount greater than the minor; or who handles place in which a dangerous substance are procedure or where they are stored or used if they can outside permanent or significantly compromise the quality of air, soil, subsoil, water or the sea, or significantly or the wider area of compromise animals, plants or fungi, or threaten the life or health; who processes, handles, uses, possesses, stores, transports, imports, exports or disposes nuclear materials or other hazardous radioactive substances a longer period or to a greater degree jeopardize the quality of air, soil, subsoil, water or the sea, or significantly in wide area endangers animals, plants or fungi, communities of animals, plants or fungi, or threatens the life or health, or exploitation of mineral resources and thereby causes substantial damage. Framework Decision allowed Member States to continue to apply its national legislation without obligation to introduce the concept of criminal organization. So national legislation will continue to act according to the rules of participation and preparatory actions in the concrete offense. In the EU Member States there are still three modules of prescribing culpability for action in a criminal group (as a separate criminal offense, through the provision of perpetration and participation in a criminal act which is / or should be committed or as conspiracy in common law) (Bakowski, 2013, p. 2). It is therefore necessary to establish a consensus between EU Member States because of the importance of facilitating harmonization and cooperation with regard to these crimes. Art. 327. para. 2. of the CC in Croatia provides possibility of effective regret for offender who participated in the establishment of an conspiracy, if he detects an agreement, while Art. 328. para. 2. of the CC regulates effective regret within criminal association only if member of association timely disclosures future commission of criminal offenses or detects criminal association before in its composition or for association commits a crime. Mentioned regulation of effective regret in the Art. 327. para. 2. of the CC and Art. 328. para. 3. of the CC are in accordance with Art. 4. of the Framework Decision which lists special circumstances that may reduce penalties for offender or that could offender exempt from penalties. Namely, each Member State may take necessary measures to ensure that penalties referred to in Art. 3 of Framework Decision may be reduced or that the offender may be exempted from penalties if he, for example: (a) renounces criminal activity and (b) provides the administrative or judicial authorities with information which they would not otherwise have been able to obtain, helping them to: (i) prevent, end or mitigate the effects of the offence; (ii) identify or bring to justice the other offenders; (iii) find evidence; (iv) deprive the criminal organization of illicit resources or of the proceeds of its criminal activities; or (v) prevent further offences referred to in Art. 2. from being committed. Here is evident that Framework Decision leaves to legislature of Member States legal institute which will be used in achieving aim how enumerated circumstances should reduce punishment or exempt from punishment. Therefore, we believe that by criminal law of Croatia, enumerated circumstances in the Framework Decision, which are not related to the prevention of material completion of the criminal offence should be analyzed through mitigation of punishment or remission of punishment in sentencing particular offender. Legislator in Croatia wants to put the knowledge that it is more important to prevent commission of the offense, which is the subject of an agreement or a criminal organization, than ex post punishment of offenders. Therefore he provides effective regret.

6. CONCLUSION

At effective regret offender has changed his initial attitude, but criminal offence is formally completed and offender can only possibly mitigate its consequences. Here offender can no

longer prevent the breach of the protected legal good (but may affect that injury is to a lesser degree). By voluntary abandonment criminal offence isn't formally completed. Therefore, the court, in spite of the same legal effects for voluntary abandonment and effective regret, should take more attention when sentencing, which will depend on particular facts. Although Art. 327. para. 2. of the CC and Art. 328. para. 3. of the CC for the existence of effective regret require disclosure of made agreement, as well as the Framework Decision (... (b) provides the administrative or judicial authorities with information which they would not otherwise have been able to obtain...), it would be useful to prescribe effective regret by conspiracy, even if the member of the agreement do not disclose the agreement but certainly prevents commission of the agreed offense. This is a situation where member of conspiracy prevents further commission of crime (for example, prevent the entry into the punishable criminal stadium). It should be noted that the institute of effective regret is aimed to prevent material completion of criminal offence which is sometimes more important than punishment of the offender. Indeed, if one member prevents further activities of other members of the agreement, there is still no guarantee that others won't continue without him, so request of Art. 327. para. 2. of the CC to disclose agreement in that case shows as justified. Even by equal legal effect of voluntary abandonment and effective regret, it can not be ignored that the optional remission from punishment gives judge possibility to punish as for the completed offense, unlimited mitigation of sentence and ultimately remission of punishment. Therefore, the legislator in Croatia used a better legal term for the legal effects of effective regret than German legislator. German CC prescribes different legal effects for effective regret depending on criminal offence (the possibility of remission of punishment, the possibility to mitigate punishment). Justification of enumerating different legal effects can only be right when CC with different forms of commission of concrete criminal offence links different legal effects of effective regret. But even in that case, it is unnecessary burden of the legal text. Neither legal solution in CC of Austria is not justified under which the offender who has taken action of effective regret can not be punished. This prevents court to assess all the circumstances of the offense (a form of guilt with which the crime was formally completed, the initiative, the manner of committing) and in accordance with the specific facts determine penalties for the perpetrators. In comparative law, on other hand, is commendable provision that prescribes "noncausal effective regret" after formal completion of the criminal offence. Therefore, the legislator in Croatia should prescribe effective regret and when the offender voluntarily and with effort tries to avoid materially completion (when he tried to avert danger by environmental crimes) and material completion of criminal offence does not occur, regardless of his actions. This possibility is a minimal concession to the offender if one takes into account that legislator in CC for crimes of Terrorist Organizations and Criminal Organization provides application of effective regret, even when there has been a material completion of the crime, if the perpetrator discovered information about the existence of the association to the competent authorities. "Noncausal effective regret" in CC of Croatia can truly be considered as circumstance that will lead to penalty be closer to special minimum of criminal offence, but is it always appropriate when offense is not materially completed and the offender has honestly and laboriously tried to prevent the material completion? There is a question whether non prescription of effective regret for offense of Endangering the Ozone Layer is justified. This is probably because the legislator material completion of criminal offense views through Art. 214. of the CC (appearance of serious consequences for the environment). The fact is that in spite of today's technology it isn't easy for the court, with the help of court experts, to determine what action to which extent damaged the ozone layer. There is similar situation with the criminal offense of Endangering with Noise, Vibrations or Non-ionizing Radiation. If the material completion of criminal offenses of endangering the environment is seen through the

serious consequences in accordance with Art. 213. of the CC, then effective regret should be prescribed for this criminal offence because serious consequences of this crime, or materially completion of this criminal offence is punishable through Art. 214 of the CC. On the end we can conclude the significance to distinguish „regular“ from „organized“ perpetration because of importance to apply provisions of effective regret prescribed in Art. 213. or Art. 327. and 328. of CC in Croatia.

LITERATURE:

1. Bakowski, P. (2013). *The EU response to organised crime*. Retrived 16.02.2016. from <http://www.europarl.europa.eu/document/activities/cont/201206/20120627ATT47779/20120627ATT47779EN.pdf>
2. Bojanić, I., Derenčinović, D., Horvatić, Ž., Krapac, D., Seršić, M. (2011). *Teorija zajedničkog zločinačkog pothvata i međunarodno kazneno pravo - izazovi i kontroverze*, Zagreb: Akademija pravnih znanosti Hrvatske
3. Busch, R., Iburg, U. (2002). *Umweltstrafrecht* (1st edition), Berlin: Berlin-Verl. Spitz
4. De Moor, A., Vermeulen, G. (2010). *Shaping the competence of Europol. An FBI perspective*. Retrived 31.05.2016. from http://www.law.ugent.be/ircp/sweetlemon/sites/default/files/pdf/Shaping_the_competence_of_Europol._An_FBI_perspective.pdf
5. Derenčinović, D. (2001). *Mit(o) korupciji* (1st edition). Zagreb: NOCCI
6. Derenčinović, D. (2004). Neka zapažanja o utjecaju međunarodnih konvencija na razvitak hrvatskog kaznenog prava. In M. Kuzmić, M. Petranović (ed.), *Aktualna pitanja kaznenog zakonodavstva*, (p. 21-41), Zagreb, Inženjerski biro
7. EU Council Framework Decision 2008/841/JHA (2008). Retrived 01.02.2016 from <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:300:0042:0045:EN:PDF>
8. Fajardo, T. (2015). *Organised Crime and Environmental Crime: Analysis of EU Legal Instruments. Study in the framework of the EFFACE research project*, Granada: University of Granada. Retrived 16.02.2016. from http://ecologic.eu/sites/files/publication/2015/efface_organised_crime_and_environmental_crime_eu_level.pdf
9. Kottmann, R. (2010). *Die abgrenzung des Rücktritts von der tätigen Reue nach Art. 23 StGB*. Retrieved 04.04.2016 from http://www.raphaelkottmann.ch/download/03_Erstjahresarbeit.pdf
10. Kurtović Mišić, A. (2015). *Suzbijanje organiziranog kriminaliteta*. Retrived 04.06.2016. from https://www.pravo.unizg.hr/_download/repository/SUZBIJANJE_ORGANIZIRANOG_KRIMINALITETA_-_predavanja_za_poslijedipl.PFZ.ppt
11. Kurtović Mišić, A., Krstulović Dragičević, A. (2014). *Kazneno pravo: Temeljni pojmovi i instituti* (1st edition). Split: Law faculty University of Split
12. Maljević, A. (2011). *"Participation in a Criminal Organisation" and "conspiracy"* (1st edition). Berlin: Duncker & Humblot
13. Maršavelski, A. (2011). Komentar sudske prakse: Delikt podobnosti kao podvrsta delikta apstraktnog ugrožavanja, *Hrvatski ljetopis za kazneno pravo i praksu* 18 (1) 291-294.
14. Mitsilegas, V. (2011). *The Council Decision on the Fight against Organized Crime: What can be done to strengthen EU legislation in the field?*. Brussels: European Parliament. Retrieved 31.05.2016. from <http://www.europarl.europa.eu/document/activities/cont/201206/20120627ATT47779/20120627ATT47779EN.pdf>

15. Novoselec, P. et al. (2007). Posebni dio kaznenog prava (1st edition). Zagreb: Law faculty University of Zagreb
16. Novoselec, P., Bojanić, I. (2013). *Opći dio kaznenog prava* (4th edition). Zagreb: Law faculty University in Zagreb
17. Turković, K. et al. (2013). *Komentar Kaznenog zakona* (1st edition). Zagreb: Narodne novine
18. Vukušić, I. (2014). *Razgraničenje pripremni radnji i pokušaja u teoriji i sudskoj praksi* (Doctoral dissertation). Zagreb: Law faculty University of Zagreb
19. Vukušić, I. (2016). “Odustanak” kod posebnih kaznenih djela ugrožavanja okoliša, *Zbornik Pravnog fakulteta u Splitu*, 53 (2) 581-600.
20. Vuletić, I. (2011). *Teoretsko opravdanje, pravna priroda i pravni učinak dragovoljnog odustanka od pokušaja u hrvatskom kaznenom pravu* (Doctoral dissertation). Zagreb: Law faculty University of Zagreb
21. Wessels, J., Beulke, W. (2010). *Strafrecht - Allgemeiner Teil* (30th edition). Heidelberg: C.F. Müller

THE EFFECTIVENESS OF CIVIL PROTECTION OF THE ENVIRONMENT

Katarina Knol Radoja

*Faculty of Law, Josip Juraj Strossmayer University of Osijek
Stjepana Radića 13, Osijek, Croatia
kknol@pravos.hr*

ABSTRACT

The human right to a healthy environment has been frequently violated and it is necessary to protect it adequately. In theory it could be established that the civil protection of the environment in Croatia is well functioning and provides effective legal protection. However, in practice, the realization of that protection showed to the plaintiffs difficult to realize because the high procedural costs made them difficult to access to the court. Thus allegations have occurred that the current system does not provide effective protection in regard of damages suffered by the plaintiffs since litigation costs such as those for the expertise that they need to pay in advance are huge. Significant interpretation gave the EU Court of Justice in the Edwards case in which held that potential applicants should not be prevented from pursuing judicial proceedings by reason of the financial burden that might arise. National laws and courts need to safeguard rights which individuals derive from EU law, and must not make it in practice excessively difficult or impossible to exercise this rights. Therefore, the basic reason why individual citizens, natural persons, rarely decide for the filing of this lawsuits is based on the fact that these procedures are costly and long lasting and on the other hand, always with uncertain outcome. Moreover, such procedures are generally conducted against more powerful opponents that have their own legal services and resources to finance the procedure more easily.

*The aim of this paper is to point out the problems faced by "ordinary citizens" and NGOs when they are seeking for the protection of their environment and to propose possible solutions. **Keywords:** access to court, civil protection of the environment, procedural costs.*

1. INTRODUCTION

Access to information, public participation in decision-making and access to justice are vital for protecting human rights and the environment (Brisman, 2013, pp. 292; Hunter, 2011, pp. 1336). One of the most cited reasons for potential litigants not proceeding with legal challenges generally speaking and related to environmental protection is the possibility of exposure to significant procedural costs and yet with uncertain outcome. It is often a struggle for others who do not engage and almost always against more powerful rivals which have its own legal services and pay lawyers easier and also have powerful lobby behind them (Šago, 2013, pp. 904). We can say that the Aarhus Convention on Access to Information, Public Participation in Decision Making and Access to Justice in environmental matters (hereinafter: Aarhus Convention, AC) is the most important document on environmental protection on international level (Pánovics, 2010, pp. 136). It is focused on creating procedural rights relating to the protection of the environment (Pánovics, 2010, pp. 140). The AC was adopted in June 1998 in Aarhus in Denmark. Aarhus Convention lays down a set of basic rules to promote the involvement of citizens in environmental matters and improve enforcement of environmental law. It is legally binding on States that have become parties to it. This convention, as the European Union is a party, also applies to the EU Institutions.

2. THE RIGHT TO ACCESS TO JUSTICE IN ENVIRONMENTAL MATTERS IN CROATIA

The right to a healthy environment is included in the basic constitutive act of the Croatia – the Constitution. In addition to the Constitution, the environment in the Republic of Croatia protects also a special act, the Environmental Protection Act (hereinafter: EPA). This Act regulates environmental protection and sustainable development principles, protection of environmental components and protection against environmental burdening, actors in environmental protection, sustainable development and environmental protection documents, environmental protection instruments, environmental monitoring, information system, ensuring access to environmental information, public participation in environmental matters, liability for damage, financing and instruments of general environmental policy, administrative and inspection supervision, and for the purposes of this paper the most important - access to justice (Art. 1 EPA). EPA defines the right of access to justice as the right to file an appeal with the competent authority and the right to lodge a complaint before the competent court which this Act, subject to the prescribed conditions, confers upon persons - citizens, other natural and legal persons, their groups, associations and organisations, with the aim of realising the right to a healthy life and sustainable environment and for the purpose of protecting the environment and individual environmental components as well as protection against the harmful effects of burdens (Art. 4/1/53 EPA). Under Article 19 of EPA any person (a citizen or other natural or legal person, their groups, associations and organisations) who considers that his request for information pertaining to environmental protection matters has been neglected, unfoundedly refused, either in entirety or in part, or that his request has not been answered in an appropriate manner, has the right to defend his rights before a court of law, in accordance with a special regulation on access to information. For the purpose of protecting the right to a healthy life and healthy environment, a person who proves the legitimacy of his legal interest and a person who due to the location of the project and/or due to the nature and/or impact of the project can prove in accordance with the law that his rights have been permanently violated, shall have the right to contest the procedural and substantive legality of decisions, acts or oversights of public authorities before the competent body and/or competent court, in accordance with the law. The EPA does not regulate which court will have jurisdiction in these cases: therefore, the general rules of civil procedure should apply. In accordance with Article 52 of the Croatian Civil Procedure Act (hereinafter: CPA) besides the court on whose territory the respondent has permanent or temporary residence (the court of general territorial jurisdiction) jurisdiction shall also lie with the court on whose territory the harmful action was performed or with the court on whose territory the harmful consequence occurred. And if the damage occurred as a result of death or bodily injury, jurisdiction shall also lie with the court on whose territory the plaintiff has permanent or temporary residence.

3. THE RIGHT OF ACCESS TO COURT REGARDING ENVIRONMENTAL PROTECTION AT THE INTERNATIONAL LEVEL AND IN THE EU

A healthy environment is an essential precondition for the quality of human living and the preservation of his health, which is expressed in the number of international and national documents. In order to protect these rights it is necessary to have the possibility to access the competent judicial and other authorities. Development of the right of access to justice in environmental matters was preceded by the regulation of the right to environmental information. Thus, the Art. 19 of the International Convention on Civil and Political Rights of 1966 guarantees the right to freedom of expression in a way that this right includes freedom to seek, receive and impart information and ideas of all kinds, regardless of frontiers, either orally,

in writing or in print, in the form of art, or through any other media of his choice. The following international act guaranteeing the public right of access to information was the Convention for the Protection of Human Rights and Fundamental Freedoms (hereinafter: ECHR) which in its Article 10 regulates that everyone has the right to freedom of expression and that this right shall include freedom to hold opinions and to receive and impart information and ideas without interference by public authority and regardless of frontiers. However, even though neither the very European Convention nor its protocols explicitly include environmental rights the European Court of Human Rights (hereinafter: ECtHR) developed the practice of environmental protection in cases related to claims where individuals argue that a violation of their rights guaranteed by the ECHR stems from the unfavourable environmental condition. Crucial for the realization of the right to a healthy environment is the existence of procedural guarantees through which we will be able to protect this right. Therefore is the access to justice in environmental matters protected by the right to a fair trial from Article 6/1 ECHR and the right to an effective remedy from Article 13 of the ECHR. The right to access to justice in environmental matters at the international level was directly and comprehensively regulated for the first time in the Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters (hereinafter: the Aarhus Convention, AC). The special provisions on access to judicial review of the Community institutions acts on the protection of the rights of the environment did not exist before the Aarhus Convention, and in relation to it the Regulation 1367/2006 of the European Parliament and of the Council on the application of the provisions of the Aarhus Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters to Community institutions and bodies (hereinafter: Aarhus Regulation). By becoming a party to this international agreement in 2005, the European Union recognized that the access to court is a key component of the protection of human rights to a healthy environment. Before the enactment of the Aarhus Regulation environmental issues were regulated fragmentary by two directives, both adopted in 2003 - Directive 2003/4/EC on public access to environmental information repealing Council Directive 90/313/EC and Directive 2003/35/EC on public participation in respect of the drawing up of certain plans and programmes relating to the environment and amending, with regard to public participation and access to justice. Both directives include provisions on access to justice, in regard to the rights contained in the pillars they are implementing. Directive 2003/4/EC on public access to environmental information repealing Council Directive 90/313/EC regulates right to access to justice in environmental matters when the request on providing information on environmental matters has not been decided and in case it has been fully or partially refused, or if it has been answered inadequately or in a way contrary to Articles 3, 4 or 5 of the Directive. In this case the applicant can institute a procedure in which the authority conducting the procedure is reviewed by another impartial and independent body. The Directive sets out the protection before a judicial or other independent body established in accordance with the national law and whose decisions are binding for the body holding the information. The Directive 2003/35/EC of the European Parliament and the Council of 26 May 2003 sets out that within the national legislation each Member state has to ensure that members of the public stating interest or proving violation of right, in case where this is required by administrative procedural law of the particular member state, shall have access to assessment procedure before the court or other established independent and impartial body established by law in order to challenge the substantive or procedural legality of a decision, an act or omission related to the right of the public to information in environmental matters. The legislation of every member state sets out what is considered as public interest and violation of the decision, act or omission for the purpose of

guaranteeing the wider access to justice for the public stating sufficient interest. In this context every interest of non-governmental organisation meeting the requirements stated in Art. 2(14) of the Directive shall be considered sufficient and additionally the organisations shall be considered to have rights that may be violated in the sense of this Directive. The stated provisions of this Directive do not exclude the possibility of preliminary review procedure before an administrative authority and does not affect the requirement of exhaustion of administrative review procedures before directing it to judicial review procedure if such a requirement exists under national law. The Aarhus Convention is an international agreement on state liability and transparency in matters of environmental protection adopted in 1998 in Aarhus, Denmark and entered into force in 2001 (Rodenhoff, 2002, pp. 343-357). A number of states and among them almost all member states of the European Union are parties to this agreement; in May 2005 the European Union became the party to the Convention. The Convention was published in Official Gazette on 12 January 2007 and entered into force in Croatia on 25 June 2007. The Aarhus Convention comprises three pillars i.e. access to information on environmental matters, public participation and right to access to justice in environmental matters. The Aarhus Convention allows for natural and legal persons, i.e. mainly non-governmental organisations to seek a number of procedural rights in environmental matters (Wates, 2005, pp. 2-11). The main aim of the Convention is to provide for the participation of the public in decision-making procedures in issues related to environmental protection. The public is in the Convention defined as one or more natural or legal persons, and, in accordance with national legislation or practice, their associations, organizations or groups; and “the public concerned” as the public affected or likely to be affected by, or having an interest in, the environmental decision-making; for the purposes of this definition, non-governmental organizations promoting environmental protection and meeting any requirements under national law shall be deemed to have an interest. For the purpose of achievement of the aim the Convention sets out the duty for the parties to take necessary legislative, legal and other measures including measures for achieving compatibility among the provisions implementing the information, participation of the public and access to justice in the Convention, along with enforcement measures for establishing and maintaining a comprehensible, transparent and consistent framework for implementation of the Convention provisions. The Aarhus Convention regulates the right to access to justice in environmental matters by setting out the obligation of the signatory states to ensure right to access to justice whereas the way and conditions of the access remain the competence of the states regulating the mentioned matters in their national legislation. Article 9, section 3 sets out that each party shall ensure within its national legislation that any person who considers that their rights to information as guaranteed by the Convention have been violated (if their request for information has been ignored, wrongfully refused, either partially or fully, improperly answered or treated contrary to the provisions), has access to a review procedure before a court or another independent and impartial body established by law. The Union, after it had become a party to the AC showed as a rule its reluctance to allow direct challenge of its acts by private persons and non-governmental organisations. Therefore a discussion has been raised before the *Compliance Committee* established on the AC on whether the EU violates its international obligation by implementing the conditions for the admissibility of an action in the sense of the need to prove individual concern for private applicants and nongovernmental organisations challenging the decisions of the institutions of the European Union. The 2011 Report in the Findings and recommendations of the Compliance Committee with regard to communication ACCC/C/2008/32 concerning compliance by the European Union in § 81 – 97 states that criteria pursuant to Art. 230 of the TEC as interpreted by the ECJ limit natural and legal entities

disputing the acts before the court. The Committee argued that the conclusion that the European Union fails to comply with Art. 9 of the Aarhus Convention since it guarantees neither access to justice nor adequate and effective remedy. However, the Committee emphasises that if court practice of the ECJ continues in the same manner after the amendments of the Treaty of Lisbon, the European Union shall not comply with the provisions of Art. 9 of the Aarhus Convention. The Treaty of Lisbon (The Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community) is an international treaty signed in Lisbon on 13 December 2007. The Treaty amends the Treaty on European Union and the Treaty establishing the European Community. By the Treaty of Lisbon the name of the Treaty on Establishing the European Community was changed into the Treaty on the Functioning of the European Union. The Lisbon Treaty introduced the Charter of Fundamental Rights of the European Union. After having been ratified by all member states the Treaty of Lisbon entered into force on 1 December 2009. The Treaty of Lisbon modifies the TFEU Art. 263(4) requirements for legal or natural entities to institute proceedings against the act addressing that entity or directly or personally referring to the entity as well as against the act directly referring to the entity but not implying enforcement measures. That after the amendment based on the Lisbon Treaty the situation would not be any different is shown by the case law of the EU Court of Justice (see joined cases C-404/12 P and C-405/12 P *Council and Others v Stichting Natuur en Milieu and Milieu and Pesticide Action Network Europe* from 13 January 2015) refusing to recognise direct effect of Article 9(3) of the Aarhus Convention (Knol Radoja, 2016, pp. 511-531). However, as for the purpose of this paper we shall focus on Article 9(4) of the Aarhus Convention saying that review procedure shall provide adequate and effective remedies, including injunctive relief as appropriate, and be fair, equitable, timely and not prohibitively expensive. In order to strengthen the effectiveness of this provision, the fifth paragraph lays down that each Party shall ensure that the information on access to administrative and judicial review procedures is provided to the public, and additionally they should consider establishing proper mechanism to eliminate or decrease financial and other barriers to access to justice. Also, it is significant to note that according to article 3(8) AC national courts are authorized to award reasonable costs in judicial proceedings. This Convention also refers to right to a speedy trial i.e. the trial within a reasonable time that is set out by the European Convention. Article 6 of the European Convention sets out the right to a fair trial as the right of every person to have their case heard fairly, in public and within a reasonable time by an independent and impartial tribunal established by law. Similarly, the Constitution of the Republic of Croatia the right to a fair trial within a reasonable time sets out as the right of every person to have their rights and obligations, suspicion or accusation of a criminal offence decided upon fairly and within a reasonable time by an independent and impartial court established by law.

3.1. Procedural autonomy and principle of effective judicial protection

It has already been said that the Aarhus Convention with regard to the right of access to justice in environmental matters stipulates only an obligation of Parties to ensure access to justice while other issues primarily those of procedural nature are left to the states to regulate in their national legislation. The principle of national procedural autonomy was first grounded in the *Rewe* case.

In this case the Court ruled that individual's rights under EU law may not be less favourable than those relating to similar actions of a domestic nature. The problem with procedural autonomy is that national procedural law regarding access to justice in environmental matters varies between the states. Also in the European Union, for lack of harmonized rules, procedural law remains to be determined by the member states (De Sadeleer, 2014, pp. 102). Although procedural rules of the Member States should not easily be set aside as they reflect their cultural

and ethical values (Arnull, 2011, pp. 52), in behalf of the number of difficulties that private individuals and environmental NGOs have deal with in some Member States in order to obtain access to court in environmental matters, it could be challenged whether the Member States' procedural autonomy should be undermined by the principle of effective judicial protection (De Sadeleer, 2014, pp. 102). According to the principle of effective judicial protection which arises from *Johnston* case national courts are required to adjust procedures to insure the rights deriving from EU law are protected. The right to effective judicial protection is now also enshrined in Article 47 of the Charter of Fundamental Rights. Pursuant to Article 47 everyone whose rights and freedoms guaranteed by the law of the Union are violated has the right to an effective remedy before a tribunal in compliance with the conditions laid down in this Article. Everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal previously established by law. Everyone shall have the possibility of being advised, defended and represented. Legal aid shall be made available to those who lack sufficient resources in so far as such aid is necessary to ensure effective access to justice. Compared with Article 13 of the ECHR, the protection offered by the first paragraph of Article 47 of the Charter is more extensive since it guarantees the right to an effective remedy 'before a court'. The same applies in relation to the right to a fair hearing of the Article 47(2) of the Charter which, unlike Article 6(1) of the ECHR, is not limited to disputes relating to civil law rights and obligations. Apart from that, the rights set out in Article 47 of the Charter correspond to those laid down in Articles 6 and 13 ECHR and accordingly, the meaning and scope of the former rights shall be the same as those laid down by the ECHR (Lenaerts, 2013, pp. 2). Similar as the principle of effective judicial protection, principle of effectiveness ensures the effective application of EU law. Distinction between this two principles has been debated in doctrine with the question if there is even a need to make a distinction at all (Prechal, 2011, pp 31). An example from the case law on the balancing between the procedural autonomy and the principles of effectiveness, concerning the interpretation of the right to access to justice in environmental matters is the *Trianel* case. In this case Court repeated that in the absence of EU rules governing the matter, it is for the legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from EU law, those detailed rules must not be less favourable than those governing similar domestic actions (principle of equivalence) and must not make it in practice impossible or excessively difficult to exercise rights conferred by EU law (principle of effectiveness). Court saying that - if those organisations must be able to rely on the same rights as individuals, it would be contrary to the objective of giving the public concerned wide access to justice and at odds with the principle of effectiveness if such organisations were not also allowed to rely on the impairment of rules of EU environment law solely on the ground that those rules protect the public interest. As the dispute in the main proceedings shows, that very largely deprives those organisations of the possibility of verifying compliance with the rules of that branch of law, which, for the most part, address the public interest and not merely the protection of the interests of individuals as such - based its decision, excepting the Aarhus Convention and the EU implementation of it, on an extensive interpreted principle of effectiveness (Lohse, 2012, pp. 249).

3.2. Problem of high procedural costs

One of the most important factors for NGOs when they consider whether to bring an environmental lawsuit is the question of the expenses of the proceeding. Among the costs, there are court fees, witnesses and expert fees and lawyers' fees. Further cost, are the costs linked to the substantial work to prepare the case that is generally done by NGOs members. In general,

the court fees do not pose a major problem because they are rather modest or at least affordable in most of the countries. Besides, in Croatia, according to the Law on Court Fees Article 16/1/18 in disputes on compensation for environmental pollution the plaintiffs are exempt from paying fees. Danish and the Portuguese legislation also exempt NGOs from court fees (in Denmark before the appeal boards and in Portugal in the proceedings where they take part as assistant to the prosecution or plaintiff) (De Sadeleer, 2002, pp. 31.). But when we talk about lawyers' fees, if they lose the case, NGOs would have to pay not only their own lawyers' fees but also the winning's party lawyer's fees (the "loser pays" rule). Therefore, lawyer's fees are probably the biggest barrier to access to justice in environmental cases. It is important to mention that in accordance with Art. 9/4 of the AC, one of the requirements for access to justice forbids *prohibitively expensive* procedures. On the question what is prohibitively expensive when it comes to legal costs, the EUCJ passed its decision in April 2013 in the *Edwards* case. It was held that the requirement that legal proceedings should not be prohibitively expensive means that potential applicants should not be prevented from seeking, or pursuing judicial review proceedings of certain environmental decisions by reason of the financial burden that might arise. The EUCJ held that, in assessing the costs against an unsuccessful claimant, a national court cannot act solely on the basis of that claimant's financial situation but must also carry out an objective analysis on the amount of the costs. In addition, it must take into account the situation of the parties concerned, whether the claimant has a reasonable prospect of success, the importance of what is at stake for the claimant and for the protection of the environment, the complexity of the relevant law and procedure, the potentially frivolous nature of the claim at its various stages and the existence of a national legal aid scheme or a costs protection regime.

4. CONSLUSION

Man has always had an impact on the environment and with the industrial development this impact has taken immeasurable proportions. Because of that, every person has to have right to protect and seek justice when environmental rights are compromised. Article 9 of the Aarhus Convention allows the public bodies or private persons the access to justice in environmental matters. It protects the rights of parties to seek redress and guarantees to the members of the public the right of access to review procedures to challenge decisions which have been made without appropriate regard to environmental law. Concerning the interpretation of the right to access to justice in environmental matters in EU, one of the problem was balancing between the principles of procedural autonomy and effectiveness, but the main problem in EU was to combine the requirements laid down in Article 9(3) of the Convention, with the restrictive access to the EU Courts due to Article 230 of the Treaty (later Article 263 TFEU), specifically, ensuring that private individuals and NGOs could file lawsuits without being directly and individually concerned. Moreover, shortage of funds may explain that very few actions have been brought to the national courts, for example Croatian, even though the conditions for standing are often facilitated in comparison to the European Union conditions. In practice the costs are one of the main obstacles for NGOs to bring environmental lawsuit. If the procedure is too expensive or entails the risk for the NGOs to pay the costs for the counter party in case of a loss, the NGO will be discouraged to bring an action. Costs have thus a high impact on access to justice for NGOs. Pursuant to Article 9, Paragraph 4 AC environmental procedures must be "*fair, equitable, timely and not prohibitively expensive*". After that, the problem was how to interpret the provision that legal challenges should not be prohibitively expensive. Assistance to this interpretation finally offered the Court of Justice of the European Union in the *Edwards* case. Court held that potential applicants should not be prevented from pursuing judicial proceedings by reason of the financial burden that might arise. National court cannot

act solely on the basis of that claimant's financial situation but must also take into account the situation of the parties concerned and a number of other objective criteria. Primarily, it should facilitate the position of the plaintiff particularly by abolishing the obligation of advance payment of the procedural costs in environmental cases. As a result, this may raise the ability for individuals and NGOs to take action in court.

LITERATURE:

1. Aarhus Convention on Access to Information, Public Participation in Decision Making and Access to Justice in environmental matters, Retrieved 15 June 2016. from <http://www.unece.org/fileadmin/DAM/env/pp/documents/cep43e.pdf>
2. Arnulf A. (2011). The principle of effective judicial protection in EU law: An unruly horse? *European Law review* vol. 36, no. 1., pp. 51 – 70.
3. Brisman A. (2013). The violence of silence: some reflections on access to information, public participation in decision-making, and access to justice in matters concerning the environment, *Crime Law Social Change* vol. 59, pp. 291 – 303.
4. Case C-115/09 Bund für Umwelt und Naturschutz Deutschland, Landesverband Nordrhein-Westfalen eV v Bezirksregierung Arnsberg Trianel Kohlekraftwerk Lünen (intervening) (2011) I-03673.
5. Case C-260/11 Edwards and Pallikaropoulos of 11 April 2013.
6. Case C-33/76 Rewe-Zentralfinanz eG et Rewe-Zentral AG v Landwirtschaftskammer für das Saarland (1976).
7. Council Regulation (EC) No 1367/2006 of 6 September 2006 on the application of the provisions of the Aarhus Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters to Community institutions and bodies [2006] OJ L 264/13.
8. Charter of Fundamental Rights of the European Union 2000/C 364/01.
9. De Sadeleer N. (2002). Access to Justice in Environmental Matters, ENV.A.3/ETU/2002/0030, Final Report, Retrived 5 June 2016 from <http://www.unece.org/fileadmin/DAM/env/pp/compliance/C2008-23/Amicus%20brief/AnnexHSadeleerReport.pdf>
10. De Sadeleer N. (2014). *EU environmental law and the internal market*. Oxford: Oxford University Press.
11. Europska konvencija o zaštiti prava i temeljnih sloboda čovjeka [European Convention for the Protection of Human Rights and Fundamental Freedoms], Official Gazette, International Treaties, No. 18/97, 6/99 – consolidated version, 8/99 – correction.
12. Hunter D. (2011). *International environmental law and policy*. (4. ed.) New York: Foundation Press.
13. Joined cases C-404/12 P and C-405/12 P Council and Others v Stichting Natuur en Milieu and Milieu and Pesticide Action Network Europe (CJEU, 13 January 2015).
14. Knol Radoja, K. (2016). Pravo na pristup sudu Europske unije, *Zbornik Pravnog fakulteta Sveučilišta u Rijeci*, vol. 37, no. 1, pp. 511 – 531.
15. Lenaerts, K., Effective judicial protection in the EU, Retrieved 13 June 2016. from <http://ec.europa.eu/justice/events/assises-justice-2013/files/interventions/koenlenarts.pdf>
16. Lohse E. (2012). Surprise? Surprise! – Case C-115/09 (Kohlekraftwek Lunen) – A victory for the environment and a loss for procedural autonomy of the Member States? *European Public Law*, vol. 18, no. 2., pp. 249 – 268.

17. Međunarodni pakt o građanskim i političkim pravima [International Covenant on Civil and Political Rights], Official Gazette, International Treaties, No. 12/1993.
18. Pánovics A. (2010). *The need for an EU-directive on access to justice in environmental matters*, Budapest: Studia Iuridica Auctoritate Universitatis Pecs.
19. Prechal S. (2011). Redefining the relationship between "Rewe-effectiveness" and effective judicial protection, *Review of European administrative law*, vol. 4, no. 2., pp. 31 – 50.
20. Rodenhoff, V. (2002). The Aarhus Convention and its Implications for the 'Institutions' of the European Community, *Review of European Community & International Environmental Law*, vol. 11., pp. 343 – 357.
21. Šago, D. (2013). Ekološka tužba kao instrument građanskopravne zaštite okoliša, *Zbornik radova Pravnog fakulteta u Splitu*, vol. 50, no. 4, pp. 895 – 915.
22. The Aarhus Convention: An implementation Guide (second edition), Retrieved 5 November 2015. from http://www.unece.org/env/pp/implementation_guide.html
23. Ustav Republike Hrvatske [Constitution of the Republic of Croatia], Official Gazette No. 85/2010 (consolidated version), 5/2014.
24. Wates, J. (2005). The Aarhus Convention: A Driving Force for Environmental Democracy, *Journal of European Environmental Planning Law*, vol. 2, no. 1., pp. 2 – 11.
25. Zakon o zaštiti okoliša [Environmental Protection Act], Official Gazette No. 80/2013, 153/2013, 78/2015.
26. Zakon o potvrđivanju Konvencije o pristupu informacijama, sudjelovanju javnosti u odlučivanju i pristupu pravosuđu u pitanjima okoliša, [The Act on the Ratification of the Aarhus Convention on Access to Information, Public Participation in Decision Making and Access to Justice in environmental matters], Official Gazette, International Treaties, No. 1/2007.
27. Zakon o parničnom postupku [Civil Procedure Act], Official Gazette No. 53/1991, 91/1992, 112/1999, 129/2000, 88/2001, 117/2003, 88/2005, 2/2007, 96/2008, 84/2008, 123/2008, 57/2011, 25/2013, 89/2014.
28. Zakon o sudskim pristojbama, [Law on Court Fees], Official Gazette No. 74/1995, 57/1996, 137/2002, 125/2011, 112/2012, 157/2013, 110/2015.

CROATIAN PROPERTY LAW BETWEEN TRADITION AND TRANSITION: A REVIVAL OF THE ROMAN PRINCIPLE *SUPERFICIES SOLO CEDIT*

Nikol Ziha

*Faculty of Law, Josip Juraj Strossmayer University of Osijek,
Croatia nikolz@pravos.hr*

ABSTRACT

After WWII, as a part of the communist SFR Yugoslavia, Croatia adopted a distinctive concept of collective property rights, which had important consequences on the development of its legal system, gradually departing from the European legal tradition and taking over the essential features of the socialist legal circle. In order to achieve collective interests, the authorities sought to create a social, and therefore a legal order imposed "from above" by marginalizing civil law in favour of public law. Property law was affected the most by this transformation, especially the traditional rule of the legal unity of real property - everything permanently connected to the ground is considered a part of it and shares the same legal status as the ground - which originated in the Roman principle superficies solo cedit. Disregarding this legal rule, common to all European civil codes, resulted in a compromised land register system and lack of legal certainty.

Through reforms of the legal system after declaring its independence in 1991, Croatia started the process of returning to the civil law roots and the European identity it once had been a part of. Although the legal unity of real property was re-established and all the requirements on the normative level have been satisfied, the consequences of privatization are still present in practice due to insufficient application of law and the atavism of socialist legal reasoning and mentality. Despite some misconceptions that former socialist countries due to their communist legacy resemble a "juridical wasteland", whose legal systems are supposed to be built from the ground up, the aim of the following contribution is to analyse the challenges of a transitioning legal system in its process of rebuilding the civil-style mode of legal thought by returning to its Roman legal foundations.

Keywords: *Roman legal tradition, Property law, Superficies solo cedit, Transition.*

1. INTRODUCTORY REMARKS

Before the Second World War, Croatian legal culture was progressing very much in line with that of Western Europe, which had emerged out of the common Roman legal tradition. The new legal system of the federally organised Yugoslavia (SFRY) imposed socialist ideological concepts throughout the civil law, which had radical consequences on private property and resulted in the abolition of the principle of the legal unity of real property, derived from the Roman principle *superficies solo cedit*, which implies that everything permanently connected to the ground is considered a part of it and shares its legal status.

Unfortunately, such a political system deprived private law of its economic basis, so that this "collision between Romanist tradition and the political demands of the socialist system has resulted in tradition being sacrificed" (Sacco, 1988, p. 65). Since the protection of private property and the freedom of contract are indispensable to the political and constitutional foundations of a free economic order, a paradoxical situation emerged in most eastern socialist countries, which Vékás (2004, p. 455) referred to as "private law without private property".

Croatia is therefore not an isolated example of transformation¹ of social into private ownership. Moreover, the far-reaching consequences of abandoning the principle *superficies solo cedit* as a backbone of property law and the struggle to deal with emerging problems are still present in other ex-communist countries.²

An immediate task of the Croatian state after gaining independence was to ensure the legislative framework for the political, economic and social transformation of the communist regime. In theory, the three principal goals for the new state were to create a democratic political system, market economy and responsive civil society, but the consequences of the transition clearly demonstrate that this is a long-lasting and complex process.

With special focus on the transformations that have occurred in the area of property law following the change of political regime, this paper is an attempt to give a comprehensive analysis of the principle of legal unity of real property, point out the challenges of a legal system in transition and suggest solutions in its process of rebuilding the civil-style mode of legal thought by returning to its Roman legal foundations.

2. THE ORIGINS OF THE LEGAL MAXIM *SUPERFICIES SOLO CEDIT* AND ITS DEVELOPMENT IN ROMAN LEGAL TRADITION

The Roman principle *superficies solo cedit* (the surface goes with the ground) emerged from the debate on acquisition of ownership through accession (Cf. Schmidt, 1890, pp. 121-164, Biermann, 1895, pp. 169-280, Kaser, 1947, pp. 219-260, Meincke, 1971, pp. 136-183, Rainer, 1989, pp. 327-357, Puhan, 1953, 332-340, García, 2008, pp. 1007-1015). Accession as an original mode of acquiring property through merging two things of different owners includes a unification of an accessory object with a principal one into an organic unity in accordance with the general rule *accessio cedit principali* (Cf. *Ulp. D. 34,2,19,13; Paul. D. 41,1,26,pr.*).³ The ownership of a movable merges with the ground in case of permanent connection; it becomes a part of the main legal object and shares its legal status. This applies to trees and other plants once they have taken root in other owners' land (*implantatio, satio*),⁴ as well as to buildings which were constructed on ground (*inaedificatio*).

According to the Law of the Twelve Tables (451-450 BC), ownership over beams and other building materials used in the erection of a house remains unaffected. Described as sleeping ownership (*dominium dormiens*), the ownership of the materials revived in the event of a separation and could be claimed with *rei vindicatio* or *actio ad exhibendum*, particularly if the

¹ Borić (2003, p. 116) argues that the term “transformation”, commonly used for the conversion of former socialist legal systems into ones based on democracy, market economy and the rule of law, represents a superficial approach, based on the wrong belief that before communism those legal systems did not have a civil law system at all. It would therefore be better, he suggests, to call this process a “reformation”.

² For the Latvian experience see Rozenfelds, 2014, pp. 43-50; for Republic of Serbia see the argumentation of Vučković, 2013, pp. 741-754; Polish problems have been analysed by Kordasiewicz, 1995, pp. 163-211; for the recent analysis of Ukrainian transition see Babie, 2016, pp. 3-37; on the restoration of Croatian property law after the fall of communism see Petrak, 2002, pp. 1046-1059.

³ The above specified rule does not apply to temporary structures. Permanent connection of the building with the land is, according to the response of Mucius Scaevola, an essential prerequisite for the acquisition of property through accession. Cf. *Scaev. D. 41,1,60 Titius horreum frumentarium novum ex tabulis ligneis factum mobile in Seii praedio posuit: quaeritur, uter horrei dominus sit. Respondit secundum quae proponerentur non esse factum Seii.* [Titius placed a movable granary for wheat constructed of wooden boards upon the land of Seius. The question arises, who is the owner of the granary? The answer is that, according to the facts stated, it does not become the property of Seius.]

⁴ Cf. *Gai. D. 41,1,7,13 Si meam plantam in alieno solo posuero, illius erit: si modo utroque casu radices egerit* [If I plant one of mine upon the ground of another, it will belong to him; provided that in either case it has taken root] See also: *Gai. Inst. II,74 & 75; Paul. D. 41,1,26,1*

building collapsed.⁵ As long as the building remained preserved, a claim for separation of the materials was not permissible. The owner of the materials had an action (*actio de tigno iuncto*) against the owner of the ground for double the value of those materials if the latter were used in bad faith.⁶ The *ratio iuris* of this regulation was primarily the preservation of the building.

While it is evident that the origins of the concept can already be found in the Law of the Twelve Tables, the term was for the first time explicitly mentioned in the Institutes of the second-century jurist Gaius: “that what is built by another on our land, although he may have built it for himself, becomes ours by natural law, because the building above yields to the ground below (*superficies solo cedit*)” (*Gai. Inst.* II, 73).⁷ He states that this principle derives from natural law (*ius naturalis*), because the inherent nature of things prevailed as the standard of legal interpretation. According to this natural structure of things, superior to civil law, every separate treatment of *superficies* and *solum* should be *a priori* excluded. It is clear that this rule, considered by Roman jurists as *regula iuris*, is not derived from strict legal institutes or based on legal acts, but rather founded on natural ratio (Schmidlin, 1970, pp. 87-90).

Owing its survival mostly to the glossators and commentators, the principle made its way into the Middle Ages and served as a basis for the famous Glossa, attributed to Accursius (13th century): “*Cuius est solum, eius est usque ad coelum et ad inferos*” [whoever owns the soil, it is theirs all the way up to Heaven and down to Hell]. However, it should be noted that in the circumstances of the prevailing medieval legal particularism that arose as a result of barbaric legal customs, which were not familiar with this Roman principle, certain medieval laws permitted separate ownership of buildings, regardless of land (Cf. Simonetti, 2008, pp. 13-18, Maršavelski, 2007, pp. 173-199).

Through gradual reception of Roman norms within *ius commune*, the concept of legal unity of real property was recognised as one of the general principles of all European legal systems⁸ and was later on incorporated into European civil codes.

The most significant for the reception of the legal principle in Croatia was the application of the *Austrian General Civil Code* (*Allgemeines Bürgerliches Gesetzbuch*, hereinafter “ACC”) in its territory. The ACC came into force in the Austrian hereditary provinces of the Habsburg Monarchy, as well as in the parts of Croatia which under its direct authority on 1 January 1812. In the period from 1812 to 1820 it was gradually introduced in the Military Border, Istria and Dalmatia, and with the imperial patent of 29 November 1852 (under the name of General Civil Code, hereinafter “GCC”) it was finally introduced in those parts of Croatia which were under the legislative authority of the Parliament of the Triune Kingdom of Croatia, Slavonia and Dalmatia. In Dalmatia and Istria, which were not under the authority of the Parliament because they were included in the Austrian part of Austria-Hungary, the amended GCC (which incorporated the novels of the ACC from 1914-1916) was in force. Although the GCC was

⁵ Tab. VI, 7 *Tignum iunctum aedibus vineave et concapit ne solvito*. Tab. VI, 8 *Lex XII tab. neque permittit tignum furtivum aedibus vel vineis iunctum neque vindicare, sed in eum, qui convictus est iunxisse, in duplum dat actionem*. [No material forming part of either a building or a vineyard shall be removed there from. Anyone who, without the knowledge or consent of the owner, attaches a beam or anything else to his house or vineyard shall be condemned to pay double its value.] See also: *Ulp. D.* 47,3,1, pr.

⁶ Cf. *Gai. D.* 41,1,7,10; *Paul. D.* 6,1,23,6; *Ulp. D.* 47,3,1, pr; *Inst.* 2,1 29 & 30. Regarding the detailed analysis of *tignum iunctum* see: Monier, 1922, p. 6-261, Watson, 1974, pp. 337-342, Hinker, 1991, pp. 94-122, Watson, 1991, pp. 141-146.

⁷ Different variations of this concise and short maxim can be found in other fragments of the Digest: *Pap. D.* 8,4,17; *Ulp. D.* 9,2,50; *Paul. D.* 13,7,21; *Paul. D.* 20,1,29,2; *Gai. D.* 41,1,7,10; *Gai. D.* 41,1,7,12; *Pomp. D.* 41,1,28; *Ulp. D.* 43,17,3,7; *Gai. D.* 43,18,2; *Paul. D.* 44,7,44,1; *Paul. D.* 46,3,98,8; and Codex: *Sev. Ant. C.* 3,32,2,1; *Diocl. Max. C.* 8,10,5.

⁸ See e.g. German BGB §§ 93sq, 946, Swiss ZGB Art. 667, 671, Austrian ABGB §§ 295, 297, 417sq, Italian Codice Civile Art. 934sq, French Code Civil Art. 552sq, Spanish Código civil Art. 334.

originally considered provisional with the intention to be substituted with an original Croatian Civil Code tailored to Croatian needs, this effort was abandoned due to the political situation, struggle for statehood and the outbreak of the WWI (Gavella, 1993, pp. 335sq; Gavella et al., 2005, pp. 29-40). Provisions of the GCC would further on play a crucial role in certain stages of the development of Croatian private law. First of all, they “bridged the transition” from feudal to modern civil law (Josipović, 2014, p. 111). Furthermore, as a subsidiary legal source they filled in the gaps in private law regulations during the involvement in the socialist legal circle and, finally, they helped Croatia in its process of returning to the civil law roots and the European identity it once had been a part of.

3. ABANDONMENT OF THE PRINCIPLE IN THE SOCIALIST LEGAL MODE

After the WWII, with its own legal framework based on old customary law and influenced by foreign laws which already permeated its legal practice and legal culture, Croatia, together with other federal entities of the Socialist Federative Republic of Yugoslavia (SFRY), formed a part of a system that was known as the socialist legal family. Considering the relativity of classification, Borić (1996, p. 24) pointed out that this legal system occupied a special position within the socialist legal circle, since each legal family has a specific historical basis and represents a legal expression of another culture. Although its legal order increasingly departed from its original Soviet model with efforts to establish “socialism with a human face” (Gavella et al., 2005, p. 24), eventually it was based on the Marxist-Leninist ideology and collectivist worldview which was reflected in the *Constitution of SFRY* and *Associated Labour Act*. Provisions of the ACC no longer applied as law in force but by virtue of the *Act on Invalidity of Legal Regulations Adopted Prior to 6 April 1941 and during Enemy Occupation* - (Official Gazette of the FRY 86/1946) they served as “legal rules” which the courts referred to only indirectly in their decisions. Based on this Act, it was permitted to apply the pre-war regulations (including the GCC) as a valid source of the lowest rank, under the condition that a given legal rule was not in conflict with the provisions of the new legal order and served to fill in the legal gap. Contrary to the individualistic and liberal approach the GCC was based on, where social relations were created “bottom up” by individuals themselves, in order to achieve collective interests (“of the working class”), the government sought to shape the social, and thus legal order “from above”. In this legal system the central position was taken by public law, suppressing and marginalizing civil law. It was property law that underwent major structural and conceptual changes, which alienated it from Central European legal traditions. In favour of collectivistic principles, the individualistic system of ownership, based on only one type of ownership (private ownership), the equality of legal subjects and equal treatment of objects were abandoned. The result was a segmentation of property law by creating diverse forms of ownership, legal inequality between subjects with different rights towards different types of objects. Abandoning the Roman principle of *superficies solo cedit* resulted in breaking the unity of real property into parts with different functions to allow the establishment of various legal rights in certain parts thereof. The real property was legally separated into two parts – the land, usually in social ownership, and the building in private ownership. However, not even the building itself remained uniform. Creating floor ownership enabled the existence of private ownership on physically inseparable, but functionally separate parts of the building - each with a different legal regime. Some flats and business premises were objects of independent property rights, and since they could not be physically separated from the rest of the property, the owner was entitled to the common parts of the building, as well as to the right of permanent land use. Allowing the original acquisition of floor ownership by adaptations, additions or annexes to the common parts of the building even further complicated the legal situation of the real property

and, once started, the process of breaking up of the property into parts was impossible to stop, which only contributed to legal uncertainty in real property trading and the disruption of the land register system.

4. RESTORING THE ROOTS AFTER INDEPENDENCE

Following the shift from socialist paradigms and the establishment of democracy after gaining independence in 1991, the constitution makers have adopted a new stance towards property law. Despite some misconceptions that the former socialist countries due to the communist legacy resemble a “juridical wasteland” (Kordasiewicz 1995, p. 163), whose legal systems are supposed to be built from ground up, for many reasons, such a perception would, at least in the case of Croatia, be improper. A particular significance in that process goes to legal education, especially Roman law which raised the cultural level of legal education and facilitated the process of reintegration into the western European legal culture (Cf. Horvat, 1951, pp. 97-117). Despite the fact that Croatia adopted numerous federal Yugoslav laws in its legal system, not all private law areas were provided with valid regulations. In order to fill in those gaps, the tradition of the GCC played a crucial role in the private law reform. Since the *Act on the Application of Legal Regulations Adopted Prior to 6 April 1941* (Official Gazette 73/91) permitted to apply, as legal rules, the regulations that were in force on 6 April 1941, if the rules were in accordance with the Croatian Constitution and were already applied in the Republic of Croatia until the day of the entry into force of the mentioned Act, the provisions of the GCC remained an important legal source to fill the gaps and modernise the neglected and marginalised areas of private law (Cf. Josipović, 2014, p.112sq). It is particularly interesting to emphasise that the principles of European tradition re-emerged (through the GCC provisions) in more or less the same way as once *ius commune* had, in a process of gradual acceptance, rather than by having been mandatorily imposed by a centralist national authority. Through gradual regulation of property law by positive Croatian legislation, the importance of the GCC decreased, but the need for the application of its provisions as legal rules has not ceased. New rules have explicitly provided that the legal relations which emerged prior to their entry into force are subject to the rules which were valid at the time of existence of such legal relations. Therefore, the courts still apply numerous provisions of the GCC in practice when deciding on relations that emerged prior to the entry into force of the new civil law legislation.⁹

With the abolition of social ownership and its transformation into private ownership, the need for legal separation of land and building ceased to exist. The legal unity of privately owned

⁹ E.g. the Constitutional Court of the Republic of Croatia in the decision *U-III/3214/2005* adopted the constitutional complaint against the ruling of the County and Municipal Courts in Osijek and returned the case to the Municipal Court in Osijek for renewed proceeding, accepting the allegations of the applicant that in this particular case he was not ensured equality before the law, guaranteed by Article 14 paragraph 2 of the Constitution, and finding that the impugned judgments violated his constitutional right. The plaintiff originally initiated a proceeding against the City of Osijek in order to determine his property rights on a house built on socially owned land, bought in 1963 from non-registered owners and later rebuilt and adapted. According to the relevant provision of the OA (Art. 367 para. 1) which incorporates the inversion of the principle *superficies cedit solo*: “If before the entry into force of this Act a building that is owned by someone and is registered in the land register as a land register unit separate from the land on which it was erected, was erected on a piece of land under social ownership, the owner of the building shall acquire the right of ownership of the entire piece of real property by unification of all land register units into one, with an entry of the right of ownership of the unified unit in favour of the owner of the building.” Since OA Art. 388 para. 2 stipulates that the acquisition and legal effects of real rights before the entry into force of that Act shall be evaluated according to the rules applicable at the moment of acquisition, if we consider that during the time of purchase and construction of the house the land was socially owned, in this particular case a provision of the GCC (Art. 418, which allowed the acquisition of property rights by constructions if the land owner allowed or did not oppose to it) needed to be applied.

buildings and socially owned land was re-established on 8 October 1991 under the assumption that buildings had been legally built. The *Act on the Adoption of the Act on the Basic Ownership Relations* (Official Gazette 53/91) replaced the rights over socially owned property with the rights of ownership (Art. 12 para. 1) and the owner of the building was *ex lege* entitled to property rights on the land which was permanently connected to the building. The process of transformation included restitution as well, whereby property that had been nationalised and confiscated was returned to its former owners in accordance with the *Act on Compensation for Assets Seized during the Yugoslav Communist Rule* (Official Gazette 92/96, 92/99, 80/02, 81/02) (Amplius Josipović, 2014, p. 118).

The reform of Croatian property law and land registry system started with the adoption of new regulations based on traditional principles of property law known to all modern European legal systems. Concerning the method of re-codification, a segmented approach was adopted by regulating specific areas of private law through separate Acts with no perspective for issuing a uniform civil code, such approach probably being a legacy from the segmented organisation of private law in the socialist republics of former SFRY.

The *Act on Ownership and Other Real Rights* (hereinafter OA; Official Gazette 91/96, 68/98, 137/99, 22/00, 73/00, 114/01, 79/06, 141/06, 146/08, 153/09, 90/10, 143/12, 152/14), which entered into force on 1 January 1997, consistently implemented the principle of the legal unity of real property according to which a real property consists of the land plot, including everything that is reasonably permanently affixed to it on the surface or below it (Art. 9 para. 1). In its legal reasoning of the final proposal of the OA, which was previously explored by Petrak, the Croatian Government explicitly mentioned the Latin phrase of the principle, explaining the necessity of its reintroduction in the Croatian civil law system by pursuing European legal tradition and the needs of business and the market economy (cf. Petrak, 2007, p. 173; Petrak 2010, p. 166). Even the courts, regardless of their instance, explicitly refer to the Latin *regula iuris* in argumentations of their verdicts.¹⁰

Based on the provisions of the OA (Art. 367-369) by which the owner of the building is entitled to the ownership of the previously socially owned land plot, including everything that is reasonably permanently affixed to it on the surface or below it, we can conclude that the re-establishment of the legal unity of real property was carried out inversely, as *superficie solum cedit*. Any legal transaction contrary to this principle since the entry of the OA into force has no legal effect (Art. 366 para. 3). Furthermore, the provisions of the regulations presently in force, regulating social ownership differently than other ownership, may be construed and applied only in accordance with the principle of uniformity of ownership (Art. 395 para. 1). After restoring the legal unity of land and building, it was necessary to establish the unity of real estate (land with building) and its functionally independent parts (flats). Austrian law once again served as a model for the reform of previous floor ownership. Since floor ownership arises from and remains inseparably connected to the proportional co-ownership share of the real property on which it is established (Art. 370), such a structure provides the legal unity of the real property and at the same time allows relatively independent exercise of ownership rights on the separate parts (Cf. Josipović, 2003, pp. 111-122).

By re-establishing the principle of legal unity of real property, the legislator focused primarily on buildings built on land in social ownership and omitted to regulate a specific traditional type of ownership existing in local Croatian customary law which adopted the concept of legal

¹⁰ Cf. the judicial practice of County Courts: Gž 1196/09-2, ŽS, Gž 530/2007-2, Gž 530/07-2, Gž.1649/05-2, Gž-5151/11-2, High Administrative Court: Us-7901/2007, Supreme Court of the Republic of Croatia: VSRH Rev 978/2009-2, VSRH Rev 1234/1991-2, VSRH Rev 1584/1997-2, Constitutional Court of the Republic of Croatia: U-III/3214/2005, U-III/2389/2011.

dualism and allowed separate ownership of olive trees regardless of the legal regime of land property. Even though the legal doctrine has emphasised the problems that arose because of exceptions in Croatian contemporary real property law to the principle *superficies solo cedit* and the dilemma of the legal dualism between real property rights on olive trees and on land in Istria and Dalmatia, the issue has not gained any further resonance with the legislator, so that the principle does not allow exceptions besides the state that existed on 1 January 1931.¹¹

5. TRANSITION OUTCOMES

After substantial changes at the normative level were carried out, it seemed that all the most important prerequisites were satisfied in order to modernise Croatian property law, ensure secure legal transactions of real estate and encourage the development of entrepreneurship, foreign investments and re-integration of Croatia into the European legal circle. Regardless of the reforms, the transitional regime caused numerous problems in practice.

First of all, the continuous changes to legislation (initially those changes relating to the transition from a socialist to a democratic legal system and later on those regarding the harmonisation of Croatian private norms with the European ones), as well as insufficient critical examination of the possible consequences of implementation of foreign legal institutes, contributed to legal uncertainty. New provisions were often implemented with no previous preparation of the substantial infrastructure or systematic education of judicial officials and civil servants. Reception of foreign legal norms was frequently a subject to false expectations. It was, and unfortunately still is, believed that the mere acquisitions of provisions which have shown successful results in practice of other states where they have been taken from, would deliver the same results in our conditions. Josipović (2014, pp. 119-120) especially emphasised the problem of incomplete or mutually conflicting regulations which were the result of inadequate professional coordination and non-systematic analyses of the relevant problems. Instead of a structured transition which would ensure a fast and simple, but legally secure transition to the new regulation of ownership, this has led inevitably to gaps and amendments and had a negative impact on legal security.

Although social ownership has been legally abolished, the consequences of the long-term abandonment of the principle *superficies solo cedit* during the socialist period are most evident in the land registers, because unfortunately it still does not reflect the actual situation of real estates. Numerous entries remain where a person is registered as the owner of the land plot on which the building is situated, while another individual owns the special parts of the real estate. There are very common situations in practice where, due to the absence of the principle of unity of the real property, a person is registered as the holder of the corresponding rights of social ownership of the land, while other individuals have property rights on the building itself, i.e. on the special parts. Given that the land register was not accurately maintained during the period of communist rule, discrepancies between the land register and the cadastral register are a common problem.

Stipulating that the persons registered in the land register as the holders of the rights to administration, use and disposition of a thing under social ownership *ex lege* acquire the right of ownership, provided that the real estate has the capacity to be the subject matter of the right

¹¹ Milotic (2013, pp. 1319-1350) analysed the problem more closely on the example of customary law in Lun, which, contrary to the principle of unity of a real property, divides the legal regimes of land and olive trees that grow on it. He correctly emphasises the omission of the legislator to incorporate this specific type of ownership as an exception to the principle of unity of a real property, generally proclaimed in Croatian property law in force.

On discussion about the same issue see also Simonetti, 2008, p. 21-22.

of ownership (OA Art. 360), and that for acquiring property rights land register entries should be relevant, has caused a series of incorrect entries. Namely, the rights of the persons who are registered as the holders of the rights to administration, use and disposition of socially owned land have in many cases been transferred to other persons or their rights ceased in the procedures of expropriation, which has not been recorded in the land register.

Private ownership is entered in the land register at the request of the parties. The registered holders of the rights to administration, use and disposition of socially owned land are required to submit to the competent courts a proposal to delete social ownership and register the private property on their behalf. This requires a break up with the passive socialist legal reasoning and a greater degree of responsibility of individuals.

The inability to legally trade socially owned real estate caused a lack of citizens' interest to report the transfer of rights to use socially owned land into the land register. This systematic neglect of the land register during a period of forty-five years has led to discrepancies between land register and cadastre, as well as between the actual state of affairs and the entries. This has resulted in an increased number of proposals for registration of real rights and in a drastic increase in the number of court cases. Additionally, the judiciary is perceived as not efficient enough, because judicial proceedings last too long to provide legal certainty and security and the case law is not always uniform.

The deadlines for ensuring confidence in the truthfulness and completeness of the land register have been constantly postponed. Until 1 January 2017, a potential buyer who has acted in good faith will not be protected under the principles of confidence and accuracy of the land register if he acquires a real estate subject to an entry of social ownership which was not deleted by 1 January 1997. It is therefore of particular importance to harmonise the land register records with the actual situation of real estate as soon as possible, because third party claims may thus not be excluded. Despite all the previous legislative amendments (*Land Registration Act*, Official Gazette 91/96, 68/98, 137/99, 114/01, 100/04, 107/07, 152/08, 126/10, 55/13, 60/13), as well as the digitalization of both registers, we have to be aware that the reform of the land registers is a long and gradual process and its harmonisation cannot be expected in a mere few years, after a long period of neglecting and not entering data.

6. CONCLUSION

The shift from socialism and centrally planned economy to democracy and free market economy encouraged a very dynamic reform within Croatian property law. Although constituting a crucial milestone for the transition from socialist legal reasoning into the process of rebuilding the civil-style mode of legal thought, this transformation has not resulted in a dramatic alteration of the pre-existing position, because prior to the implementation of socialist law in 1945, Croatia enjoyed an extensive civilian legal history. Against the usual misapprehension that the legal systems of former socialist countries are due to their communist legacy supposed to be built from scratch, we have tried to prove that, for many reasons, such a perception would, at least in the case of Croatia, be incorrect and that regime change does not have to mean a radical break with the old tradition. Belonging to a separate socialist legal family, the system did not exclude the existence of the Romanist substrata within its very core. This was, *inter alia*, possible because of a continuous education of lawyers, since, despite ideological differences, Roman law constituted an integral part of the university curriculum during socialism, without interruptions. There was also a long tradition of drawing upon Western models for drafting codes and developing the legal system. It is therefore important to emphasise that the principles of this Romanist tradition re-emerged gradually in more or less the same way as once *ius commune* had, through continuous acceptance, rather than by having

been mandatorily imposed by an authority. In this process, the provisions of the GCC played a crucial role in certain stages of the development of Croatian private law, assisting the transition from feudal to modern civil law, filling in the gaps in private law regulations as a subsidiary legal source during the involvement in the socialist legal circle and, finally, helping Croatia in its process of returning to the civil law roots and European identity it once had been a part of.

Through a comprehensive analysis of the traditional principle of the legal unity of real property which originated in the Roman postulate *superficies solo cedit*, we tried to illustrate how the involvement in the socialist legal environment transformed the essence of the legal institute and caused very turbulent changes in property law, resulting in a compromised land register system and legal uncertainty.

Even after the re-codification of property law, the transitional regime is still fraught with difficulties. Taking into consideration that the legislation has taken a segmented approach and that specific laws are constantly enacted without a thorough prior preparation of the infrastructure or adequate education, Croatia needs to start applying a well-planned and comprehensive approach with a long-term perspective, rather than action of a revolutionary nature.

The abandonment of the principle *superficies solo cedit* during the socialist period caused the most profound consequences in the land register and cadastre. It is thus of particular importance to harmonise the land register records with the actual situation of real estate as soon as possible in order to ensure its main function - legal protection of confidence in the truthfulness and completeness of its content. Since entries into the register are recorded at the request of the parties, patience and a gradual change of mentality would be essential. Given that the long-term inability to legally trade socially owned real estate caused a lack of interest among citizens to report the transfer of rights to use socially owned land into the land register, the legacy of such reasoning has left behind traces of passive mentality. A proactive approach of all participants in the society would therefore be of great significance - the state by providing a clear and secure legal framework, citizens by not expecting the government to solve their problems and by taking responsibility, as well as lawyers by constantly educating and improving their knowledge, in order to contextualise legal problems and avoid simple, technical enforcement of regulations.

LITERATURE:

1. Babie, P. (2016). Ukraine's Transition from Soviet to Post-Soviet Law: Property as a Lesson in Failed Regulation. In *East/West: Journal of Ukrainian Studies* Volume III, No. 1
2. Biermann, J. (1895). *Superficies solo cedit*. In *Jherings Jahrbücher für die Dogmatik des bürgerlichen Rechts* 34
3. Borić, T. (1996). *Eigentum und Privatisierung in Kroatien und Ungarn: Wandel des Eigentumsrechtssystems und Entwicklung der Privatisierungsgesetzgebung*. Wien: Verlag Österreich
4. Borić, T. (2003), Zur Wiederkehr des Vertragsrechts in Mittel- und Osteuropa am Beispiel Kroatiens, In M. Eiselberg (ed.) *Europäisches Vertragsrecht. Vereinheitlichtes Recht - Rechtsvereinheitlichung in Europa* 25, Wien: Manz
5. García, A. Z. (2008). *Superficies solo cedit*. In *Anuario da Facultade de Dereito da Univesidade da Coruña* 12
6. Gavella, N. (1993). Građansko pravo u Hrvatskoj i kontinentalnoeuropski pravni krug – u povodu 140. godišnjice stupanja na snagu OGZ u Hrvatskoj, [Civil law in Croatia and

- Continental-european legal family - on the occasion of 140th anniversary of entering into force GCC in Croatia]. In *Zbornik PFZ [Collected Papers of Zagreb Law Faculty]* 43-4
7. Gavella, N. et al. (2005). *Teorijske osnove građanskog prava - Građansko pravo i pripadnost hrvatskog pravnog poretka kontinentalnoeuropskom pravnom krugu [Theoretical basis of civil law - Civil law and affiliation of Croatian legal order with the continental-european legal family]*. Zagreb: Pravni fakultet
 8. Hinker, H. (1991). *Tignum iunctum*. In W. Kaiser, M. J. Schermaier, G. Thür (eds.), *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte: Romanistische Abteilung* 108. Wien, Köln: Böhlau Verlag
 9. Horvat, M. (1951). *Rimsko pravo u našem pravnom studiju [Roman law in our legal studies]*. In *Zbornik PFZ [Collected Papers of Zagreb Law Faculty]* 2
 10. Josipović, T. (2003). *Prilagodba hrvatskog građanskopravnog poretka europskom povratkom na načelo superficies solo cedit [Harmonisation of the Croatian civil law order to the European by returning to the superficies solo cedit principle]*. In *Das Budapester Symposium - Beiträge zur Reform des Sachenrechts in den Staaten Südosteuropas*
 11. Josipović, T. (2014). *Private Law Codification in The Republic of Croatia*. In W. Wang (ed.), *Codification in International Perspective: Selected Papers from the 2nd IACL Thematic Conference*, Heidelberg, New York, Dordrecht, London: Springer
 12. Kaser, M. (1947). *Die natürlichen Eigentumserwerbsarten im altrömischen Recht*. In W. Kaiser, M. J. Schermaier, G. Thür (eds.), *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte: Romanistische Abteilung* 65. Wien, Köln: Böhlau Verlag
 13. Kordasiewicz, B. (1995). *Polish Civil and Commercial Law*. In S. Frankovski and B. Stephan (eds.), *Legal Reform in Post-Communist Europe: The View from Within*, Dordrecht: Martinus Nijhoff Publishers
 14. Maršavelski, A. (2007). *Građenje na tuđem zemljištu kao temelj za stjecanje prava vlasništva* [Building on another's ground as a special form of gaining ownership]. In *Pravnik [Lawyer]* 41.84
 15. Meincke, J. P. (1971). *Superficies solo cedit*. In W. Kaiser, M. J. Schermaier, G. Thür (eds.), *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte: Romanistische Abteilung* 88. Wien, Köln: Böhlau Verlag
 16. Milotić, I. (2013). *Vlasništvo maslina na Lunu (otok Pag) i načelo superficies solo cedit [The ownership of olive trees in Lun (island Pag) and the principle superficies solo cedit]*. In *Zbornik PFZ [Collected Papers of Zagreb Law Faculty]* 63
 17. Monier, R. (1922). *Le tignum iunctum*, Paris: Univ. de Paris.
 18. Petrak, M. (2002). *Rimska pravna tradicija i hrvatsko stvarno parvo [Roman Legal Tradition and Croatian Property Law]*. In: *Zbornik PFZ [Collected Papers of Zagreb Law Faculty]*, 52, 5
 19. Petrak, M. (2007). *The Significance of Ius Commune in the Contemporary Croatian Legal System*. In *Slovenian Law Review* 4
 20. Petrak, M. (2010). *Ius commune and Croatian property law*. In: *Annals of the Faculty of Law in Belgrade – Belgrade Law Review* 58
 21. Puhani, I. (1953). *Superficies solo cedit*. In *Annals of the Faculty of Law in Belgrade*, 3-4
 22. Rainer, J. M. (1989). *Superficies und Stockwerkseigentum im klassischen römischen Recht*. In W. Kaiser, M. J. Schermaier, G. Thür (eds.), *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte: Romanistische Abteilung* 106. Wien, Köln: Böhlau Verlag
 23. Rozenfelds, J. (2014). *Reform of Land Registration in Latvia*. In *Juridica International* 22
 24. Sacco, R. (1988). *The Roman substratum in the Civil law of the socialist countries*. In *Review of Socialist Law* 14 (1). Dordrecht: Martinus Nijhoff Publishers

25. Schmidlin, B. (1970). *Die römische Rechtsregeln: Versuch einer Typologie*, Köln-Wien: Böhlau Verlag
26. Schmidt, A. (1890). Das Recht der Superficies. In W. Kaiser, M. J. Schermaier, G. Thür (eds.), *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte: Romanistische Abteilung* 11. Wien, Köln: Böhlau Verlag
27. Simonetti, P. (2008). Pravno jedinstvo i pravni dualitet nekretnine I [Legal Unity and Legal Duality of Immovable Property]. In *Hrvatska pravna revija [Croatian Law Review]* 1
28. Vékás, L. (2004). Integration des östlichen Mitteleuropa im Wege rechtsvergleichender Zivilrechtserneuerung. In *Zeitschrift für Europäisches Privatrecht* 3
29. Vučković, M. (2013). Aktuelnost načela superficies solo cedit [The relevance of the principle superficies solo cedit]. In *Zbornik radova 1700 godina Milanskog edikta [Collected papers 1700 years of Edict of Milan]*
30. Watson, A. (1974). Tignum Iunctum: The XII Tables and a Lost Word. In *Revue Internationale des Droits de l'Antiquite*, Ser. 3, Vol. 21
31. Watson, A. (1991). *Legal Origins and Legal Change*. London-Ohio: A&C Black

THE INFLUENCE OF LEGAL AND ECONOMIC CONDITIONS ON THE APPEARANCE OF THE INSTITUTE OF *PRECARIUM* IN MODERN REGULATION OF CIVIL-LAW

Jelena Kasap

Faculty of Law, Osijek, Croatia
jkasap@pravos.hr

ABSTRACT

*In the collection of legal documents from the period of the medieval Germanic law the terms precarium and precaria are used in almost identical context. It is impossible, however, not to wonder whether, in accordance with the needs of the medieval legal transactions, the original Roman-legal Institute precarium lost its meaning and became an alternative instrument for the realization of property rights interests or, on the other hand, the developed legal trade in the Middle Ages generated a new legal instrument suited to satisfy the requirements of feudal state government. If the relevance of the latter assumption is determined, it is particularly important to distinguish the two legal instruments. Already at first glance it is quite clear that the demarcation of the two instruments is going to be based on the border between the contracting lease of things for the use and characteristics of precarious holding of the things. Therefore, the basic objective of the proposed work is to establish the context in which, when it comes to the modern civil law regulation, the incidence of two different legal terms may be determined. **Keywords:** precarium, precaria, Middle Ages, feudal law, modern system of civil law.*

1. INTRODUCTION

Based on the wildly learning about the reception of Roman law regulation in the private law tradition of European countries, landing of the things in the period of application of the *ius commune* could be realized through two basic institutes, *commodatum* and *precarium*. At the outset it is important to stress that *precarium* as the contractual relationship was regulated even in the Justinian law and it retained this indicated model in the time of application of the *ius commune*.

2. CHARACTERISTICS OF ROMAN LAW INSTITUTE *PRECARIUM* IN THE SYSTEM OF *IUS COMMUNE*

The legal sources relevant to the *ius commune* attempted to determine the difference in achieving loan by applying both legal institutions, thus *precarium* as an object of the legal regulation of the source is mainly addition to the loan for use. Older sources of *ius commune* contextually demarcated institutes of *commodatum* and *precarium* by analyzing four criteria of demarcation known from Accursii's *Glossa simile* with D. 43, 26, 1, 3.

First of all, in addition to free revocation, which makes a fundamental distinguishing mark, *Glossa non officium* includes vagueness of the use of things as fundamental characteristic that distinguishes *precarium* from loan for use; *Glossa non officium* with D. 13, 6, 17, 3: "...*commodatum semper date cum praeinitione certi usus*." ¹ The next difference suggested by the

¹ Accursius, *Glossa Ordinaria*: *Glosa non officium*, ad. 1. In *commodato*, ff. *Commodati* in addition to D. 13, 6, 17, 3: "...loan is always granted on the assumption of determination of the application.."; Accursii's *Glossa Ordinaria* hereinafter cited according to: *Accursii Glossa in Digestum novum (Corpus glossatorum iuris civilis)*,

legal sources makes up the fundamental characteristic of *precarius* in the system of *ius commune*, which was undoubtedly taken from the Roman legal formulation of the Institute. Different from the loan that is not dependent on the will of lenders in respect to termination of the contract, *precarius* was significantly marked by the free revocability of legal rights of the lender. The right to revoke was not limited in time, thus the lender was authorized to demand the return of things at any time. In this regard, *precarius* was in no way different from its Roman ancestor, thus following those characteristics significant reception of Roman legal rules can be confirmed.² In terms of accountability criteria that defined the legal position of the precarist in Roman law it is to determine their identity in the legal system of common law. *Glossa simile* in addition to D. 43, 26, 8, 3 and 5 defines the responsibility of the precarist as follows. Just as the precarist in Justinian's law, the precarist in common law was responsible for any damage or destruction of the borrowed thing that could have been caused by his evil intent or gross negligence. In relation to the responsibility of the borrower in common law which we had previously described, the legal position of the precarist was significantly more favorable, especially if one takes into account that the responsibility of the borrower had to be justified for any, even the slightest degree of negligence in relation to the preservation of the borrowed things. However, further in Accursii's glossa in addition to D. 43, 26, 8, 3³, it is clear that the limitation of liability of the precarist to the above standards, *dolus and culpa lata*, does not apply after the beginning of litigation. From that point, the legal position of a precarist in terms of liability for damage of borrowed things is equated with those of the borrower and expands on *omnis culpa*. Finally, as an important distinguishing criterion of the two institutes Accursii recognizes the nature and type of things that might have been the object of borrowing in one of the two legal forms. While in common law the subject of loan could only be movable property, the subject of *precarius*, according to the interpretation of Accursii, could be real estates. If the manifesting form of a signed contract was not explicitly defined, the lending of real estate was considered *precarius*, while *commodatum* was considered in the case of lending of movable property. Modern Romanistic literature, which attempted to critically interpret the sources of the common law, represents the opinion according to which the application of the rules of *precarius* was much more prevalent in cases of a loan of the land. (Lydorf, 2012, p. 601) Therefore, it is surprising, according to Lydorf, that the content of the glossa in addition to D. 43, 26 does not mention for example the case of borrowing land. (Lydorf, 2012, p. 601) The content of glossa can not serve as a rule according to which particular types of things would become the subject of a particular legal institute.⁴ The above glossa in addition to D. 43, 26 just set indications of the existence of the contract on the loan in those cases where it was a loan of movable property in question, and the content of a legal transaction did not clearly indicate whether it was a loan for use or *precarius*.

(1483), Nuremberg, Anton Koberger, April, 20, Retrieved from <http://tudigit.ulb.tu-darmstadt.de/show/inc-v-123>; and according to: Chiari, Girolamo, Crassus, Bernardinus, Accursius, Franciscus <Senior>, Corpus iuris civilis, Digestum vetus mit der Glossa ordinaria von Accursius Florentinus und Summaria von Hieronymus Clarius, (1494), Venedig, Retrieved from <http://bildsuche.digitale-sammlungen.de/index.html?c=viewer&bandnummer=bsb00051834&pimage=00717&v=pdf&nav=&l=it.>, June 20, 2016.

² Glossa ordinaria to D. 43, 26, 12: "*Precarium in omni tempore liberalitatis, in principio et in fine...*"

³ Accursius, Glossa ordinaria, *Glosa ex liberalitat*, ad. 1. *Quaesitum est*, ff. *De precario*. to D. 43, 26, 8, 3: "*...quia hic de dolo et culpa lata tantum tenetur: nisi litis constentatio.*"

⁴ This is opposed by glossa to D. 13, 6, 1, 1 in which Accursius discussed on the questioned existing even in the Roman law about a possibility to loan a land.

Indicating the possibility of a precarious loan of land, even in the sources of common law, raised a question of demarcation of the mentioned Institute from medieval feudal Institute of *precaria* whose occurrence is related to the period of the 8th century. This need is even more meaningful if one bears in mind the fact that the feudal institution is the foundation of land relations throughout the Middle Ages, especially in France.

3. CHARACTERISTICS OF THE FEUDAL INSTITUTION *PRECARIA*

As *precarium* in the field of medieval France had specific characteristics in relation to the regulation of the same institute in the field of German countries which took over provisions of Justinian law, these characteristics will be specifically analyzed.⁵ In legal literature the Institute of *precaria* is often identified with *empfytheusis* and the right of usufruct. In this sense, in order to clarify the actual functions and characteristics of *precarium*, it is necessary to delineate these legal relations. The latter distinction is more evident in the period in which *precarium* becomes a contractual relationship that results in guaranteed certain rights of the precarist, thus necessarily loses its free nature. Although the difference between the Institutes *precarium* and *precaria* is convincingly expressed in terms of their fundamental characteristics it should be determined further in the text whether the listed differences also refer to the absolute absence of common elements.

Social opportunities arising between the 3rd and 4th century, directed against slaveholding achievements of the Roman Empire created a suitable conditions for the development of agricultural agreements, which will mark the Frankish state and the law.⁶ In reality the mentioned contracts pointed to the permanent lease of land (*precarium*), i.e. the contract was concluded between the landowner (*potens*) and the lessee (*humilis*) including payment of a symbolic rent. Thereby the lessee did not acquire real legal right of the land, and duration of the relations depended mainly on the will of *potens*. (Ellul, 1964, p. 65; Lesne, 1940, p. 314) The same instrument started to be used by the church, of course, with more prominent characteristic of gratuitousness, and the name *precarium* is in every day used in the feminine form *precaria* to label the above mentioned relations. (Levy, Castaldo, 2002, p. 376) Different sub forms of the instrument *precaria* are known in legal literature by various names such as *precaria data*, *precaria oblata*, *precaria renumeratoria*, *precaria sub verbo Regis*. The mentioned relations were forms of lifetime use of the land without the right to inheritance, but they retained the nature of revocability *ad nutum* as a fundamental characteristic of the relationship of non-contractual nature compliant to medieval needs.

The occurrence of benefits, which are primarily of Germanic origin, coincided with the occurrence of the institute of *precarium* in common law, and a common name "*precarium*" acquired these relations relatively late due to the expansion of the canonical legal provisions on

5

It should already be noted that English law did not recognize the institute of *precarium* in the sense which was assigned to it by continental systems of law, therefore, comparative analysis of the existing medieval law, as well as one of the modern for the area where the true English law remains deprived of its content.

⁶Boudot, Michael, Finding, Susan, Introduction: Approches historiques comparées de la précarité, Retrieved from https://www.google.hr/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEWjW0KLB8fTNAhVB2RoKHbS2CjwQFggfMAA&url=http%3A%2F%2Fwww.academia.edu%2F19086304%2FAp%2Fproches_historiques_compar%25C3%25A9es_de_la_pr%25C3%25A9carit%25C3%25A9_France_Angleterre_2014&usg=AFQjCNHaCr9ffaICr6wN0m4KFJ1TlBNAUQ, 11.07.2016., p. 3-4.

property rights relations.⁷ (Schröder, 1889, p.158 with references to literature in note 30l). However, to what extent is a nature of such legal relations synonymous to Roman Institute of *precarium*? It should not be overlooked that both legal institutions have a common name, that they represent the idea of free cession based upon a request of an authorized person and that they are not contrary to the law of the land. However, there were certain legal interpretations which found the lack of common origin of the two institutes, claiming suspended gratuitousness of the first of them or questioning the revocability as a fundamental characteristic of the latter. (De Coulanges, Iùistol, 1873.). Nevertheless, Rolland says that this statement is contradictory to historical development of the institute although he acknowledges the need of extreme effort in order to determine the links between them. (De Rolland, 1877, p. 85). An explanation of the historical development of the institute *precaria* Rolland argued by the need of social practices of the Middle Ages which were significantly improved by the adoption of the royal constitution, which, however, also resulted in a changed frequency of the use and meaning of the Roman *precarium*. For Rolland Demante's opinion on the matter seemed acceptable to justify the above assertions. "During the period in discussion the principles of long-term lease funds expanded its use from larger to smaller similar areas. It is unlikely that in such circumstances the difference between *precarie ut possideret* and *précaire ut in possessione esset* were preserved. The holder was approved the lease and *precarie* likely to execute them independently, that is, on his own behalf. Having been granted legal title, the holder was regularly recognized protection in the form of *actio in rem*, which, combining the lease and *precarie*, caused assumptions for the formation of long-term lease, emphyteusis. (Demante, 1860, p. 52-53). This way, lease relations, according to Demante, already in the 8th century received precarious prefix, although the meaning is far from the Roman legal sources. (Demante, 1860, p. 53). For both legal institutions applied the same formula taken from Justinian codification which was followed by a significant connection of the Institute. Even though he had a quality of possession *per precarium possidet*, beneficial owner of such holdings had physical possession of the land inconsistent with *animus rem sibi habendi*. This way such a form of ownership was significantly away from *precaria possessio*.

Although *precarium* in *ius comune* retained its characteristics it had in *Corpus Iuris Civilis*, medieval canon law, in addition to this one, also regulated the special Institute of *precaria*. It was used by the church in order to cede the land on the use of their customers for a limited time. The difference between Roman *precarium* and *precaria* is fully developed in X 3, 14, 3. In his *Summa Hostiensis* described this special institute in the following way.

Summa Hostiensis Libri 3, § 14 (*de precariis*): „*Contractus qui dicitur precaria magis durat quam homo vivat quod transit in heredum sed de quinquennio in quinquennium est revocandus...et puto quod praestatur sub certo censu quia forte est terra minus utilis et dabitur usque ad quinquennium alicui Rustico cuius labore meliorabitur illa terra.*“⁸

This legal relationship lasted no longer than until the death of the beneficiary, and if the duration of the mentioned relation was contracted to a shorter period, the parties had the option to

⁷ Schröder emphasizes that the confusion which arises from using the two terms *beneficium* and *precaria* did exist, but it was only terminological. In practice, the use of both expressions referred to the cession of land to use.

⁸ *Summa Hostiensis* Libri 3, § 14 “The contract called *precaria* lasts no longer than until the death of beneficiaries, and then it passes to the heirs, after the expiry of the five-year period the contract is revoked... although originally the land was granted to anyone, after the expiry of the five-year period, the land was granted exclusively to the one whose work had most improved the land.”

explicitly extend the relationship after the expiry of the five-year period, otherwise the relationship was tacitly prolonged as *locatio conductio*. (Coing, 1985, p. 371). A similar regulation of the eponymous institute is present in the content of Gratian Decree.⁹ The decree states that the holdings entitled *precaria* should not be presumed as church property unless they follow from the characteristics of giving. But glossa *Precaria* with C IIII *Ecclesiasticarum rerum precarietā qualiter fieri debeant* points out that by giving, entitled *precaria*, it is considered handing of ecclesiastical goods to usufruct in exchange for certain benefits and it mentions alleged similarity of previously mentioned cessions with emphyteusis, where the difference between the two institutes lies in a limited period of the Institute *precaria* to five years, in a request that establishes the provision and in the right to free revocation. Unlike the Roman *precarius*, this legal relationship could not have been unilaterally revoked. Hartmann believes that Roman law of the Institute of *precarius* had nothing in common with medieval *precaria*¹⁰ (Hartmann, 1906, p. 340; Seeliger, 1903, p. 21) except for the name. (Hartmann, 1906, p. 340). Because what was crucial and characteristically for the *precario possidere*, and that was the possibility of absolute revocation at any time, could have been found in many formulations of *precarius* as well as in many documents, and only exceptionally in many documents about *precarius*, and a medieval *precarius* was regularly imposed a number of obligations which were not compatible with the essence of Roman *precarius*. (Seeliger, 1930, p. 13; Hartmann, 1906, p. 340.)

In the continuation of his research on the relationship between the Italian and Frankish medieval *precaria* and Roman *precarius* Hartmann (Hartmann, 1906, p. 340) sought to determine the circumstances that led to the development of this institute and concluded the following: "If the alleged connection is not observed from legal but from a historical point of view, it is easy to guess the question how ... *magis one ad donationes et benefits cause, quam ad negotii contracti spectat precarietā conditio* could have emerged from the Roman Institute, which had only

9

For research purposes the source was cited according to: Decretum Gratiani emendatum et notationibus illustratum una cum glossis, (1584), Apud Magnam Societatem, Retrieved from [¹⁰ *Precaria* in the recent use of the word does not apply to legal content, but the form of the conclusion of the contract, which can preferably be applied to a variety of legal matters. In Italy, the lease contract to 19 or 29 years was called "*libellus*". The name stems from the application in which the tenant asked for cession of the plot as shown in Cod. Just. XI, 66, 2. The contract is marked upon this request, which had already given all the conditions, although it was followed by "*praeceptum*" of the lessor, while both the *libellus* and *praeceptum*, and did not merge into a single document. In Italy "*precaria*" was also a technical term for emphyteusis concluded with three generations, because borrowing should have been preceded by "*petitio*" emphyteusis. So here and elsewhere *precaria* is not a contract on revocable cession of things or a right – a contract, which after all had never had to be concluded in writing, but a written request in which it was legally requested for cession of a thing in any form, and only later in the course of time both the contract and legal relation itself which was determined according to the written request. That *postulatio*, *petitio*, *precaria* is also missing in any of the Frankish formulations that supposedly formed the basis for a variety of legal relations and the relations of the loan. Seeliger says rightly: "It may be noted only one thing in common: *precaria* is borrowing that resulted from a request"; Hartmann, L. \(1906\)](https://books.google.hr/books?id=dANnAAAACAAJ&pg=PA1179&lpg=PA1179&dq=decretum+gratiani+precaria+ecclesiasticarum&source=bl&ots=XP90hGuqAC&sig=7C5Bd3TnSID4KV57U1VyKOtCVxs&hl=en&sa=X&ved=0ahUKEwjUq7by09HNAhVCmBoKHRMjDrwQ6AEIPTAF#v=onepage&q=decretum%20gratiani%20precaria%20ecclesiasticarum&f=false; July 1, 2016</p></div><div data-bbox=)

, Bemerkungen zur italienischen und fränkischen *Precaria*, St. Bauer; L. M. Hartmann; G. von Below, Vierteljahrschrift für Social und Wirtschaftsgeschichte 4., p. 341.; Seeliger, G., (1903), Die soziale und politische Bedeutung der Grundherrschaft im frühen Mittelalter. Untersuchungen über Hofrecht, Immunität und Landlehen, Leipzig, , p. 21.

minimal significance during the late Roman Empire."¹¹ Since such a relationship was rather consisted of providing binding services than of legal form for the economic relevant fact it was one of the fundamentals of the mentioned medieval legal relations. The same is confirmed by Voltelini, stating that the Frankish feudal *precaria* undoubtedly stemmed from the Roman legal Institute. (Voltelini, 1922, p. 261; Dopsch 1918-1920., p. 21).

Borrowing of the property, i.e. a house or land was originally unknown to Germanic law. The impossibility of borrowing real estate is a specificity of civil legal regulation of medieval statutes that regulated the legal relations in German cities.¹² (Schultz, 1922, p. 81). However, the development of economic and social conditions in the area of Germanic countries resulted in the reception of Roman and canonical legal provisions, thus the loan of land became an integral part of medieval legal practice. In this context there can be noticed the establishment of the Roman Institute of *precarium* as the contractual nature of the relationship with the element of gratuitousness and free revocation. (Brunner, 1892, p. 249) The conclusion of the mentioned relations were preceded by a written request of the authorized user, which has been known since the Roman law as *precaria*. The above request became a reversible document through which the lender could have requested for revocation, and a legal relationship that was established on the basis of that document was called *precaria*.

Given the characteristics of the previously displayed Institutes, the Roman legal *precarium* and feudal *precaria*, it can be conclusively stated that the development path of loan relations could have been such that the contradiction between economically dependent and economically independent loan and lease relations was destined already in Roman law. (Hartmann, 1906 p. 348) Furthermore, the right of usufruct of the church property was determined by imperial and ecclesiastical protecting provisions; however, due to the encroachment of the new royal power in the church property these restrictions were lifted, and it came to the creation of *beneficium* of Carolingian period. (Hartmann, 1906, p. 348). Previously shown presentation on the characteristics of the two institutes tried to establish their common characteristics which during the middle Ages met the needs of real estate transactions. Already at first sight it is obvious that the Roman legal Institute *precarium* lost its meaning in legal transactions, and the idea of free cession of the things was replaced by acquiring possession of things, i.e., real estates, which was conditioned by completing various military or land services and marked by the inability of free revocation. Such the relationship involved only the execution of actual power over the thing, i.e. its detention, but with no will to really detain it *animus rem sibi habendi*.¹³ (Romic, 1994, p. 141; Von Savigny, 1865, p. 144-146; Von Savigny, 1848, p. 42-45; Kaser, 1955, p. 123) With no difference from the Roman legal Institute *precarium*, which is, when it comes to legal sources, the object of analysis in the regulations on obligatory and legal relations, it is quite obvious that it is necessary to analyze the medieval Institute *precaria* in accordance with the rules of the law of obligations. It remains, therefore, to determine, in what context, when it

¹¹ D 43, 26, 14: „.....situation based on *precarium* is based more on donation and benefits rather than on contractual legal relation. “

¹² Schultz suggests that the above provisions of the city right should be interpreted in a way that the borrowing of real estates was never ruled out, but the circumstance that the borrowing of land never happened in practice is the reason for non-inclusion of real-estates as a potential object of borrowing in the content of city law.

¹³ When the Roman speaks of *possessio naturalis* it refers to the factual usual hold of things (*corpus*) without intent to keep hold of it permanently (*animus possidendi*). During medieval law this form of holding things was called detention. Detainers were mainly people who run things through a mandatory relationship. They are not the possessors of things as property belongs to persons in whose name detainer run things.

comes to modern civil arrangements, is possible to interpret the term *precarium* from the contractual perspective and when from the perspective of property right organization.

Influenced by the pandect science which critically analyzed Roman legal sources, trying to match them with the needs of legal practice it came to the development of the concept of precarious property. In his important work *Das Recht des Besitzes* Savigny significantly separated the term holdings from precarious detention, i.e. holding things. According to Savigny, *precarium* is non-binding institute of obligatory legal nature, defined by the following characteristics: "... a precarist is the one who holds the thing, the owner is the one who actually owns the thing and who transfers it into the hands of a precarious holder. If the possessor of a thing is not really the owner, only the owner can file a lawsuit to demand its return." (Savigny, 1848, p. 223- 224) Such a detention is called the *precarium* detention because the precarist can not gain possession of things, but just keep it through the will of the real owner. A special situation occurs when the precarist does not obey to return the thing even upon the request of the owner. In that case he becomes vicious, dishonest possessor of the thing. From the perspective of property right organization it is possible, therefore, in the above-mentioned case, to equate the legal position of the precarist to that of the owner.

4. PRECARIUM IN MODERN CIVIL LAW SYSTEMS

When it comes to modern codification of civil law, there is a different approach to the interpretation of legal position of the precarist. A detailed analysis of some of the property rights provisions of certain regulations leads to the impression that the possessive conception (subjectivist or objectivist), upon which particular civil law system was based, significantly influenced the incidence of the obligatory legal *precarium*. In order to clarify the confusion caused by the two-sided incidence of the eponymous institute in the context of modern organization of the civil law, in continuation we are going to try to delineate the term contractual cession of things to the use from the precarious hold of things.

German BGB does not recognize a separate obligatory legal regulation of the institute *precarium*. What makes up the facts needed for the emergence of obligatory legal *precarium* is covered by the provisions of the BGB in § 604/3 referring to a separate regulation of the contract of loan.¹⁴

When someone has the factual power which is executed without independent legal status, on the basis of consent by the third party, it is about dependent detention within the context of § 855¹⁵. The fact that in the above-mentioned case, treated in § 855 BGB, is about cession of things due to the dominant position of the lender and dependent regulation of the position of the borrower makes the legal consequences related to the protection of the property unnecessary and unwanted. The legal situation is the same as with the incomplete *precarium* because the effects typical for legal possession do not apply to that term. Although it seemed at the first glance that the BGB in the provisions of § 855 included the case of precarious relations, now we can surely claim that the incomplete possession, which can often be set up in everyday human relations, was not significant enough for legal transactions to be assumed legal regulation by a legislator. The reason is practical if one keeps in mind that the need for retention of *precarium* did not exist in the BGB from the standpoint of possessory legal protection. (Staudinger, 2005, p. 431) In accordance with the provisions (§ 855) a precarist could count on

¹⁴ § 604/3 of BGB: "If the duration of the loan neither has been specified nor is to be inferred from the purpose of the loan, then the lender may demand the thing back at any time."

¹⁵ § 855 of BGB: "If a person exercises actual control over a thing for another in the other's household or in the other's trade or business or in a similar relationship, by virtue of which he has to follow instructions from the other that relate to the thing, only the other shall be the possessor."

possessory legal protection because just as borrower he was protected by the rules of compulsory relations. (Esser, Schmidt, Weyer, 1984, p. 195) Due to the regulation of the contract of loan and the regulation of the legal position of the holder in the BGB it would be difficult to determine in which direction such a regulation would be possible at all. As the effects of the legal position of the holder could not be applied to precarists just as well as the associated legal protection in accordance with the current conception of BGB he can only be provided legal protection from bondage. This way the *precarium* is retained in the content of the BGB as a subset of the contract of loan with the right of the lender to at any time require the return of borrowed things.

Different from German law, which due to the specific construction of possessory relations does not provide protection of possession to the lender, but only the one that results from bondage, and considers *precarium* a subset of the loan contract, the Austrian ABGB recognizes *precarium* as a separate contractual relationship. (Rummel, 1983, p. 1118)¹⁶ Older understanding of *precarium*, which denied the institute's contractual nature, is considered obsolete, hence modern jurisprudence is in favor of a contractual nature of *precarium*. In legal practice it often does happen that the thing is ceded to another person without contracting *precarium* or borrowing. If such a use lasts for a longer period of time than by applying § 863, I¹⁷ it can be considered that the use of things is allowed until the time of revocation, which depends on the will of the lender. In this case, by a contractual claiming the lender of the thing will be entitled recovery of a thing if the thing had not been returned upon having it reclaimed. Should contractual nature of *precarium* be denied there would be no possibility for the lender to request for the recovery of the thing in the form of contract lawsuit. Upon expiry of the period in which it was possible to file a lawsuit against trespassing a lender could achieve protection only by *rei vindicatio* or *actio publiciana*¹⁸. This would in any case make the burden of proof more difficult by the lender, but as the subject of *precarium* may be someone else's property the question is whether the lender in general could be reimbursed for things through the above process means. The answer to the question whether the precarist is really the owner of rights and whether in this respect he is entitled to protection of possession was tried to be found through the interpretation of § 345 of ABGB¹⁹. The content of the above paragraph determines when the possession is considered illegal and unfair, i.e. false, and the definition leads to the conclusion about the falsity of the property acquired by abuse of courtesy (*precario*). Schey believes that obligatory legal permission of the rights of use can be given until the revocation

¹⁶ § 974 ABGB: „Hat man weder die Dauer, noch die Absicht des Gebrauches bestimmt; so entsteht kein wahrer Vertrag, sondern ein unverbindliches Bittleihen (Precarium), und der Verleiher kann die entlehnte Sache nach Willkür zurückfordern. “; In case the term and the intention of the use has not been determined; no real contract exists, but a not obligatory precarium and the lender can at his pleasure demand back the thing borrowed.

¹⁷ Application of § 863/1 explains the possibility for the will, in this case aimed at contracting the *precarium* to be declared not only expressly by words and signs generally adopted, but also tacitly by such acts, which in consideration of all circumstances admit no reasonable ground for doubt that the contract has been concluded.

¹⁸ Ownership lawsuit from § 366 of ABGB authorizes the owner of the thing to exclude every other person from the possession of his thing and that the owner has the right to demand back the thing judicially from everyone who withheld the thing from him. The burden of proof is borne by the plaintiff who must prove his ownership and the defendant's detention of things. On the other hand, *actio Publiciana* as a lawsuit of assumed property owner facilitates the burden of proof to its applicant who has to prove the title and true method of acquiring the property. In relation to the holder without legal titles or lesser legal title the plaintiff is to be considered the owner of the things.

¹⁹ § 345 ABGB-a: If someone forces himself or sneaks secretly by fraud or entreaty, into the possession, and endeavors to change into a constitution right that, which has been permitted him from kindness, without taking upon himself a lasting obligation, the possession in itself illegitimate and mala fide becomes besides spurious, in contrary case the possession is considered not spurious.

which depends on the discretion of the lender, thus precarist acquires legal possession and the right to protection of possession. (Schey, 1895, p. 271) In a review of ABGB Klang appropriately explained that the legal nature of *precarium* does not depend on whether the precarist has the right to protection of possession, but it depends on the interpretation of § 345 of ABGB. In order to answer the question it is necessary to determine if by the agreement on cession in *precarium* borrower is actually granted the right to use or not. (Klang, 1934, p. 702) If so, then we can not talk about the acquisition of *precarium* in terms of § 345 because it is not necessary for the precarist for what was given as an expression of courtesy by the lender to transform into the right. In this case the borrower acquires the legal possession and protection of possession. But if he is permitted the use only as a mere courtesy, then it is a case of acquisition from § 345 and it can not be either a case of possessory protection or the existence of the contract. In previous interpretation Klang is probably trying to determine the boundary between the acquisition of exploitation rights on the basis of a negotiated cession of things in *precarium* and unauthorized acquisition of things by misuse of courtesy of a lender. Protection of possession, therefore, can only be given to the precarist who was allowed the use of things based upon the agreement of the parties. Whoever owns the thing by misuse does not have the legal basis of ownership, and in this respect, is not entitled to possessory protection. (Apathy, Riedler, 2010, p. 649). Content of conducted consideration on the legal nature of *precarium* and legal position of precarists in relation to the thing given in *precarium* leads to the following conclusions. From § 974 of ABGB results that "*precarium*" is not "real contract". The title of the contract does not result either in a right or obligation neither for the lender nor for the borrower; cession of things in *precario* does not mean the transfer of the right to use which "continues to last" even after that moment. Consequently it follows that through this cession, in accordance with § 313, precarist does not acquire property rights. His detention is based, as it is added by § 974, only on the "non-binding *precarium*". If the precarist, upon having it reclaimed and contrary to the will of the lender aims to "convert to permanent right what was allowed to him out of service, without being subjected to an ongoing obligation", the precarist arbitrarily comes into possession of things or rights of use. However, this possession of his is wrong, i.e. false according to § 345 and may be seized from him by a lawsuit to protect the property from § 346. In accordance with the contents of the mentioned paragraph it can be required from any untrue holder to establish previous state as well as compensation. Both are under the jurisdiction of the court upon conducting hearings and regardless of the stronger right. Therefore, in this case, preference is given to possessory right over the petitory request of the lender. If one examines the situation of the lender of things in *precarium* during the execution of revocation of things upon reclaiming it remains to determine the appropriateness of the use of contract lawsuit against the precarist in Austrian law. In the period after the entry into force of the Code Civil (hereinafter CC) *precarium* was modified into the contract of loan with the right of free revocation and return of things at any time and as such it was very often applied.

Such legal use stems from the extensive interpretation of § 1888 of CC, which enables the lender to require recovery of things at any time if duration of use had not been agreed at the time of the legal transaction or subsequently. However, it must not be concluded that in such a case it is the question of a special institute of *precarium*, but the question of a contract of loan, as evidenced by regulation of responsibilities which is in this case applied to the recipients of things, and is determined by paragraphs 1880-1887 of CC. Editors of the legal text were less successful in the formation of a unique term, thus called the holders of things, within the meaning of § 2236 of CC, the precarists. This way the old law was used incorrectly.

Determination of certain categories of legal holdings to which legal provision is applied is necessary because of the continuing reconstruction of the meaning and nature of the legal

relation, which the adjective “precarious ” from the legislation refers to. In the cases to follow in French CC owning is mentioned under the common *precarium* name. The first of these is the legal position of the lessee in respect of things ceded in the lease. Furthermore, legal position of lender in terms of things ceded to lease is the same, as well as the position of a borrower in terms of a borrowed thing and a precarist. The latter requires clarification. In quite an old commentary on the French law of obligations from the second half of the 19th century Pont found that the use and exploitation of *precarium* as contractual relationship are in practical use although the editors of legal text omitted to expressly regulate this legal institute. (Pont, 1877, p. 26) The use of the above mentioned institute was, yet, limited to the rural parts of France. Pont stated that due to the lack of legal regulation of *precarium* in the CC the rules of Roman law should be applied to the regulation of *precarium*. (Pont, 1877, p. 26) Rolland rejected this claim stating that according to the French mandatory law based on CC it is impossible to call the precarist ordinary detainer of things. (Rolland, 1877, p. 104) This is also opposed to by the previously mentioned rules which refer to differentiation of the detention and possession of things when it is primarily referred to the definition of possession in § 2228 of CC. Rolland represents the function of *precarium* the same as the one in the old French law, therefore, a different manifestation of the contract on loan of things, which is marked by gratuitousness and free revocation at any time dependent on the willingness of lender of things to *precarium*, i.e. lending. (Rolland, 1877, p. 105) In this respect the precarist has only physical contact with the borrowed thing that he holds on behalf of its owner or lender in *precarium* (since the lender does not necessarily have to be the owner of the thing), and instead of the former liability for *dolus* and *culpa lata* he is subjected to more broadly regulated responsibilities that result from the contents of § 1880- 1882 of CC. Indeed, as soon as the agreement of *precarium* showed only loan for the purpose of using things, altered only in terms of duration, it was not possible for the precarist to be considered the owner of the thing in terms of *animo rem sibi habendi*. On the other hand, if the *precarium* is placed in the same position as the contract on the loan to the extent they do not differ from one another in use, it is necessary to determine the circumstances which will be the base for determining the differences in their effects. "Owning as the borrower means to only have physical possession of the thing whose ownership belongs to another." In the same way precarious possession is defined. In this way, the difference between owning *animo domini* called civil possession and common ownership or natural possession are eliminated. The first one is *in jure consistit*, the second one *in corpore*. The first one can only belong to someone who is the real owner, the other can apply to all quasi-deed possessors, as the one who possesses *vi, clam, precario* i.e. by force, stealthily and by application method. The term general precarious possession, replaced in some way with the natural possession, is used in order to mark the position of all those who do not have civil possession. On the other hand, by marking precarious possession the French civil law made a distinction between the property and the detention, where precarious possession is the possession of a person who has a physical power over things, but which in relation to the subjective element *animus* significantly differs from the legal definition of property.

5. CONCLUSION

The incidence of two almost namesake institutes, general legal *precarium* and feudal *precaria* during the middle Ages requires a very cautious approach due to the similarity in the name. In reality it refers to the absence of common elements. The analysis of legal sources, already at first sight, make it obvious that the Roman legal Institute *precarium* lost its meaning in medieval legal transactions, and the idea of gratuitous giving of things to use was replaced by acquiring possession of things, i.e., real estates, which was conditioned by completing various military or

land services and marked by an inability to free revocation. Such a relationship involved only the execution of actual power over things, i.e. its detention, yet with no will to keep it really *animus rem sibi habendi*. No different from Roman legal Institute *precarium*, which, when it comes to legal sources, is the object of analysis in the regulations on obligation relationships, it is quite obvious that the medieval Institute *precaria* is necessary to analyze in accordance with the rules of the law of obligations. At least when it comes to feudal arrangement since with the disappearance of feudalism the mentioned institute loses its legal relevance. When it comes to the modern civil-law regulation, the emergence of the term *precarium* can imply two meanings, contractual loan for use with the right to free revocation and the method of acquiring the possession of things by abusing the trust (*precario modo*). In both cases the legal position of the precarist in every modern civil law system must be viewed from the perspective of possessory system. Depending on whether a concept of possession within a specified civil law system falls under objectivist or subjectivist theory, the legal position of the precarist is equated with the possessor, i.e. detainer of things which indirectly affected the ability of private regulation of this institute in the context of the law of obligations. Although the *ius commune* on the basis of the reception of Roman law in the European legal tradition advocated the need for a separate regulation of *precarium*, the mentioned characteristic was not accepted by the drafters of the BGB and the Civil Code considering it precarious superfluous. ABGB generally mentioned *precarium* in § 974, however this did not meet the prerequisites of separate regulation of the institute, but was absorbed by the contract on the loan, thus becoming the subset of the dominant contract.

LITERATURE:

I Monograph

1. Apathy, P., Riedler, A., (2010), Bürgerliches Recht, Band III., Schuldrecht- Besonderer Teil, 4. aktualisierte Auflage, Wien-New York, Springer
2. Brunner, H. (1892), Deutsche Rechtsgesichte, Leipzig, Duncker & Humblot,
3. Das Bürgerliche Gesetzbuch mit besonderer Berücksichtigung der Rechtsprechung des Reichsgerichts und des Bundesgerichtshofes (1974) Kommentar, Germany (West)., Bundesgerichtshof Grosskommentare der Praxis, Berlin-New York, Walter de Gruyter,
4. De Coulanges, M. Iùistol, 1873., Origines du régime féodal, Revue des Deux-Mondes
5. De Rolland, H., (1877), Du Precarium et de la possession précaire, Grenoble, Imprimerie Et Lithographie F. Allier Père Et L' ils Grande-Rue, 8, Cour De Chaulnes
6. Demante, (1860), Des précaires ecclésiastiques dans leur rapport avec les sources du droit romain, Revue historique de droit français et étranger, Tome 6., Paris, Auguste Durand et Pedone-Lauriel
7. Dopsch, Alfons, (1918-192), Wirtschaftliche und soziale Grundlagen der europäischen Kulturentwicklung, Band 2., Wien
8. Ellul, J., (1964), Histoire des institutions, tome 2, PUF
9. Kaser, M., (1955) Das römische Privatrecht: Erster Abschnitt. Das altrömische, das vorklassische und klassische Recht., München, No. 2. Ch. Beck
10. Klang, H., (1934), Kommentar zum Allgemeinen Bürgerliches Gesetzbuch (Klang Kommentar zum ABGB), 2. Band., 2. Halbhand, §§ 859 bis 1089, Wien
11. Lesne, E. (1940) Histoire des propriétés ecclésiastiques , tome 1er, chapitre XXVI, Les précaires ecclésiastiques
12. Levy, J., Castaldo, A., (2002), Histoire du droit civil, 1re éd, Dalloz

13. Pont, P., (1877), *Commentaire-traité des petits contrats*, Tome 1, Paris, Delamotte et fils
14. Rolland, H. (1877), *Du Precarium et de la possession précaire*, Grenoble, Imprimerie Et Lithographie F. Allier Père Et L'ls Grande-Rue, 8, Cour De Chaulnes
15. Romac, A., (1994) *Roman Law*, 5th Edition, Zagreb, Školska knjiga
16. Rummel, P., (1983) *Kommentar zum Allgemeinen bürgerlichen gesetzbuch (u nastavku: Rummel Kommentar zum ABGB)*, 1. Band, § 1 bis 1089 ABGB, Wien, Manz Verlag und Universitätsbuchhandlung
17. Schey, J., (1895), *Die Obligationsverhältnisse des österreichischen allgemeinen Privatrechts*, Band 1., Wien, Manz
18. Schröder, Richard, (1889), *Lehrbuch der deutschen Rechtsgeschichte*, Leipzig, Verlag Von Veit & Comp.
19. Schultz, H., (1922), *Darlehen und Leihe in romanisierten süddeutschen Stadtrechten des fünfzehnten und sechzehnten Jahrhunderts*, Göttingen
20. Seeliger, G., (1903), *Die soziale und politische Bedeutung der Grundherrschaft im frühen Mittelalter. Untersuchungen über Hofrecht, Immunität und Landlehen*, Leipzig
21. Staudinger, J. (2005), *Eckpfeiler des Zivilrechts*, Volue 8 J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen, Walter de Gruyter
22. Von Savigny, (1848), *Savigny's Treatise on Possession: Or, the Jus Possessionis of the Civil Law*, Westport, Hyperion Press
23. Von Savigny, F. C., (1865), *Das Recht des Besitzes*, 7. Auflage, Wien, Gerold's Sohn

II Journal article

1. Hartmann, L, (1906) , *Bemerkungen zur italienischen und fränkischen Precaria*, St. Bauer; L. M. Hartmann; G. von Below, *Vierteljahrschrift für Social und Wirtschaftsgeschichte* 4.
2. Lydorf, Claudia, (2012), *Die Abgrenzung zwischen Leihe und Prekarium in der Gl. simile zu D. 43, 26, 1, 3.*, J. Rückert, H. de Wall, P. Oestmann, A. Their, W. Kaiser, H.-P. Haferkamp, *Zeitschrift der Savigny-Stiftung für Rechtsgeschichte. Romanistische Abteilung* 73., Böhlau, Hermann Böhlau Nachfolger
3. Voltolini, H., (1922), *Prekarie und Benefizium*, St. Bauer; L. M. Hartmann, G. von Below; K. Kaser, *Vierteljahrschrift für Sozial- und Wirtschaftsgeschichte*, 16. Bd., H ¾.

III E-Books

1. Accursii Glossa in Digestum novum (Corpus glosatorum iuris civilis), (1483), Nuremberg, Anton Koberger, April, 20, Retrieved from <http://tudigit.ulb.tu-darmstadt.de/show/inc-v-123>; June 5, 2016.
2. Chiari, Girolamo, Crassus, Bernardinus, Accursius, Franciscus <Senior>, *Corpus iuris civilis, Digestum vetus mit der Glossa ordinaria von Accursius Florentinus und Summaria von Hieronymus Clarius*, (1494), Venedig, Retrieved from <http://bildsuche.digitale-sammlungen.de/index.html?c=viewer&bandnummer=bsb00051834&pimage=00717&v=pdf&nav=&l=it.>, June 20, 2016.
3. *Decretum Gratiani emendatum et notationibus illustratum una cum glossis*, (1584), Apud Magnam Societatem, Retrieved from, <http://bildsuche.digitale-sammlungen.de/index.html?c=viewer&bandnummer=bsb00051834&pimage=00717&v=pdf&nav=&l=it.>, June 20, 2016.; <https://books.google.hr/books?id=dANnAAAcAAJ&pg=PA1179&lpg=PA1179&dq=de>

cretum+gratiani+precaria+ecclesiasticarum&source=bl&ots=XP90hGuqAC&sig=7C5Bd3TnSID4KV57U1VyKotCVxs&hl=en&sa=X&ved=0ahUKEwjUq7by09HNAhVCmBoKHRMjDrwQ6AEIPTAF#v=onepage&q=decretum%20gratiani%20precaria%20ecclesiasticarum&f=false; July 1, 2016.

4. Summa Hostiensis, Summa is the content of the work cited by: Henricus and Segusio cardinalis Hostiensis Aurea suma, (1612), Ghent, Lazarus Zetzner., June 4, 2016.
https://books.google.hr/books/about/Henricus_a_Segusio_cardinalis_Hostiensis.html?id=AQtCAAAAcAAJ&redir_esc=y, June 22, 2016.

PROTECTION OF WHISTLEBLOWER'S EMPLOYMENT STATUS

Zeljko Mirjanic

*Faculty of Law of the University of Banja Luka, Bosnia and
Herzegovina zemirjanic@gmail.com*

Jasna Cosabic

*Banja Luka College, Bosnia and Herzegovina
jasnacosabic@live.com*

ABSTRACT

This paper analyses a normative question of whether the whistleblower's employment status rights should be regulated in a separate manner comparing to rights of employees that are not whistleblowers. Legislative principles in this matter differ: in some states a whistleblowers' protection has been provided by a special law, and in some states the protection of persons reporting corruption and other types of misconduct of employer is provided by labor law. The status of person being a whistleblower differs as well, ranging from protection only in public service, to protection of person being engaged in either current employment, or future or past employment, according to principles of International Labor Organization. The protection of whistleblowers by the European Union, in sense of, inter alia, latest efforts by the European Parliament and Ombudsman shall be analyzed and Council of Europe recommendations and legal views as well, having especially regard to some recent key judgments of the European Court of Human Rights, which dealt with the whistleblowers' protection in scope of their right to freedom of expression, creating thus a valuable case-law in this respect. Finally the legal protection of whistleblowing in Croatia, Serbia, Montenegro and Bosnia and Herzegovina is analyzed. Being a key feature of a democratic society, the absence of adequate whistleblowers' protection from retaliation, discourages the reporting of misconduct, fraud and corruption, which is done in good faith and in public interest, and deprives the society of one essential factor of its control. Therefore, effective legal protection of whistleblowers provided for in a special law and effectively implemented in praxis is of utmost importance.

Keywords: *corruption, fraud, employment, freedom of expression, protection of rights, whistleblowers.*

1. INTRODUCTION

The subject of the legal research is the protection of whistleblower's employment status, as over the last few years, some neighboring countries have furnished the whistleblowers protection for the first time, while others lead a dialogue on the implementation of anticorruption strategies and the applicable court proceedings. Legislative regulation of the whistleblowers protection in certain European countries is likely to grow into a normative trend in the region. The protection of employees' status once they bring out the information on corruption or of illegal acts done by employer is secured within the protection of rights of all employees, even without legislative regulation of whistleblower's protection, but it becomes overly accepted that such a protection is not enough. The risk of corruption is particularly high in societies which did not provide for appropriate whistleblower's protection. Both in private and in public sector, employees are the ones who notice the irregularities at work first. Therefore, the protection of whistleblowers is of utmost importance in order to support reporting on misconduct, fraud and corruption (OECD, 2012). Contrary to assumption that the protection of whistleblower's rights encourages the employees to report the corruption, there

are cases in which whistleblowers and employees who supported them, were exposed to retaliation, despite of being protected by law. So here comes a question of importance of provisions on whistleblowers protection in such a legal order where the strict implementation of provisions is a huge problem. What is the influence of the European Union (EU) law and the European Court of Human Rights ('ECtHR') case-law on the protection of whistleblowers? Regulation of whistleblower's protection comes due to corruption being both an internal problem, and a global issue as provided by certain European and international acts. Thus, the Council of Europe ('CoE') in its Recommendation CM/Rec (2014)7 of 30 April 2014 and Appendix to Recommendation CM/Rec (2014)7, calls its Member states to have in place a normative, institutional and judicial framework to protect individuals who, in the context of their work based relationship, report or disclose information on threats or harm to the public interest stressing out the need for national legislation for the protection of whistleblowers. By the Civil Law Convention on Corruption of 1999, the CoE asks the Member states to provide in their internal laws appropriate protection against any unjustified sanction for employees who have reasonable grounds to suspect corruption and who report in good faith their suspicion to responsible persons or authorities.

The subject of the analysis at issue are the provisions on protection of employment status of whistleblowers of the Law on the Protection of Persons who Report the Corruption in the Institutions of Bosnia and Herzegovina, the Law on the Protection of Whistleblowers in Republic of Serbia, the Law on the Prevention of Corruption in Montenegro, as well as in the provisions for whistleblower's protection in Croatia, within the Labor Law and the State Civil Servants Law. Since multiple laws are being applied in the proceedings for whistleblowers protection, the introductory provisions thereof should regulate their connection to other laws, otherwise it is a legal technical omission which may lead to a dispute. In the said laws the rules for the protection of employment status of whistleblowers may vary, while the aims and reasons for legal protection are the same or alike, with the common subject matter: who may acquire the whistleblower status, the way of reporting the corruption and other kinds of misconduct contrary to public interest, the employer's obligation not to retaliate the whistleblower, proceedings of protection and sanctions for the violation of whistleblower's rights. The protection of whistleblowers in these laws and in the European law, determines the subject, aim, thesis and methods of this paper. There is a question of which persons may obtain the status of whistleblower, what encompasses the protection of those persons and what is its social value, and why we need to use dogmatic, normative and axiological method. The aim of research is to analyze the rules on whistleblowers' protection and to open discussion on a normative question: is it enough to provide only for the protection of rights regarding all the employees within labor law, and the protection inherent to all civil servants and officials according to law on state officials; is the regulation of the protection of the employment status of persons who report corruption the subject of a special law or of provisions dispersed in various laws? The protection of whistleblowers from repercussions out of labor or other kind of working engagement is not the subject of this legal analysis. The research starts from a general thesis that in transitional societies the legal regulation of whistleblower protection is inevitable, since the corruption is one of the most important obstacles for gradual setting up the rule of law. It makes also a serious obstacle for development of such societies, the causes of which being some non-democratic features of former socialist systems, some elements of tradition in those societies, underdeveloped institutions of civil society and a huge discrepancy between the need for some services and possibilities to satisfy them (in the area of health protection, education and social services) (Malenica, 2010, p. 841). This research is based on a

thesis that provisions which regulate the protection of employees do not suffice, but the protection of whistleblowers should be separately regulated. That may be done by a special law on protection of whistleblowers or by law on protection of employment status of whistleblowers, but also by certain provisions within labor legislation. The protection of whistleblowers may be observed as a subject of trade union protection and in that sense it may be a subject of a social dialogue. Available information on the scale of corruption and a passive relationship of employees towards that problem, point out to inquiry of how the employees may be encouraged to report corruption, which has been neglected although good management should encompass encouraging of whistleblowing (Lipman, 2012).

2. WHISTLEBLOWER NOTION

Legal literature refers to various features of whistleblower notion, and relates to a person who, in the course of work or in work related circle reports on acts according to his/her knowledge, that are contrary to legal order, public morals, ethics, etc. Regarding the subject of this paper, important issues are provided by the Organization of United Nations (OUN), Council of Europe and International Labor Organization (ILO). OUN gave its recommendations on how the system of whistleblower protection should be created, with the reporting in good-faith and the protection against retaliation being the basic guidelines. It is recommended that broad definition of whistleblowing is used, threshold qualifications for whistleblower protection, procedures for disclosing information possessed by whistleblowers, penalties for violations, legislative oversight and administrative processes and adequate resources for investigations and enforcement. Also, anonymity and confidentiality are important, institutions structure and national authorities that must be efficient in supervising the functioning of structures that have been created to advise and protect whistleblowers (Popescu, 2015, p. 137). OUN introduced the whistleblower reporting system within its structure, in order to reveal irregularities and to root out the misconduct, to make this organization transparent and open. According to the CoE Recommendation CM/Rec(2014)7, whistleblower means any person who reports or discloses information on a threat or harm to the public interest in the context of their work-based relationship, whether it be in the public or private sector, irrespective of the nature of their working relationship and whether they are paid or not. Special rules may apply to information relating to national security, defense, intelligence, public order or international relations of a state. ILO is of the view that the status at issue may be attributable to current and former employee, and it defines the notion and actions of whistleblowing as ‘the

reporting by employees or former employees of illegal, irregular, dangerous or unethical practices by employers” (ILO Thesaurus). Such definitions may be referred to when enacting the legislative provisions on the whistleblowers protection in member states of the above international organizations, due to possible variations in defining the whistleblower notion. The protection of whistleblowers varies in different legal systems and we may come to the notion of whistleblower in comparative law by extracting certain common features in most or just some legal systems, while for the later, the practical value for common definition is limited to compared legal systems. The analyzed laws on the whistleblowers’ protection, in their introductory provisions contain definitions of a whistleblower notion, and of other notions that are related to protection of whistleblowers, in accordance with nomo-technical rule that matter of definitions are new notions, which were unknown in legal praxis or traditional notions when other meaning is attributed to them (Mirjanić, 2014, p. 75). Definitions of notion of whistleblower, contained in these laws, differ, and those differences are even more

prominent when we compare this notion with definitions of other notions. The elements of normative notion of whistleblower in a broader sense, are considered to be the subject, subject matter and the modality of whistleblowing. The reason for broader approach is the dependence of the whistleblower notion upon content of provision which defines it, and upon the content of provisions defining other notions related to the protection of whistleblowers, which together make one logical entity. Thus, the definitions of public interest, whistleblowing and corruption show the difference between the whistleblower and other person which reveals or reports illegal acts. Therefore, the public interest means general benefit for society, so the whistleblower cannot be a person revealing internal information only for reason of obtaining personal gain and interest. What is a public interest and which information are relevant for public, are the questions which are dealt by particular sovereign states, and for that reason the notion of whistleblower inevitably varies depending on a definition of public interest (Martić, 2016, p. 214). The features of whistleblower notion in a broader sense, depend also upon the content of provisions which regulate the obtaining of whistleblower status. Having that in mind, the whistleblower in BaH is a person employed in BaH institutions and legal persons, who, acting in a good faith without the misuse of whistleblowing, submit a report to competent persons or institutions due to reasonable doubt or circumstances that indicate existence of corruption in some of these institutions or legal persons; on the other hand, whistleblower in Serbia is a person which makes a disclosure with a view to his/her working engagement or during the employment process or in the course of using services by state and other authorities, public bodies or public services, through business cooperation and the right of ownership over a business company through exposing information on provision violation, human rights violation, exercise of public authority contrary to its purpose, life threat, public health danger, security threat, environment, and prevention of great damages. Attribution of whistleblower notion to persons that are not currently employed, is in accordance with the afore mentioned CoE recommendation: The national framework should also include individuals whose work based relationship has ended and, possibly, where it is yet to begin in cases where information concerning a threat or harm to the public interest has been acquired during the recruitment process or other pre-contractual negotiation stage. Contrary to whistleblowers in BaH and Serbia, whistleblower in Montenegro is a person who gets a right to a reward: whistleblower who by his submitting a report on public interest harm, indicating a corruption, has contributed to public income or income of a business company, has a right to a monetary reward from the authorities, business company, other legal person, or a businessman who gained profit. The right to reward being acquired starting from the moment of gaining profit or from the moment of irrevocability of decision on permanent seizure of property, if the whistleblower's report caused the initiation and conduct of criminal proceedings.¹ According to other approach, the protection of whistleblowers is provided by laws which regulate working relations of civil officials and servants and employees, and they contain whistleblowing elements in provisions on protection of these persons, since they do not determine whistleblower notion. Labor

¹ The amount of reward for a whistleblower is determined according to his contribution in relation to the level of acquired income or seized property, and cannot be less than 3% nor higher than 5% from income, or property.

law of Croatia, in its chapter regarding the unjustified reasons for dismissal (Article 117) prescribes that reporting by employees due to reasonable doubt of corruption or submission a report in good faith for that reason to responsible persons or competent state authorities, is not a justified reason for dismissal. This provision, does not provide the protection of employee who submits the information on his employer to media, which may cause harm to employer's dignity. In case the employee submits the information to competent executive authorities and media, he would not be protected for the submission of information to media (accordingly that could be a reason for his dismissal) (Milković, 2014, p. 244). Also the Law on State Officials of Croatia (article 14.a) prescribes that reporting of a state official due to a reasonable doubt as to the corruption or submission of report about that doubt to competent persons or state authorities, cannot be a justified reason for cessation of employment. The anonymity of reporting official is guaranteed to be safeguarded, if the competent authority determines that a severe form of corruption, or protection from denying or limiting rights and protection from maltreatment, is at issue. On the contrary, the above mentioned laws on whistleblowers' protection provide for reporting to the public by exposing information through public media. What laws at issue have in common is that the meaning that they provide for the notion of whistleblower corresponds to recommendation of the mentioned European and international organizations.

3. PROTECTION OF WHISTLEBLOWERS IN THE EUROPEAN UNION LAW

Rules on protection of whistleblowers are not subject of pre-accession harmonization of national laws with the law of the EU as provided by individual stabilization and association agreements entered into between the current or potential candidate countries (BaH, Serbia, Montenegro) with European Communities. As countries with (un)finalized transition process, they aim to complete the process of transition of domestic law by making their legal system in accordance with the law of EU and its particular member states. (Mirjanić, 2014, p. 129) EU has not yet adequately regulated the protection of whistleblowers, but this issue is subject of discussion and acts. The EU institutions and member states give great attention to protection of 'whistleblowers'. Most of the states do not have special laws on protection of whistleblowers, but the protection provisions are envisaged by other laws, for example by labor laws. (Habazin, 2010, p. 346) European Parliament has adopted in 2013 a Resolution on organized crime, corruption and money laundering, calling on the European Commission to submit a legislative proposal by the end of the year, with a view to establishing an effective and comprehensive European whistleblower protection program in public and private sector. It was aimed to protecting persons who discover irregularities and report cases of national and cross-border corruption relating to EU financial interests, and to protect witnesses, informers, and persons cooperating with courts. The Parliament has also called on the Member States to provide appropriate and effective protection for whistleblowers. The Parliament has pleaded to increase the transparency of work of public bodies and that so called 'red tapes' are removed from their documents, and that access to information on every aspect of administrative organization and activity must be provided, first of all through effective

protection scheme for whistleblowers.² Having in mind that the Commission did not act as the European Parliament has called on it for several times, the Parliament has submitted a parliamentary question to the Commission in June 2015, of whether it intends to submit a legislative text on whistleblowers' protection, stressed out that some Member States are currently amending their laws on that issue and inquired the Commission if it intends to at least issue guidelines for them. The European Parliament, in its Resolution on the situation of fundamental rights in the European Union, of 8 September 2015, again called on the Commission and member states to adopt a whistleblower protection system. The Commission has adopted a Commission Implementing Directive in December 2015, underlying that it is important that the procedures for the protection of persons working under a contract of employment, irrespective of the nature of their working relationship and whether they are paid or not, who report infringements, retaliation, discrimination or other types of direct or indirect unfair treatment. The Commission has suggested that these disputes are settled through dispute resolution rules, i.e. out of courts, or by available judiciary procedures. The Commission opted for a Directive, since that form leaves the states certain flexibility, including legal, process, and institutional aspects.³ However, at the EU level, the protection of whistleblowers was still not adequately broadened. As from 1 January 2014 the EU institutions have been obliged to issue internal rules on whistleblowing, and only two out of nine have done that. The European Ombudsman has adopted internal rules on whistleblowing. Although the work of EU on the process of whistleblower protection is slow and uneven, still the commitment for strengthening the legislative mechanisms is obvious, both at the Union institutions level and at the Member States level, as a modality of direct control of work of institutions in public and private sector. Thus, the EU approaches the USA, but speaking of the level of protection and in general of popularity and the use of whistleblowing in Europe and America, there are clear differences regarding the length of time the directive covering this issue is at force. In America, the protection of whistleblowers is present even in private sector as from 1989, while in the public one it was introduced more than 10 years before, in 1978 (Shimabukuro, Whitake, 2012). A lot of attention is given to the institution of whistleblowers there, as it is considered to one of guarantees of democratic society. National Whistleblower Center deals with the protection of whistleblowers in proceedings that are being initiated against employers due to fraud, corruption, etc. The protection of whistleblowers, who point out the problems in society functioning, to corruption, and alike, and the support of whistleblowers is considered to be a part of popular culture. Hollywood movies glorify the individual who wins a system putting himself to a risk (Kaplan, 2001, p. 38), by which a powerful influence to public opinion is made, and potential whistleblowers are motivated. Still when the protection of individual rights is at stake, a unified approach is

² The Commission was asked to promote appropriate legislative framework on whistleblowers protection, access to information and transparency of lobbying, because it is necessary in order that civic control of governments and institutions of EU be provided in the European Parliament resolution of 11 March 2015 on the Annual Report 2013 on the Protection of the EU's Financial Interests – Fight against fraud

³ Directive and not Regulation is therefore the most appropriate instrument in order that Member States are allowed to make their proceedings of reporting of violations efficient in their national systems including the institutional frame.

needed between America and the EU, in order that the protection is exercised as efficiently and uniformly as possible (Čošabić, 2015, p. 59).

4. PROTECTION OF WHISTLEBLOWERS BEFORE THE EUROPEAN COURT OF HUMAN RIGHTS

Apart from CoE acts encompassing recommendations to member states, extremely important is the case-law of the ECtHR, which gives guidelines and recommendations by its judgments not only to states parties to the proceedings, but according to principle of general prevention, to all member states, as a legal framework that they should obey, in order to avoid the similar future proceedings against themselves. Whistleblower protection may be regarded as an integral part of the human rights and fundamental freedoms protection, which makes a sufficient reason for legal regulation of this protection. In ECtHR judgments, whistleblowing is analyzed through Article 10 of the European Convention for the Protection of Human Rights and Fundamental Freedoms, the freedom of expression - the right to impart information. The judgments that should be pointed out are *Guja v. Moldova* and *Heinisch v. Germany*.

In *Guja v. Moldova* case the applicant was employed as a Head of Press Department of the Prosecutor General's Office of Moldova. He was dismissed due to exposing two documents that involved interference by two highly ranked politicians in the course of a criminal proceedings. He complained under Article 10. The Court has noted that nor the legislature of Moldova nor internal regulations of the public Prosecutor Office have contained any provision that would regulate the reporting irregularities by employees. Therefore, the applicant did not have a recourse to which he could address regarding the misconduct, except to his superiors, and there was no any procedure for reporting of such misconduct. The Court considered that in such cases, external reporting, even to journalists may be considered justified. The applicant lost his job which was according to the Court the most severe sanction, which had not only a negative influence to the career of the applicant, but also could have a negative impact to other employees of Prosecutor's office, and discourage them from reporting any misconduct. Having in mind that the case received a media attention, such negative influence could have spread to other public servants and officials. This was the first case of this kind before the Court, so the Court defined criteria that have to be met by whistleblowers in order to be protected by the Convention, as follows: 1. - the question of whether the applicant had alternative channels for the disclosure; 2. -the existence of the public interest; 3.- the authenticity of the disclosed information; 4.- detriment to the employer is smaller compared to the need that public interest is protected; 5.- the applicant acted in good faith; 6.- the severity of the sanction. The Court noted that having in mind the importance of the right to freedom of expression on matters of general interest, the right of civil servants and other employees to report illegal conduct and wrongdoing at their place of work, the Court came to the conclusion that the interference with the applicant's right to freedom of expression, in particular his right to impart information, was not "necessary in a democratic society", which led to a violation of Article 10 of the Convention.

In the case of *Heinisch v. Germany*, the applicant was employed as a nurse in a Geriatric department which was predominantly owned by Berlin Land. She and her colleagues have pointed out at a regular intervals to the management that they are overburdened due to staff shortage and that services are therefore not being properly documented. During the inspection examination it was established that there were serious shortcomings in care, including insufficient number of staff, unsatisfactory care and inadequate documentation. Legal

representative of the applicant addressed in writing to the company alleging the staff problem and inquiring as to how the company plans to avoid criminal responsibility. When the company dismissed the complaints, he submitted a criminal claim, alleging aggravated fraud, and knowingly not providing a high level of care announced in its advertisements, systematically hiding problems and requested staff to forge reports on services. The applicant was dismissed in the same month. Trade union and friends wrote in their letters that her dismissal is a political disciplinary measure, in order that employees are prevented from disclosing information. The Court considered that there existed a public interest since it was a sensitive older population at stake. Domestic courts dismissed the applicant's complaints. The Court has pointed out that the applicant acted in a good faith. The Court considered that criminal complaint by the applicant has to be regarded as 'whistleblowing' in line with Article 10, and that the applicant's dismissal, as well as the domestic court acts led to interference into her right to freedom of expression.

Although the 'interference' was prescribed by law and had a legitimate aim of protecting rights of others, first of all of business dignity and interests of employer, it was not proportionate, and domestic courts failed to find a justified balance between the need to protect the employer's dignity and the need to protect the applicant's right to freedom of expression. In that sense, violation of Article 10 was established.

The Court has thus established whistleblower criteria and the grounds for their protection. The above mentioned judgments include the whistleblowers in public sector, as well as employees out of public service. The common feature of these cases is the existence of public interest, which was in Guja case, prevention of infringement of the course of criminal proceedings, and in Heinisch case, protection of elderly. Accordingly the public interest may be outlined through the work of public servants and through the work of employees out of public service.

5. THE WHISTLEBLOWERS' RIGHT TO EMPLOYMENT STATUS PROTECTION

Regulation of whistleblowers' rights is based on an assumption that it is realistic to expect the employee to accept the risk that is inherent to whistleblowing, if an efficient protection is provided, convinced that employer could not expose him to threat of dismissal or other harming illegal actions. Harming action is acting or failing to act regarding the whistleblowing by which the whistleblower, is deprived of his rights or suffers their violation or is put in unfavorable position. Apart from fear from losing job, the employee faces also a moral dilemma in case of illegality of work of his employer – to be loyal to employer (in order to protect his private interest) or to be loyal to public interest. Public interest is morally and legally superior comparing to private interest of employer (Lubarda, 2012, p 395). There is a prevailing attitude that legal regulation of protection of rights of employees, and first of all of protection from dismissal, is an important form of prevention of corruption. The first international document which recognizes the institute of whistleblower according to its content, is a Termination of Employment Convention enacted by ILO in 1982, providing that one of the reasons of termination of employment which is not to be considered justified is 'the filing of a complaint or the participation in proceedings against an employer involving alleged violation of laws or regulations or recourse to competent administrative authorities'-Article 5c. With respect to the place of protection, there is a protection at the employer, protection through agency, before the court, and by bodies competent to supervise the enforcement of law (employment inspection and administrative inspection). The content of protection of whistleblowers' rights may vary: in BaH institutions, those are corrective measures prohibiting, decreasing or removing causes or consequences of retaliation, in the Republic of Srbija, those are interim measures that may be requested before, during and after the judicial proceedings, issued by court in order to

prevent, remove or decrease harming consequences. The function of such protection is to prevent or stop harming actions of employers, in due time: whistleblower in a BaH institution may inform the Agency for prevention of corruption, that there is a harming act against him, and the Agency shall give instruction to the head of institution to remove the consequence, He must enforce the instruction within three days from its receipt⁴, or may be fined. Corrective measure may be annulled by irrevocable judgment in labor dispute. Function of out of court protection in Republic of Srbija is provided differently, as parties are informed by court that they may resolve their dispute through mediation or peaceful resolution of labor disputes. The most important form of protection of whistleblowers' rights is the court protection upon action for determining legality of individual act of employer, which concerned the rights, obligations and liabilities occurred during work. Also, depending on the law provisions, action for data protection of whistleblowers and action for damages may be submitted as well. Whistleblower in Montenegro has the right to court protection from discrimination and work ill treatment in accordance with the law which regulates the prohibition of discrimination and the law which prohibits ill treatment at work. Judicial protection of whistleblowing usually differs from other kinds of labor disputes in: grounds for action, content of action, time-limits for initiating labor disputes and court members. In judicial proceedings employer must prove that actions done against the whistleblower were not due to his whistleblowing.

6. CONCLUSION

The legislative frameworks of protection of whistleblowers and discussion in that regard show that legal regulation of whistleblowers' rights emerging from employment status and other work related status by a special law or special provisions within labor legislation, is considered to be irreplaceable form of fight against corruption. The subject matter of protection may be wider then the corruption, encompassing the environment protection, security and health, protection of consumers, irrational disposal of public resources, etc. In line with regulation of whistleblowers' protection, it is necessary to accomplish confidence that the law shall be implemented. Otherwise, significant affirmation of whistleblowing cannot be expected since the employees rather protect their own rights and interests which may be endangered if they reveal information of submit a report against the employer's interests. Enactment of first laws on protection of whistleblowers is a beginning, and legal praxis and knowledge gained in the course of their implementation may serve as guidance for writing laws which will more suite specific circumstances, tradition, and legal conscience in a concrete social community. Therefore, it is possible to decrease the gap between the enactment and implementation of laws, which is inevitable, when speaking of whistleblowers and whistleblowers protection.

LITERATURE:

1. Lipman, D. F. (2012). *Whistleblowers: Incentives, Disincentives, and Protection Strategies*. New Jersey: John Wiley & Sons, Inc. Hoboken.
2. Lubarda, B. (2012). *Radno pravo – rasprava o dostojanstvu na radu i socijalnom dijalogu*. Beograd: Pravni fakultet Univerziteta u Beogradu.
3. Milković, D. (2014). *Prestanak ugovora o radu, Komentar Zakona o radu*. Zagreb: TIM press.

⁴ If the Agency establishes that the harming action was taken regarding the submission of report, then the person in charge has to prove that the same action would have been carried in respect of employee also in case that he did not submit a report.

4. Mirjanić, Ž. (2014). *Pisanje i donošenje zakona*. Banja Luka: Pravni fakultet Univerziteta u Banjoj Luci.
5. Čošabić, J., (2015). *Territorial Implications of the 'Right to be Forgotten'*, New York: Psychosociological Issues in Human Resource Management Volume 3(2), 2015, pp. 53– 64, ISSN 2332-399X
6. Habazin, M., (2010). *Zaštita "zviždača"*, Hrvatska javna uprava. god.10. br.2.
7. Kaplan, E., (2001). *The International Emergence of Legal Protections for Whistleblowers*, The Journal of Public Inquiry. Retrieved 22.06.2016. from <https://www.ignnet.gov/sites/default/files/files/f01c10.pdf>
8. Malenica, Z., Jeknić, R. (2010). *Percepcija korupcije i borba protiv korupcije u Republici Hrvatskoj*. Split: Zbornik radova Pravnog fakulteta u Splitu, god.47, 4/2010.
9. Martić, M., (2016). *Uporedno- pravni aspekti pojma uzbunjivač*. Strani pravni život, br. 1.
10. Mirjanić, Ž., (2014). *Značaj socijalnog dijaloga u procesu usklađivanja domaćeg prava sa pravom Evropske unije*. Niš: Zbornik radova sa međunarodne naučne konferencije: "Usklađivanje prava Srbije sa pravom Evropske unije", Pravni fakultet Univerziteta u Nišu
11. Popescu, A.I., (2015). *Finance and law a critical analysis of whistleblower protection in the European Union*, 7/2015. Journal of public administration.
12. Shimabukuro, O.J., Whitake, L.P. (2012). *Whistleblower Protections Under Federal Law: An Overview*. Retrieved 03.07.2016. from <https://fas.org/sgp/crs/misc/R42727.pdf>
13. *Civil Law Convention on Corruption*. (1999) Retrieved 07.05.2016. from <https://www.coe.int/en/web/conventions/full-list/-/conventions/treaty/174>
14. *Commission Implementing Directive (EU) 2015/2392 on Regulation (EU) No 596/2014 of the European Parliament and of the Council as regards reporting to competent authorities of actual or potential infringements of that Regulation*, Retrieved 05.07.2016. from <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32015L2392>
15. *European Parliament resolution of 8 September 2015 on the situation of fundamental rights in the European Union (2013-2014)* Retrieved 05.05.2016. from <http://www.europarl.europa.eu/P8-TA-2015-0286>
16. *European Parliament resolution of 23 October 2013 on organised crime, corruption and money laundering: recommendations on action and initiatives to be taken (final report)* Retrieved 03.06.2016. from <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2013-0444&language=EN>
17. *Guja v. Moldova*, judgment of the ECtHR (2008). , Retrieved 12.05.2016. from <http://hudoc.echr.coe.int/eng?i=001-85016>
18. *Heinisch v. Germany*, judgment of the ECtHR, Retrieved 01.06.2016. from <http://hudoc.echr.coe.int/eng?i=001-105777>
19. *Recommendation CM/Rec (2014)7 of 30 April 2014 and Appendix to Recommendation CM/Rec(2014)7*, (2014) Retrieved 01.06.2016. from [https://www.coe.int/t/dghl/standardsetting/cdcj/CDCJ%20Recommendations/CMRec\(2014\)7E.pdf](https://www.coe.int/t/dghl/standardsetting/cdcj/CDCJ%20Recommendations/CMRec(2014)7E.pdf)
20. *Termination of Employment Convention*, (1982). Retrieved 30.04.2016. from http://www.ilo.org/dyn/normlex/en/f?p=NORMLEXPUB:12100:0::NO::P12100_ILO_CODE:C158

21. *Whistleblower protection: encouraging reporting*, OECD, (2012). Retrieved 02.06.2016. from <http://www.oecd.org/cleangovbiz/toolkit/50042935.pdf>
22. *Zakon o zaštiti lica koja prijavljuju korupciju u institucijama Bosne i Hercegovine*. Službeni glasnik Bosne i Hercegovine br.100/13
23. *Zakon o zaštiti uzbunjivača*. Službeni glasnik Republike Srbije, br. 128/2014.
24. *Zakon o sprječavanju korupcije*. Službeni list Crne Gore, br.53/14.
25. *Zakon o radu*. Narodne novine Republike Hrvatske br. 93/14.
26. *Zakon o državnim službenicima*. Narodne novine Republike Hrvatske br. 92/05, 142/06, 77/07, 107/07, 27/08, 34/11, 49/11, 150/11, 34/12, 49/12, 37/13, 38/13, 01/15, 138/15.

HOW TO ENSURE IMPARTIALITY OF ARBITRATORS?

Zvonimir Jelinic

J.J. Strossmayer University of Osijek, Croatia

Faculty of Law

zjelinic@pravos.hr

ABSTRACT

The impartiality of party appointed arbitrators presents an issue of outmost importance in tripartite commercial and investment arbitral proceedings.

In this paper, the author will question whether the problem of impartiality of arbitrators can be resolved by purely prescribing the duty of arbitrators to be impartial. Taking into account that impartiality is a subjective concept, a kind of the mental state of an arbitrator towards the parties and the dispute, in most of the cases it will be extremely difficult to establish a personal bias, particularly when it is not possible to determine one arbitrator's link with the parties, their lawyers, other arbitrators or with the subject matter of the dispute. On the other hand, being a party to the proceeding the outcome of which may be shaped according to one party's preferences rather than according to the law results with innumerable negative repercussions that may easily undermine all arguments in favor of arbitration over resorting to a court in the traditional sense.

The existence of numerous international and domestic principles on impartiality of arbitrators is important, however not sufficient for coming close to reaching the ideal. The mere fact that the parties appoint their own arbitrators, often those for whom parties believe that they will deeply understand the nature of the party's specific position will often, from the point of view of interested public, lead to conclusion that the parties' appointed arbitrators are partisan. That is why, if we take for granted that the quality of one arbitration is directly linked to the quality of arbitrators themselves, we may assert that professionalism and ethical obligations of arbitrators to maintain their integrity and fairness of the process present the most effective means of securing the quality of one arbitration.

Keywords: *commercial arbitration, independence, impartiality, fairness, motion for challenge.*

1. INTRODUCTION

The issue of independence and impartiality of arbitrators in a tripartite arbitration is extensively discussed both in academic literature and case-law of arbitral tribunals as well as that of ordinary courts of justice. Even a brief look at laws governing arbitration proceedings, available publications and texts reveals that there are number of rules of international and domestic origin that promote the need to secure impartiality and independence of arbitrators towards the parties. There is a general attitude that both independence and impartiality constitute the very core of arbitrator integrity and that the lack of any of mentioned features would undermine the procedural guarantee of the right to a fair arbitral proceedings. On the other hand, in practice different situations occur even in the most sensitive cases involving vast amounts of money or even unresolved cross-border disputes between states.¹ Besides, the fact that different data and information on cases and practices regarding the application of principles of independence and

¹ One of the latest incidents concerning independence of the arbitrator has occurred in the course of arbitral proceedings between the Republic of Croatia and the Republic of Slovenia. See partial award (case number 2012-04) of June 30, 2016. Retrieved 23.07.2016. from <https://pca-cpa.org/en/home/>.

impartiality can be found suggests that the issue of arbitrators' independence and impartiality has never been more important than nowadays.²

Does that mean that the principles on impartiality and independence are of questionable practicality and influence? Is impartiality nothing but an ideal that is impossible to attain to the full extent? By all means, the answer to the posed question is all but simple.

Arbitration is a lot different than court litigation. If we put aside regularly proclaimed advantages of arbitration over court litigation (the ones that usually point out the effectiveness, the user friendliness and confidentiality, the procedural effect of an award as well as the procedural flexibility of arbitration) we will see that the usually remarked reasons why parties choose arbitration in most areas of cross border and domestic business relate to a few facts. The first one is that, unlike the judges, arbitrators often possess knowledge and expertise helpful to fully understand the subject matter of the dispute and peculiarities of particular industries and their business and legal surroundings. Although resorting to experts presents a common way of assistance to the arbitral tribunal, the competency of arbitrators frequently plays a major role when deciding whether to resort the case to the arbitration or to the court apparatus. Secondly, it is easy to observe that today's standard form contracts suggested and widely used by industry organizations or books for contract drafting contain arbitration clauses.³ Such an approach results with stronger incentives to resort to arbitral tribunals, not only in international commerce cases as it was before, but also in different types of domestic transactions, including the transactions between traders and consumers.⁴

The third issue that can be identified relates to the clear tendency of the state court system to respect and enforce the choice of the parties to opt out of the judicial system in favor of arbitration.⁵ At the national level, this kind of trend is being supported not only by the laws on arbitration that prescribe that in case the parties have agreed to submit their dispute to arbitration, the court before which the matter was brought shall declare its lack of jurisdiction upon defendant's objection unless it finds that the arbitration agreement is null and void,⁶ but also with different state actions aiming at popularization of alternative dispute resolution mechanism in order to lower pressure on courts and to support speedier and sometimes cheaper dispute resolution alternatives.

The fact that arbitral proceedings are often regarded as a better, faster and generally speaking more convenient method of dispute resolution than ordinary court litigation does not mean that they do not have shortcomings. One of the most intense problems concerns the issue of impartiality. Namely, for arbitration proceedings to achieve a fair resolution of disputes, the arbitrator should be able to make his decision without any kind of bias.⁷

The first issue we shall address in this paper is the difference between the fair trial standards of independence and impartiality. As we will see, sometimes the terms "impartial" and "independent" induce greater confusion than clarity.⁸ However, the doctrine of procedural law

² See, e.g., Renna, V. (2016). *Report on Independence and Impartiality of Arbitrators*, Institute for Promotion of Arbitration and Mediation in the Mediterranean. Retrieved 23.07.2016. from <http://www.ispramed.it/>.

³ Böckstiegel, K.H., Kröll, S. M., Nacimient, P. (2007), *Arbitration in Germany. The Model Law in Practice*. Cologne and Frankfurt: Kluwer Law International (p. 6-7).

⁴ Cf. *ibid.*

⁵ Cf. *ibid.*

⁶ See art. 42 of the Croatian Law on Arbitration (Official Gazette no. 88/2001).

⁷ Murphy, E.A. (1996), Standards of Arbitrator Impartiality: How Impartial Must They Be? (1996), *Journal of Dispute Resolution* Vol. 1996/iss2/7., (p.465).

⁸ See Croft, C., Kee, C., Waincymer, J. (2013), *A Guide to the Uncitral Arbitration Rules*. Cambridge University Press (p. 130).

allows for making a distinction between these two terms. Although in the focus of this paper is the issue of impartiality *per se*, for the purpose of clarity, it will be necessary to point out the interference of both standards, especially from the aspect of their practical application.

Secondly, we shall check what national approaches to this matter are in force in different legal systems. Available materials clearly indicate that the U.S. courts are prone to support a very liberal interpretation of the standard of impartiality in domestic arbitral proceedings. In their epic work “International Commercial Arbitration” *Fouchard, Gaillard and Goldman* point out that the status of party appointed arbitrators remains a subject of controversy and that there is some support in Europe for denouncing the hypocrisy behind the requirement that party appointed arbitrators are and must be independent.⁹ Due to interrelation of the two concepts, the lack of independence would definitely lead to the lack of impartiality, albeit, it is not clear whether the opposite situation would always result with the determination of the lack of independence on one arbitrator’s side. It is imaginable that the arbitrator is partial to one side while independent in the sense of not having any personal relationship with the parties or their appointed representatives.

In the third part, we will bring forth different ideas on how to foster the arbitrators’ impartiality. The very end of the paper is reserved for concluding remarks.

2. THE ARBITRATORS’ DUTY TO SAVE THEIR INDEPENDENCE AND IMPARTIALITY

One of the most important features and advantages of arbitration over court proceedings is the freedom of the parties in choosing the arbitrators.¹⁰ Ordinarily, in tripartite arbitral proceedings each party appoints one arbitrator while the third one who shall then act as chairman of the panel and who is often required to be “neutral”, is appointed either by the arbitral institution before which the proceedings are taking place or by the two party appointed arbitrators.¹¹ Arbitrator conflicts of interest usually fall into one of two categories: lack of independence and/or lack of impartiality.¹² The lack of either negatively influences the ability of arbitrator to make his judgement free from any kind of prejudice. As pointed out by *Park*, in a cross-border context of commercial arbitration, the prohibition on bias justifies itself by reference to the very same goal underlying the decision to arbitrate: promoting a level playing field that will be free from any kind of favoritism or bias.¹³ Obviously, any kind of legitimized and/or recurring favoritism of one party over another would undermine the success of arbitration in its national and cross border dispute resolution context. Therefore, every arbitral proceeding should be able to provide guarantees of the right to a fair trial of the same quality as regular courts of justice. It turns out from the case-law of the European Court of Human Rights that this does not necessarily mean that the right to impartial arbitrator cannot be waived by the parties themselves. When compared to independence, impartiality presents a concept which is

⁹ Fouchard, F., Gaillard, E., Goldman, B. (1999), *International Commercial Arbitration*, Kluwer Law International, (p. 574).

¹⁰ See Böckstiegel, K.H. *et. al.*, op. cit. (p. 191).

¹¹ The UNCITRAL Model Law on International Commercial Arbitration (1985), with amendments as adopted in 2006. prescribes that in case the parties or the arbitrators fail to agree on a procedure of appointment of the arbitrators or about the appointment of the third arbitrator, the appointment shall be made, upon the request of a party, by the court or other authorized authority. This solution has been followed by national legislators that have modeled national laws on arbitration according to the UNCITRAL Model Law. See, e.g., art. 1035 of the German Zivilprozessordnung (ZPO) and art. 10 of the Croatian Law on Arbitration.

¹² Park, W.W. (2009), Arbitrator Integrity: The Transient and the Permanent, *San Diego Law Review*, Vol. 46 (p. 629).

¹³ Cf. with Park, W.W. (2009), op. cit. (p. 633).

somewhat elusive. The most frequent academic commentary that can be found is that the difference between the two terms lies primarily within the possibility to identify the link between the parties or someone associated with them and the arbitrator. While independence concerns the absence of actual identifiable relationship, impartiality, in contrast, is a subjective concept that would not necessarily require tangible relationship which may lead an arbitrator to favor one party.¹⁴ From a practical point of view, impartiality will need to be assessed against objective factors such as those used to determine independence.¹⁵ That is to say, independence is a situation capable of objective verification while impartiality, on the other hand, constitutes a mental state, a kind of a psychological category which will necessarily be subjective and rarely possible to prove directly.¹⁶ While there is a number of situations that have been identified as detrimental to the arbitrator's freedom of judgement in terms of his independence,¹⁷ the impartiality presents the concept which is primarily disputed on the basis of several grounds. Naturally, the list of grounds has no end so it is conceivable that numerous situations may serve as a trigger for questioning one arbitrator's impartiality. While the first set of circumstances that may give rise to an arbitrator's impartiality concerns the situation in which the arbitrator is already familiar with the dispute or any connected dispute because of which he or she will no longer have the objectivity required of a judge taking a new case, the other situation would concern the arbitrator's prior conducts with respect to the positions he has taken on a legal or professional matter of importance for the dispute.¹⁸ Both independence and impartiality present guarantees that are immanent for judges. The question whether the arbitrators carry out a judicial function same as that of judges has been considered by the European Court of Justice. In its *Hoffman v. Finanzamt Trier* judgement the Court has clearly indicated that the services of an arbitrator are principally and habitually those of settling a dispute between two or more parties, even though this is done on an equitable basis.¹⁹ The fact that arbitrators perform the functions of a judge opens space to question one other matter at issue. Namely, is the first paragraph of art. 6 of the European Convention on Human Rights, the one that includes both independence and impartiality as principles of prominent value for courts in democratic societies, directly applicable to arbitral tribunals?²⁰ Direct application of the Convention to arbitral proceedings would mean that the basic principles of independence and impartiality should be duly respected in all kinds of arbitral proceedings, even in those that are not of compulsory nature, which would eventually lead to the incapability of parties to waive procedural rights and guarantees as established in the Convention. This way,

¹⁴ See Croft, C., Kee, C., Waincymer, J. (2013), *A Guide to the UNCITRAL Arbitration Rules*. Cambridge University Press (p. 131).

¹⁵ Ibid. Fouchard *et al.* (ref. no. 10) mention the decision of the Swiss Federal Tribunal which has rightly observed that accusations of partiality will be rejected if based solely on „a subjective feeling of one of the parties rather than solid facts objectively and reasonably justifying mistrust in a person reacting normally” (see Fouchard *et al.*, op. cit., p. 567).

¹⁶ Cf. Fouchard *et al.* (p. 564).

¹⁷ From the Report on Independence and Impartiality of Arbitrators (see supra, ref. no. 2), it is clear that different kind of relationships of the arbitrators with the parties, arbitrators' relationships with the parties' counsels, arbitrator's relationships with another arbitrator or arbitrator's relationship with the subject matter of the dispute may amount to the occurrence of justifiable doubts as to the arbitrator's independence and impartiality. Logically, all examples should be viewed in the light of circumstances that surround every particular case.

¹⁸ Fouchard *et al.* (ref. no. 10), op. cit. (p. 567-571).

¹⁹ See para. 17 of the Judgement of the Court of Justice of the European Communities of September 16, 1997 (Case no. C-145/96.).

²⁰ The full text of the first paragraph art. 6 of the European Convention on Human Rights states as follows: In the determination of his civil rights and obligation or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law.

the requirements of independence and impartiality in legal documents other than the Convention would be, if not obsolete, then of weaker effect and influence than the Convention. However, the European Court of Human Rights has held that, in certain situations of voluntary waiver of court proceedings in favor of arbitration (which is acceptable from the point of view of art. 6), the parties are allowed to waive the fundamental right to an impartial arbitrator if this is done in an unequivocal manner.²¹

Today it is apparent that a number of legal texts including national laws, the rules of different permanent arbitration courts and international conventions provide that arbitrators must be independent and impartial. Whenever national laws on arbitration do not address the issue by clearly pointing out the obligation of the arbitrator to remain independent and impartial throughout the proceedings, as it is the case, for example, with the Croatian Law on Arbitration, the rules on challenge of arbitrators cover the issue by prescribing that any circumstances likely to give rise to justifiable doubts as to the arbitrators' independence and impartiality may be used for challenging an arbitrator.²²

Similar to many other jurisdictions, Croatian legislator has also followed the very influential concept of the UNCITRAL Model Law on International Commercial Arbitration. In its text, the UNCITRAL Model Law mentions impartiality two times. Firstly, when it requires the court or other authority to secure the appointment of an independent and impartial arbitrator and secondly, when it requires a potential appointee to disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality and independence.²³

The current Rules of Arbitration of International Chamber of Commerce in its general provisions contain a declaration that every arbitrator must be and remain impartial and independent of the parties involved in the arbitration. Moreover, before accepting an appointment, every prospective arbitrator has to sign a statement of acceptance, availability, impartiality and independence.²⁴

Rule no. 6 of 2006 Arbitration Rules of the International Centre for Settlement of Investment Disputes include provision similar to that highlighted in the previous sentence; any arbitrator failing to sign a declaration which includes the disclosure of relationships, to judge fairly and according to the applicable law without accepting any instruction from aside shall be deemed to have resigned.²⁵

The 2013 Commercial Arbitration Rules and Mediation Procedures of the American Arbitration Association (AAA) reveal the American approach to the matter at issue. The rule no. 13 prescribes that where the parties have agreed that each party is to name one arbitrator, the arbitrators so named must meet the standards with respect to impartiality and independence unless the parties have specifically agreed that the party-appointed arbitrators are to be non-neutral and need not meet those standards. The parties may agree in writing, however, that arbitrators directly appointed by a party shall be non-neutral, in which case such arbitrators

²¹ See decision of the European Court of Human Rights as to the admissibility of Application no. 31737/96 by Osmo SUOVANIEMI and others against Finland of 23 February 1999.

²² See art. 12 of the Croatian Law on Arbitration.

²³ See art. 11 and 12 of the UNCITRAL Model Law on International Commercial Arbitration (1985, amended in 2006).

²⁴ See general provisions of 2012 ICC Rules of Arbitration.

²⁵ The proposed statement reads as follows: "To the best of my knowledge there is no reason why I should not serve on the Arbitral Tribunal constituted by the International Centre for Settlement of Investment Disputes with respect to a dispute between..... I shall judge fairly as between the parties, according to the applicable law, and shall not accept any instruction or compensation with regard to the proceeding from any source except as provided in the Convention on the Settlement of Investment Disputes between States and Nationals of Other States and in the Regulations and Rules made pursuant thereto."

need not be impartial or independent and shall not be subject to disqualification for partiality or lack of independence. Such an approach obviously acknowledges the institution of partial arbitrators which is a phenomenon that still lives in the U.S. *Murphy* points out that in order not to disrupt some of the efficiency benefits of arbitration, American courts have compromised justice in the interest of efficiency. That is why they have preferred to affirm the awards granted by potentially biased arbitrators at the expense of eventual dissatisfaction with the arbitration process on behalf of the public.²⁶ Still, in the procedures involving parties of different nationalities, the AAA has followed a universal approach. Art. 13 of the International Dispute Resolution Procedures directly addresses the issue by prescribing that arbitrators shall be impartial and independent and shall act in accordance with the terms of the Notice of Appointment provided by the Administrator. Furthermore, as pointed out in the Rules, upon accepting appointment, an arbitrator shall sign the Notice of Appointment affirming that the arbitrator is available to serve and is independent and impartial. The arbitrator shall disclose any circumstances that may give rise to justifiable doubts as to the arbitrator's impartiality or independence and any other relevant facts the arbitrator wishes to bring to the attention of the parties. One of the most comprehensive and far reaching document concerning impartiality of arbitrators is the newest edition of the Guidelines on Conflicts of Interest in International Arbitration (2014) which was prepared by the International Bar Association.²⁷ This material which applies to both commercial and investment arbitration indicates that the problem of impartiality and conflict of interests should not be underestimated, especially because the usage of frivolous challenges hinder arbitration proceedings and delay delivery of arbitral awards. Apart from setting a general principle of independence and impartiality of arbitrators that should extend to entire proceedings until the final award has been rendered, the Guidelines explicate the meaning of the “justifiable doubts” standard. It is established that doubts are justifiable if a reasonable third person, having knowledge of the relevant facts and circumstances would reach the conclusion that there is a likelihood that the arbitrator may be influenced by factors other than the merits of the case as presented by the parties in reaching his or her decision.²⁸ Despite of the fact that it is open to doubt what should be regarded as the point of view of a reasonable person, the prior duty of arbitrators to reveal all kinds of facts and circumstances that may result with the motion for their challenge plays a major role and the simplest and most effective mean of *ex ante* control over impartiality in arbitral proceedings.

3. THE MEANS OF PROTECTION OF THE IDEAL OF IMPARTIAL ARBITRATOR

The states enjoy considerable discretion in regulating the question on which grounds an arbitral award can be quashed, since the quashing of a rendered award will often mean that a long and costly arbitral procedure will become useless and that considerable work and expense must be invested in new proceedings.²⁹ No matter what practical solutions are chosen and implemented by the states, it is important to remember that failing to file a challenge and to subsequently exhaust all legal remedies against the arbitrator whose impartiality is suspicious will eventually result with impossibility to successfully oppose the enforcement of an award.³⁰ That is why all

²⁶ Murphy, E.A. (1996), Standards of Arbitrator Impartiality: How Impartial Must They Be?, *Journal of Dispute Resolution*, Vol. 1996:2/7. (p. 476).

²⁷ IBA Guidelines on Conflicts of Interest in International Arbitration (2014). Retrieved 25.07.2016. from http://www.ibanet.org/Publications/publications_IBA_guides_and_free_materials.aspx.

²⁸ See Rule no. 2(c) of the IBA Guidelines on Conflicts of Interest in International Arbitration (2014).

²⁹ The decision of the ECHR as to the admissibility of application no. 31737/96 by Osmo Suovaniemi and others v. Finland of February 23, 1999., p. 6.

³⁰ According to art. 12(7) of the Croatian Law on Arbitration if a challenge before an arbitral tribunal is not successful, the challenging party may, within 30 days after receiving notice of the decision rejecting the challenge,

opportunities to advance the arguments about one arbitrator's impartiality should be employed in a timely manner since challenging an arbitrator in a final stage of proceedings may be understood as nothing but a procedural maneuver aimed at delaying the delivery of award.³¹ Obviously, requesting the arbitrators to inform the parties to the fullest extent helps the parties to make a quality assessment of the arbitrators' position regarding their impartiality. Taking into account that the lack of impartiality is a subjective concept which is hard to verify without being aware of the circumstances which may affect one arbitrator's impartiality, an in depth look into links that may jeopardize the arbitrator's independence shall always be essential. On the other hand, as pointed out by *Landau*, it is ironical that even if the party appointed arbitrator is completely neutral, he will be frequently viewed by his co-arbitrators as expounding to some extent the party line thereby diminishing his influence within the panel and, most notably, with the Chairman.³² This is why a party nominated arbitrator should always be careful when advocating the interests of a party that nominated him regardless of the merits of the case. This kind of favoritism is not only problematic from the professional and ethical point of view, but it can be also counterproductive for the party whose interest the appointed arbitrator is trying to advocate.³³ The procedural instrument of challenge of the party appointed arbitrators together with imposing obligation towards arbitrators to reveal all facts and circumstances that may be relevant when assessing their independence and impartiality present an inherent feature, a kind of default of the arbitral institutions and laws worldwide. Without strictly imposing the duty of disclosure by the arbitrator and allowing challenges whenever justifiable doubts about the arbitrator's impartiality exist, the general principles of independence and impartiality would be nothing but a dead letter. Constantly reminding the whole arbitration community about the need to protect the standard of impartiality to the greatest extent, together with the continuing modernization of the guidelines on conflicts of interests is one way to secure fairness in arbitration which may result with even wider acceptance of arbitration, both domestically and internationally. Nevertheless, as long as the parties appointed arbitrators are being perceived as non-neutral (despite there is no compromise over the nature of their role which is clearly judicial) the problem will remain and it is in question whether it can be resolved at all, particularly concerning the ideal of impartiality. Different unexpected affairs we can read about occasionally imply that the only thing that can be done is to induce arbitral community to maximize its efforts in assuring that impartiality is protected, respected and publicized. One of the ways to address the problem would be to take a very strict stance towards arbitrators' independence and impartiality. For instance, it appears that the French courts are very severe in their approach to an arbitrator's duty to disclose because of the idea that the arbitrators must not merely be independent and impartial, but that they must also appear to be so.³⁴ In other

request from the Commercial Court in Zagreb to once more decide on the challenge. More about the system of challenge of arbitrators in Croatian law see in Babić, D., Mustafa, Z. (2015), Challenge of Arbitrators under the 2011 Zagreb Arbitration Rules, *Journal of the Faculty of Law Zagreb*, Vol. 65(2)2015. (p. 213-235).

³¹ See e.g., the decision of Constitutional Court of the Republic of Croatia no. U-III-4618/2012. of November 19, 2015.

³² Referenced according to Bastilda, B. M. (2007), The independence and impartiality of arbitrators in international commercial arbitration from a theoretical and practical perspective (La independencia e imparcialidad de los árbitros en el arbitraje comercial internacional desde una perspectiva teórica y práctica), *Revist@ e-Mercatoria*, Vol. 6(1), 2007.

³³ Ibid.

³⁴ See Kleiman, E., Dehaudt-Delville, Y. (2016), Independence and Impartiality: Supreme Court confirms stern approach to duty of disclosure. Retrived 25.07.2016. from <http://adresources.com/ad-headlines/4340/independence-and-impartiality-supreme-court>.

words; “not only must Justice be done; it must also be seen to be done.”³⁵ This is also important because of broadly accepted approach that the arbitrator’s lack of impartiality may serve as the basis upon which a court may vacate the award.

However, it would be wrong to go to extremes and to widely accept the policy which application would be very insensitive and severe. Application of this kind of policy might lead to the removal of an arbitrator for whom it is practically impossible to establish his partiality. Therefore, the facts and circumstances surrounding each case are important and they should always serve as the basis for the test of justifiable doubts about one arbitrator’s independency and impartiality. Approaching the issue with a stance that party appointed arbitrators are normally partial because they are appointed by the parties would be wrong as it would be wrong not to protect the arbitrators from unfounded challenges and accusations of bias. International commercial and investment arbitration community is a small world and frequently it will be possible to find something that will indicate that the arbitrator is biased towards one of the parties, although that something presents only a hypothesis that is hard to prove because it lacks evidence and logical argumentation.³⁶

The appearance of impartiality can be promoted by introducing means other than prescribing the duty of disclosure and regulating the challenge procedure. For instance, encouraging arbitrators to write a dissenting opinion when they express disagreements with other members of the panel would reveal a lot about their line of reasoning. Strictly applying ethical standards and special conditions imposed on arbitrators is also important. Since the quality of arbitrators is of utmost importance for the fairness of proceedings, the arbitral institutions need to ensure that the selection of arbitrators and their admittance to panels and lists is carefully assessed. It is anticipated that arbitrators who are professionals of high moral character and recognized competence in the field of law will always strive to keep their professional integrity intact.³⁷

4. CONCLUSION

In the world of international commercial and investment arbitration it is widely accepted that all arbitrators must remain independent and impartial towards the parties throughout the proceedings. Nevertheless, the problem of impartiality of the party appointed arbitrator still presents a controversial issue. Namely, because it is a subjective concept, the presence of bias will be usually very hard, if not impossible to prove in situation where no external factors exist which would reveal that the arbitrator is being insufficiently independent. Therefore, the requirement that party appointed arbitrators must be impartial presents the ideal that can be hardly satisfied to the full extent. This does not mean that the problem should be left to solve itself. In order to contribute the appearance of fairness the existing laws, conventions and arbitration rules need to be constantly improved and publicized. Besides, urging arbitrators to be responsible towards their role of the judge in a trial also presents efficient way of dealing with the issue. Voting for the party who had appointed him regardless of the merits of the case can hardly happen to the arbitrator of high moral standards and integrity.

³⁵ This is the quote from the well-known case concerning the impartiality of judges (*R. v. Sussex Justices, Ex parte McCarthy* ([1924] 1 KB 256, [1923] All ER Rep 233)).

³⁶ Because it is a small community, it makes it easier for the worldwide arbitration community to ensure that any past failure of one arbitrator to comply with the general principles of independence and impartiality results with putting out of business of the arbitrator who had been violating the standards of impartiality and independence.

³⁷ See e.g. art. 14 of the 1965 Washinton Convention (*The ICSID Convention on the Settlement of Investment Disputes between States and Nationals of Other States*).

LITERATURE:

1. Babić, D., Mustafa, Z. (2015), Challenge of Arbitrators under the 2011 Zagreb Arbitration Rules, *Journal of the Faculty of Law Zagreb*, Vol. 65(2)2015.
2. Bastilda, B. M. (2007), The independence and impartiality of arbitrators in international commercial arbitration from a theoretical and practical perspective (La independencia e imparcialidad de los árbitros en el arbitraje comercial internacional desde una perspectiva teórica y práctica), *Revist@ e-Mercatoria*, Vol. 6(1), 2007.
3. Brown, C., Miles, K. (2011), *Evolution in Investment Treaty Law and Arbitration*, Cambridge University Press.
4. Commercial Arbitration Rules and Mediation Procedures of the American Arbitration Association (2013)
5. Croft, C., Kee, C., Waincymer, J. (2013), *A Guide to the UNCITRAL Arbitration Rules*. Cambridge University Press.
6. Fouchard, F., Gaillard, E., Goldman, B. (1999), *International Commercial Arbitration*, Kluwer Law International,
7. Goode, R., Kronke, H., McKendrick, E. (2007), *Transnational Commercial Law. Text, Cases and Materials*. Oxford University Press.
8. Holtzmann, H.M., Neuhaus, J. E. (1989), *A Guide to the UNCITRAL Model Law on International Commercial Arbitration. Legislative History and Commentary*. The Hague: Kluwer Law and Taxation Publishers.
9. IBA Guidelines on Conflicts of Interest in International Arbitration (2014). Retrieved 25.07.2016. from http://www.ibanet.org/Publications/publications_IBA_guides_and_free_materials.aspx
10. Kleiman, E., Dehaudt-Delville, Y. (2016), Independence and Impartiality: Supreme Court confirms stern approach to duty of disclosure. Retrieved 25.07.2016. from <http://adrresources.com/adr-headlines/4340/independence-and-impartiality-supreme-court>.
11. Murphy, E. A. (1996), Standards of Arbitrator Impartiality: How Impartial Must They Be? (1996), *Journal of Dispute Resolution* Vol. 1996/iss2/7.
12. Murphy, E.A. (1996), Standards of Arbitrator Impartiality: How Impartial Must They Be?, *Journal of Dispute Resolution*, Vol. 1996:2/7.
13. Park, W.W. (2009), Arbitrator Integrity: The Transient and the Permanent, *San Diego Law Review*, Vol. 46
14. Relevant decisions of the European Court of Justice and European Court of Human Rights.
15. Renna, V. (2016). *Report on Independence and Impartiality of Arbitrators*, Institute for Promotion of Arbitration and Mediation in the Mediterranean. Retrieved 23.07.2016. from <http://www.ispramed.it/>.
16. Rubino-Sammartano, M. (1990), *International Arbitration Law*. Kluwer Law and Taxation Publishers.
17. UNCITRAL Model Law on International Commercial Arbitration (1985, amended in 2006)..
18. Van Dijk, P., van Hoof, F., van Rijn, A., Zwaak, L. eds. (2006), *Theory and Practice of the European Convention on Human Rights* (4th ed.). Intersentia.

SOCIAL-CRIMINAL PREVENTION PROGRAMMES FOR JUVENILES

Ivana Radic

Faculty of Law in Split, Croatia

iradic@pravst.hr

ABSTRACT

Main purpose of every prevention programme is to prevent children and juveniles from becoming a criminal offender in the future, but the benefits from an effective prevention of juvenile delinquency are much wider because it influences not only the lives of juveniles and their families who are participating in the programmes, but it also improves the quality of life for the whole community. Prevention is promoting a positive lifestyle for juveniles by helping them overcome their problems in different aspects of life (family, peers, school, workplace) and it is also more cost effective for the state to influence the risk factors of a child and his family at an early stage than have to pay for the treatment of that same child when he enters the judicial criminal system. That is why it is necessary that every state develops an effective prevention policy that should become a part of national criminal and social policy in long-term. Prevention needs to be focused on the so called children at risk which means that prevention programmes should be used to eliminate the causes of criminal behaviour in child's life and indirectly in his family and community as well. This paper analyzes what are some of the basic principles that have to be taken into consideration when implementing an effective prevention program for juveniles regarding international documents for juvenile offenders (UN, Council of Europe, European Union) and main developments in prevention of juvenile delinquency and also what are some of the prevention programmes that were or are still being implemented in different European countries.

Keywords: Juveniles, Prevention, Prevention programmes, Risk Factors.

1. INTRODUCTION

The goal of every prevention programme in the broader sense is to prevent the occurrence of future offenders and that is why society takes different general measures to combat crime in order to eliminate the negative effects of social environment and to ensure normal conditions for the development of individual's personality, which is especially important for the development of children and juveniles (Singer, Kovčo Vukadin, Cajner Mraović, 2002, p. 358).

Prevention of criminality is a continuous activity of a number of entities that takes place progressively, at the level of a community and at the level of an individual to whom it is directed. The concept of prevention implies well planned, designed and organized measures which are being aimed to eliminate or at least reduce the direct and indirect causes of criminal behaviour, especially of those the hardest (Horvatić, Cvitanović, 1999, p. 96). We can also define prevention as a process whose goal is to reduce the incidence and prevalence of behavioural disorders and risky behaviour of children and juveniles. It is a proactive process that empowers individuals and systems to meet the challenges of life events and changes by creating and strengthening the conditions in order to promote healthy behaviour and lifestyle (Bašić, 2012, p. 12-13). There are two basic types of prevention: primary and secondary prevention. Primary prevention includes a wide range of different preventive measures which are focused on the general criminological factors in every society (all aspects of socio-cultural environment) and on the most sensitive groups in the society like juveniles. Secondary prevention is more focused on the specific risk factors, and it is usually directed to those individuals that have already shown some kind of behavioural disorder due to which they are

in a greater risk to commit a criminal offence or that have already committed criminal offence (Singer, Kovčo Vukadin, Cajner Mraović, 2002, p. 359). Primary prevention programmes target the general population of juveniles and include efforts to prevent smoking, drug use and teen pregnancy. Secondary prevention programmes target youth at elevated risk for particular outcome, such as delinquency or violence, a group that might include those in disadvantaged neighbourhoods, those struggling school or those exposed to violence at home (Grenwood, 2008, p. 196).

Prevention as a practice started more than hundred years ago in medicine, first in public health (prevention of the infective disease) and later in the aspects of mental health. After that prevention was developed in other areas from social psychology, prevention of different kind of addictions (drug or alcohol abuse) and prevention of criminality. The concept of public health remains to this day one of the key theoretical and practical settings for the prevention of behaviour disorders and risky behaviour of children and juveniles and some of the basic principles that were established in this field of prevention science can also be used in other aspects of prevention, including the prevention of criminality (Bašić, 2012, p. 12-13). At first the aim of prevention programmes for juveniles was not to prevent criminality but to improve the life conditions for children from deprived neighbourhoods by addressing the health and education skills of mothers and the child's cognitive development. Only later the prevention programmes were recognized as a need for a successful prevention of juvenile delinquency (Junger-Tas, 2009, p. 140).

2. CHILD AT RISK

Prevention programmes are set to provide various forms of assistance to all young people who are willing to participate in them, but the maximum impact on future behaviour can be achieved if in those programmes participate children and juveniles that are at greater risk of developing a delinquent behaviour. That means that social-criminal preventive programmes should be concentrated on the children at risk (Singer, Kovčo Vukadin, Cajner Mraović, 2002, p. 371).

Child at risk is a term that has been in use since the 80-thies of the last century. Term “child at risk” means that there is a series of supposed causes in dynamics which places child or juvenile in danger of developing problematic behaviour in the future. It means that some specific behaviours, attitudes or defects that the child is showing during his development can be seen as initial markers for later behavioural problems. It is important to note that the term child in risk only implies that there is a probability that the child or juvenile how have some of the risk factors can become juvenile delinquents in the future or that they can have trouble in some other aspects of their life (school, work, personal relationship) but that doesn't mean that those risk factors will materialize in every single situation with every individual (Bašić, 2009, p. 36-40). What are some of the risk factors that have to be taken under a consideration in making an effective prevention policy? Studies have shown that specific family factors are the most powerful predictors of later criminal behaviour. Some of the risk factors in the child's family are: the degree of supervision (lack of supervision: too little or too much control are related to a higher rates of delinquent behaviour); the degree and nature of discipline, the emotional bond between the parents and the child, child abuse and neglect (violence in the family), alcohol or drug abuse by parents, criminality of parents or siblings, poverty, unemployment of the parents, structural family risk factors (teenage motherhood, broken home, divorce or desertion). Family is the most important part of every child's development, but for the development of criminal behaviour regarding family life, the most important thing is the quality of the interpersonal relationship between child and his parents, and this relationship has more impact on the future behaviour than family structure. Except for family there are also other risk factors that refer to

every individual. Some of the risk factors regarding the child are: impulsive and disruptive behaviour, being resistant to discipline and early aggressive and/or anti-social behaviour, sensitivity to the influence of peers, lack of social competence, use of drugs and alcohol, association with delinquents peer, running away from home, long absence from home. There are also different risk factor that can be found in child's social environment, school and local community. Risk factors regarding school are: absence from school, school failure, peer violence (bullying), dropping out of school, learning difficulties. Community risk factors are: bad neighbourhood (ghetto) which are characterised by high rates of criminality, poor overcrowded housing, gangs, arm assault, poverty, social exclusion (Bašić, 2009, p. 44-47, Junger-Tas, 2009, p. 127-134, European Economic and Social Committee Opinion on The prevention of juvenile delinquency, (2006/C 110/13), art. 2, see more: Singer, Kovčo Vukadin, Cajner Mraović, 2002, p. 167-197). Most of these risk factors are dynamic and can be readily altered. There are a lot of ongoing analyses that carefully monitor the social development of cohorts of at-risk youth beginning in infancy and early childhood so that we could understand better how these risk factors develop and interact over time (Grenwood, 2008, p. 186.). Risk factors can affect child's future behaviour but not all of them have the same impact, because some of them are more and some of them are less significant for the child's development. Most important risk factors are the ones regarding family and individual person. All children will have one or more risk factors in some point of their life while growing up, but the majority of them will not be involved in any criminal activities and will simply manage to outcome those problems with the help of their family and friends. But it is important to note that the children who have more risk factors are in more danger of developing a delinquent behaviour in the future. Risk is bigger for children who display problem behaviour in several systems, for example school and family, problem behaviour at an early age or children who show a varied pattern of problem behaviour. The accumulation of the risk factors is therefore crucial to accurate prediction of child's future behaviour, but the research have shown that if circumstances in child's life are changed radically, their behaviour will also change (Junger-Tas, 2009, p. 135). That is why it is important that preventive programmes don't focus only at one or two risk factors but they should connect different risk factors from different areas of child's life and that is why they should be aimed at specific target groups and in their development and implementation different individuals and agencies from differen parts of social community should be included (Singer, Kovčo Vukadin, Cajner Mraović, 2002, p. 370-371).

Regarding risk factors it is interesting to see the views of student what they thing who has or who can influence their behaviour. In 2011 and 2012, the study „*Youth deviance and youth violence: A European multi-agency perspective on best practices in prevention and control*“ (more information about the study can be found: <http://www.youprev.eu/>) has been conducted in six European countries (Belgium, Germany, Hungary, Portugal, Slovenia and Spain). The study collected data on prevention of youth crime and deviant behaviour, both from the perspective of adult practitioners and experts, and from adolescents because they are the target group of preventive programmes. Regarding Young People's Perception of Prevention the results of the conducted study showed that students see parents and peers as the most important sources of preventive influence on their behaviour. Compared to these everyday social network partners, the perceived potential influence of institutions and professions is limited. The police gain relatively positive rating, but youngsters view social workers, sports coaches, and especially teachers as little influential on their behaviour. Young people also think that the potential influence of school on substance abuse is very limited, but they also expressed that school has bigger influence on prevention of the violence behaviour. In all of the participating

countries results of the research showed that the majority of students had been included in some kind of substance abuse prevention programme during last year. Regarding prevention measures students from all countries think that that measures and approaches which are aimed at strengthening social integration, especially integration in the labour market, and who are addressing individual strains and problems have good preventive potential. Punitive approaches were not rejected summarily but were described as less influential. To some extent, young persons' views on prevention mirror findings from criminological research (Görge, Evenepoel, Kraus, Taefi, 2013, p. 538-541, 546).

3. INTERNATIONAL DOCUMENTS

Juvenile delinquency is a problem that all countries have and that is why prevention of juvenile delinquency is being discussed at an international level in international documents of relevant organizations, from United Nations to regional organization like Council of Europe and European Union. International organizations have recognized the importance of creating an effective preventive policy in national level and that is why in international documents we can find some of the basic principles for the development and implementation of an effective prevention programmes at national level. Riyadh Guidelines (United Nations Guidelines for the Prevention of juvenile Delinquency, UN 45/112, 1990) states that prevention of juvenile delinquency should be an essential part of crime prevention in every society because young person can develop non-criminogenic attitudes by engaging in lawful, socially useful activities and by adopting a humanistic orientation towards society and outlook on life (art. 1). Successful prevention of juvenile delinquency requires efforts from the entire society and preventive programmes that are being implemented into the national juvenile justice system should be focused on the well-being of a young person from their early childhood (art. 2-4). States should include preventive policy and programmes at all levels of political authorities (national, provincial and local governments) and in that process they should also include private sector, health, social, child-care, labour, educational and justice bodies and agencies. Successful prevention policy requires interdisciplinary cooperation, well defined responsibilities and specialized personnel at all levels of political authority and it should include different public and private bodies and agencies. All policies, programmes and strategies should be based on prognostic studies and they need to be continuously monitored and carefully evaluated in the course of their implementation (art. 9). Special emphasis should be given to preventive policies which are facilitating the successful socialization and integration of all children and juveniles, through family, community, peer groups, schools, vocational training, world of work and voluntary organizations (art. 10). Prevention should be especially focused at children and family who are affected by rapid and uneven economic, social and cultural changes in the society (indigenous, migrant and refugee families) (art. 15). Prevention programmes should provide families with the opportunities to learn more about their parental skill, obligations, child care and they should also promote positive parent child relationship (art. 16). In all countries educational system should extend particular care and attention to young persons who are at social risk and special attention should be given to comprehensive strategies for the prevention of alcohol, drug and other substance abuse by young persons (art. 25). Riyadh Guidelines also states that countries need to develop more community-based services and programmes which respond to the special needs, problems, interests and concerns of young persons and which offer appropriate counselling and guidance to young persons and their families (art. 32-33). Prevention programmes should be planned and developed on the basis of reliable scientific research and findings, and they need to be periodically monitored, evaluated and adjusted accordingly (art. 48). Participation in all of the programmes should be voluntary and young

person need to be involved in the process of their development (art. 50). States should encourage collaboration in undertaking scientific research regarding effective modalities for youth crime and juvenile delinquency prevention and the findings of such research should be widely disseminated and evaluated (art 64.).

Council of Europe has also reflected the problem of juvenile delinquency in several of its documents. Recommendation concerning new ways of dealing with juvenile delinquency and the role of juvenile justice (Rec(2003)20) notes that one of the principal goals of juvenile justice is to prevent juveniles from offending and re-offending and that in that process juvenile justice system should only be seen as one small part of a broader community based strategy that should include all aspects of society from family, school to local community and judicial system (art. 1-2). National states should invest more resources in addressing serious, violent, persistent and drug and alcohol related offending and they should also develop more appropriate and effective measures of prevention for specific target groups (ethnic minorities, juveniles, young women, children under the age of criminal responsibility) (art. 3-4). Responses to juvenile delinquency should be planned, coordinated and implemented on a local level with the participation of the police, social services, judicial, education and health system, and also agencies and bodies from the voluntary and private sector (art. 21).

Recommendation on the role of early psychosocial intervention in the prevention on criminality (Rec (2000) 20) states that preventive programmes in regards to early psychosocial intervention should include only measures that have been scientifically proven to be effective and they should particularly encourage the development of social and cognitive skills, pro-social values and attitudes in children, their strong attachment to family and encourage them to associate them self with pro social peers and adults outside their home (art. 4-6). Measures in the programmes should target possible risk factors within the primary domains of child's life; family, school, friends (peer group) and local neighbourhood. Successful implementation of preventive programmes in practice requires a good statutory solution on a national level, as well as good coordination and cooperation between different bodies from public and private sector, from relevant ministries to local partnership (art. 11-12). Prevention programmes should be based on the best interest of the child, families and society, principle of proportionality (minimum intervention), non-stigmatization, non-discrimination and they should respect the privacy and integrity of every participant (art. 13). Programmes should be well planned, co-ordinated and based on scientific knowledge of what works and all persons included should know their responsibilities (art.14). In implementation of preventive programmes countries should make use of their existing services and resources, they should include local communities, schools and families and they should construct an action plan which should include realistic targets. Countries also need to ensure adequate resources for the predicted programmes and there needs to be adequate monitoring and reviewing process so that every programme can be evaluated. Rec(2000)20 also notes that participation in all programmes should be organized on a voluntary or contractual basis and that compulsory participation should be avoided (art. 15-17).

Recommendation on Social reactions to juvenile delinquency (R (87)20) notes that countries have to take continuous efforts and actions for the prevention of juvenile delinquency and in particular: implement a comprehensive policy which promotes social integration of young people; provide special assistance and introduce various specialised programmes in schools or in others organization where young people meet for young people how are experiencing different problems in family or schools and also try to reduce opportunities for young people to commit offences by implementing different technical and situational measures (art. 1).

The European Parliament in his Resolution on juvenile delinquency, the role of women, the family and society (2007/2011(INI)) states that the EU needs to develop a European model for the protection of young people which should be based on three pillars: prevention, judicial and extra judicial measures and social reintegration and social inclusion of all young people (para. 1). The Resolution also notes that effective prevention of juvenile delinquency requires involvement from different parts of society: the State as central administration, regional and local authorities, educational institutions, the family, NGOs and especially youth NGOs, civil society and every individual. All of them need to be involved in developing and implementing an integrated national strategy which has to promote high social and civic values in the society that should be incorporated in school, social, family and educational policy on national level (para. 2-3). Prevention of juvenile delinquency requires also state intervention in different aspects of society like housing, employment, vocational training and leisure (par. 5-6). It is also important that the states provide and develop adequate support for the parents, especially to those families who have financial and social problems and to make sure that they are aware of their responsibilities for their children behaviour (para. 7-9). Regarding schools it is important that the teachers get a special training so they can learn new skills on how to manage and work with heterogeneous classes and with juveniles at risks (para. 13). In their Resolution Parliament especially stresses that mass media have also important role in modern society and that they have a big impact on the juveniles, so they should also take part in preventing juvenile delinquency by increasing public awareness on the mention problem (para. 17). Media should focus more on the promoting and informing public about positive contribution that the young people have on the society and try to avoid programmes which promote violence behaviour or use of drugs and guns (para. 30). Parliament also gave support for NGOs initiatives and international cooperation between member states in prevention of criminality and also gave support for development of pilot projects in a regional and local level which should become the base for the best national practice which should be promoted throughout Europe (para. 34). At first states need to ensure sufficient funds for preventive activities and that scientific research's can be conducted because all implemented programmes should be based on the best prevention practice and they should include innovative solution which includes multi-sector approach.

European Economic and Social Committee (EESC) in their Opinion on The prevention of juvenile delinquency (2006/C 110/13) states that EU is aware of the effects that juvenile delinquency has in every member state and that effective response to juvenile delinquency has to combine prevention, punitive-educational measures and social integration of juvenile offenders. The EESC emphasizes that EU needs to make a common strategy regarding the prevention of juvenile delinquency because if the states react on time and take adequate measures towards young people in risk (usually those are also young people how are at risk of social exclusion) that will provide their better social integration and it will also have positive impact on the prevention of the criminality in the future (para. 1.2). In order to prevent juvenile delinquency states have to implement effective preventive programmes with different types of preventive measures which need to be combine with active interventions and sanctions in the juvenile justice system. Those measures should be focused on achieving social integration of juveniles throughout family, community, peer groups, schools, vocational training and labour market (para. 2.3) The best way to combat juvenile delinquency is to prevent emergence of young offenders by implementing preventive strategies in every aspect of social life: judicial sphere, social service, local authorities, education sphere, labour market and economics in general, private and public companies (para. 3.1.1). For the success of prevention programmes there needs to be a high level of coordination and collaboration between different agencies and

different individuals and they need to focus their knowledge on the same cause, reducing juvenile delinquency (para. 7.1.4.1.).

4. PREVENTION PROGRAMMES – BASIC PRINCIPLES

In development of prevention of juvenile delinquency there have been some changes in the last 50 years. In the beginning prevention was seen as a repressive activity whose goal was to influence the citizen's through the fear of punishment. Later prevention began to be more focused on eliminating risk factors from the child's personal life and social environment in order to ensure conditions for their normal development. During these last two decades prevention is even more focused on improving the quality of life not only for children and families at risk but for the whole community (Bašić, 2009, p. 85). This means that successful prevention not only influences the lives of the individuals who are included in prevention programmes, but it also has a general good influence on the whole society, education level rises, incomes are higher, labour participation also increases and it improves physical and mental health in general (Junger-Tas, 2009, p. 137). What are some of the basic principles of an effective prevention policy and programmes? First, problem of prevention needs to become an integrated part of every youth, social and criminal policy which should be implemented at national and local level. Preventive policy needs to be systematic, well planned, coordinated and it should address the roots of the experienced difficulties in local community, especially economic inequalities and the frustration they generate. It should create better living conditions for juveniles; better education, job opportunities, better ways to spend their leisure time, which means it should be focused on positive socialization and on providing long term opportunities for juveniles in their local community and in that way it will have an impact on the whole society (Breger, 2015, p. 59). Prevention programmes have to be focused on more than one risk factors from different areas of juvenile's life which means that they primary must be focused on the children who are in greater risk of offending or reoffending (Singer, Kovčović, Vukadin, Čajner Mraović, 2002, p.

370-371). Except for children preventive programmes should include important adults from their surrounding especially their parents. Parents should always be included in prevention programme with their child because they have the biggest influence on their development and they are one of the most important elements in reducing risk factors (Görge, Evenepoel, Kraus, Taefi, 2013, p. 544-545). Research have showed that most successful community based programmes are those that emphasize family interactions and that is why many of those programmes focus in providing skills to the adults who are in best positions to supervise and train the child (Grenwood, 2008, p. 198). That is why preventive programmes should help parents develop better teaching, parenting and cognitive skills and they should try to influence their knowledge and attitudes in all aspects of social life and in that way they can help them in their task of raising a child in a troubled society (Junger-Tas, 2009, p. 138; Bašić, 2009, p. 66). Except for parents prevention programmes also need to include other important individuals and bodies. Schools should be included in the process of development and implementation of preventive policy in every society because many of the exclusion processes begin with school failure and in many cases first problems with the child are detected in school (Breger, 2012, p. 58). In the process of prevention of juvenile delinquency all other important institutions should also be involved: police, social workers, judicial system, peers, non-governmental and civil organizations, religious organizations, local government (interagency approach) because all of them have influence on juveniles lives and their behaviour. For a successful prevention there needs to be a good collaboration and coordination between all of the mentioned institutions and agencies (Bašić, 2009, p. 66; Görge, Evenepoel, Kraus, Taefi, 2013, p. 544). Prevention programmes need to be well planned and every participant needs to be exposed to enough of the

prevention measures during the program period for it to produce the desired effects (sufficient dosage). All programmes that are being implemented need to have a theoretical justification which means that they should be based on accurate information and should be supported by empirical research. Program providers need to be well trained regarding the implementation of the preventive programmes, competent, sensitive and they need to have sufficient support and supervision when implementing program in practice (Nation, Crusto, Wandersman, Kumpfer, Seybolt, Morrissey-Kane, Davino, 2003, p. 451-454). Many research have showed that early intervention with young children have considerably more effect than treatment of juvenile delinquents, which means that preventive programmes need to be implemented early enough in child's life, when criminal carreras have not yet begun, so that it could have a maximal impact on their future development and they also need to be sensitive to the developmental needs of every participant (Nation, Crusto, Wandersman, Kumpfer, Seybolt, Morrissey-Kane, Davino, 2003, p. 453; Junger-Tas, 2009, p. 136-137, Görgen, Evenepoel, Kraus, Taefi, 2013, p. 545).

Preventive programmes will be more effective if they have a positive approach which means that they should emphasize the positive opportunities and possibilities for healthy social, physical and mental development of every individual and help them make positive choices in all aspects of their life instead of just being focused on the prevention of juvenile misbehaviour (Singer, Kovčo Vukadin, Cajner Mraović, 2002, p. 372-373). For the development of a successful prevention practice it is important to invest in research and there should be enough founding for a proper implementation of the developed prevention programmes (Bašić, 2009, p. 67, 84-85). Programmes needs to have clear goals and objectives and make an effort to systematically document their results relative to the goals. Evaluation of every preventive programme is necessary so that it could be determinate if the program is effective and is there a need for intervention in the program. (Nation, Crusto, Wandersman, Kumpfer, Seybolt, Morrissey-Kane, Davino, 2003, p. 454). From the late 80-ties there have been a number of research's that have been reviewing prevention programmes and their strategies especially in the USA. All of these researches have showed that there are successful prevention programs for juveniles who can actually reduce the number of juvenile delinquents and that there are evidence that some of the effective prevention programs are more cost effective than the others (Lipsey, Howell, Kelly, Chapman, Carver, 2010, p. 11-16, Bašić, J., 2009., p. 82.) General problem with prevention programmes is that although there are more and more research from a variety of disciplines who have identified or developed an array of intervention strategies and specific program models who have been proven to be effective in reducing delinquency, cost effective and who are promoting pro-social development of juveniles these evidence based programs are still not being well implemented in practice. Many of these programs have also developed a variety of training methods and other technical assistance so that others can replicate them but the problem is that the administration and politics still do not recognize the value of these programs and that there is still not enough funding for their implementation (Grenwood, P., 2008, p. 204-206, also: Lipsey, Howell, Kelly, Chapman, Carver, 2010, p. 47-52). Prevention programmes can be effective only if these basic principles are respected in the practice because if prevention programmes are implemented with no regards to these principles, programmes will not be successful and some of them can even have an opposite effect. Some of the causes of no-effective preventive programs are: insufficient scientific base for the program which means that preventive programme has not been proven to be effective (there is not enough evidence what works and for who); poor and inadequate planning of preventive measures and mistakes in the process of implementation of the program such as: insufficient funds, not enough people for the implementation of program, not educated staff, lack of communication and coordination between agencies and individuals included in the program,

programmes are not directly focused on the causes of delinquent behaviour (risk factors for the child and families). But one of the biggest reasons why prevention is not successful is because in many cases it doesn't change the real causes of delinquency meaning economic, social and political elements of the society who are very complex and can't easily be altered because they depend on so many other elements including the current political situation in every state which is also important in creating an effective preventive policy (Bašić 2009., p. 84-85; Singer, Kovčo Vukadin, Cajner Mraović, 2002, p. 382-386)

5. GOOD PRACTIC IN EUROPEAN COUNTRIES

Prevention programmes in European countries are usually focused on young male (migrant) adolescents aged 14 to 17 years and many of the programmes are specialized in prevention of abuse of alcohol, drugs and school related violence. Preventive programmes usually involve not only children/juveniles but also their parents and many of them require the involvement of other adults like; police officers, social worker, school teachers and persons from the judicial system. In European countries there are many preventive programmes that are being implemented in practice but one of the main problems in almost all European countries is the fact that many of these preventive programmes are not being evaluated by an independent third party which means that in many cases there is not enough evidence if the programmes are effective in reducing criminality.

5.1. The Netherlands

The Good behaviour Game, a program for primary school pupils (more information about the Good behaviour Game: <http://goodbehaviorgame.org/>), and Skills for Life, a program for secondary school students, both American social competence programs, have been adopted to Dutch culture and both have been extensively tested and found effective. In Dutch in many communities, especially in deprived neighbourhoods, there are so called large schools. In 2009 there were more than 600 primary large schools and about 300 secondary large schools. In large schools after the classes are over different programs are being held in school for children and their parents. Communities have reintroduced social work in school, lengthened the school day with recreational activities, involved neighbourhood residents, introduced programmes for parents (parent training) and different social competence programmes for pupils (early education, reading and book club, cooking club, different cultural programs. Schools also collaborate with different institutions from local communities like sport organisations, leisure and cultural organizations, local library, the music school, social work and Child care organizations and the police. The main goal of this kind of programme is to extend the schools function in local community by connecting the school more with the community (children, parents and different organizations) so that there is a better social environment for children (Junger Tas, 2009, p. 142). One of the most popular prevention programmes in the Netherlands is the HALT program (more info on the HALT program: <http://www.halt.nl/en/>). HALT programme includes a unique form of settlement that is offered by the police to juvenile (under the age of 18) who is a first time offender who has committed a minor offence like theft, vandalism, graffiti, arson, truancy. If the juvenile agrees to this settlement he is obligated to fulfil a specific obligation which normally includes some kind of damage compensation and/or community service or training up to 20 hours. Once the program is successfully completed charges against juvenile are officially dismissed. HALT program is conducted by a special HALT organization which has a national network of offices and their main goal is to prevent and combat juvenile crime.

HALT program can be seen as a measure of diversion because it diverts juveniles from formal criminal proceedings and it also includes parents of the juvenile and requires their cooperation (Euwema, 2015, p. 371-372).

5.2. England and Wales

TRIAGE PROGRAM: Triage scheme is a program that is conducted by police and local Youth Offending Team (YOT) with participation of juvenile offender, his parents and in some cases the victim. Main goal of this practice is to divert young people who have committed minor criminal offence from the formal criminal proceedings. Juvenile will be included in the Triage program if he has been arrested under a suspicion that he has committed minor offence for which he has admitted guilt and if he doesn't have any previous criminal record. After juvenile is brought into custody the police officer will contact local YOT and they will send their worker in the police station, how will then work with the police and help them collect information about juvenile and his family so that they could make an inform decision is the juvenile suitable to enter the program. The YOT worker will interview the juvenile and his parents and he will gather information's about juvenile from different institution (Social service, judicial system) in order to assess and help police to make a decision about the juvenile according to his personal and family situation. If the police finds that the juvenile is suitable for the Triage program, he will then have to fulfil some obligations that are usually based on elements of restorative justice for example, he will have to write letter and apologize to the victim; he will have to participate in mediation between him and his victim; reparation to the victim or to the community. If juvenile fulfils his obligation his criminal offence will not be recorded. Some of the benefits of a Triage program are: early identification and assessment of risk of reoffending and needs of juvenile (including vulnerability); quick interventions for juvenile and the parents; victims input into interventions through a restorative justice approach; prevention of reoffending, reduction in numbers of the First Time Entrants into the criminal system; better coordination and information exchange between agencies (Accessing youth people in custody: An examination of the operation of the Triage scheme, Home Office, 2012, p. 4-16).

5.3 Austria

In Austria crime prevention is a part of the Ministry of the interior's responsibilities. In 2013 there were several ongoing projects which were organized by the Federal Criminal Agency: *Click&Check*: aim of this project is to develop responsible use of modern communication devices, mobile phone and Internet in terms of cyber bullying, dangerous political, violent and religious content, dangers connected with the chat-rooms and social networks in general. *Bleibsauber-Jugend OK* (Juveniles Keep Clean OK): this programme focuses mainly on violence, cyber crime, youth protection regulations and betting shops. The main goal of this programme is to improve collaboration and cooperation between police, parents, schools and juveniles themselves in order to generate a positive outcome regarding prevention of criminal behaviour. During this program responsible employees from school and local government are asked to give speeches to relevant target groups at events within or outside of school.

Alles Right- alles was Recht is a project that is focused on preventing juvenile delinquency and violent behaviour in general. The program is intended for juveniles in 7th and 8th grade and during the program period a prevention officer visits school and shows the pupils short video clips involving typical situations in cases of juvenile delinquent behaviour (examples of theft, robbery, vandalism and assault) while also including certain school related topics (gangs, participation in criminal offence with peers). The videos also shows the victims perspective of the situation and after they see the videos pupils are discussing the situations and expressing

their opinion about what have they seen in them (role-playing, discussion). The aim of this program is to present juveniles and explain to them what are the consequences of a criminal offence for the perpetrators and their families and for the victims. The program takes at least for lessons. Way out is a program for juveniles aged 14 to 21 who are first time offenders and who show problematic consumption of drugs or alcohol. The goal of this program is to prevent the juveniles who are having problems with addiction to commit new criminal offence and to show them that there are alternative ways to behave. The project is conducted by the police and the organization Neustar and around 100 juveniles take part in project every year. There are also different programs where juveniles are taught how to resolve their problems in a peaceful way with no violence: Aggression-training and conflict resolution for juveniles; Peer mediation or programmes that involves different aspects of social and cultural life (Ruderstaller, 2015, p. 27-39).

6. CONCLUSION

Reason why countries are interested in the problem of juvenile delinquency is the fact that although the statistic shows that juvenile delinquency in many of the European countries is stable, there is a general opinion that there are reasons for concern because the number of offences committed by children under the age of criminal responsibility is increasing and the acts committed by juveniles are becoming increasingly brutal, there are more and more 'juvenile gangs' and more violence at school, which is particularly widespread in some European countries and in some cases very difficult to investigate and deal with (Opinion of the EESC on The prevention of juvenile delinquency, 2006/C 110/13, par. 1.5). More and more juveniles are living in bad neighborhood's, many of them are included in criminal activities or are leaving school at early age or are addicted to drugs or alcohol and have little opportunities for a good life in the future. These are only some of the reasons why every state needs to tackle the problem of juvenile delinquency on time by implementing an effective preventive policy at national and local level. In regards to international document and the results of some of the researchers and the development of prevention science there are some basic principles that have to be considered in creating an effective prevention policy.

Prevention policy should be essential part of every national, criminal and social policy that has to be developed at a national level by national government (politicians) who has to be aware that the best way to prevent criminality in the future is to invest in making an effective preventive policy today and to implement evidence based preventive programmes in practice. Those preventive programmes need to be focused at the risk factors (child, family and social environment) and they should be developed in accordance with the needs of the specific target groups. In their development and implementation it is important to include different agencies, bodies and individuals from different areas of social life and they have to use their knowledge and experience to help create the best practice, programmes and measures which should be based on the specific needs of every society and its social-cultural particularities. This means that there has to be cooperation and coordination between those different bodies, agencies and individuals who are included in the process: national and local government, judicial, social, educational and health systems, private, voluntary and religious organizations. It is important that children/juveniles and their parent have the opportunity to express their opinion in creating a prevention policy because they are going to be more willing to participate in programmes that are tailored to their needs and problems. Measures in the prevention programmes need to have positive approach, they have to include not only juveniles but also their parents and they should be aimed at helping them achieve better social skill and competence (parent training, strengthening juveniles positive social skills, create better educational and job opportunities,

better ways to spend their free time) and try to influence their future behaviour, opinion and values. Countries should try to implement the programmes that have been proven to be effective in some other countries that have similar social-cultural surrounding and juvenile justice system and problems in regards to juvenile delinquency. That is why it is important that prevention programmes are based on the newest scientific researches and knowledge in prevention practice and that they are evaluated by an independent third party so that there was evidence which off the programmes work and for who. For all of this to happen first there has to be sufficient funds for the implementation of successful preventive programmes in national states and those funds have to be stable and not depended on a political situation in the country because a prevention policy is a long term investment that should not be affected by every day politics. Prevention policy also requires a good legislation solution so that all of these previously mentioned elements can be implemented in practice.

LITERATURE:

1. *Accessing youth people in custody: An examination of the operation of the Triage scheme*, (2012). Institute for Criminal Policy Research, Birkbeck, University of London, Home Office, Retrieved 15.7.2016. from https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/116265/occ106.pdf
2. Bašić, J. (2009). *Teorije prevencije: prevencija poremećaja u ponašanju i rizičnih ponašanja djece i mladih* (1st edition), Zagreb: Školska knjiga
3. Bašić, J., (2012). *Prevencija poremećaja u ponašanju u školi*, Zbornik priopćenja sa stručnih skupova pravobraniteljice za djecu “Zaštita prava i interesa djece s problemima u ponašanju, (p. 11-23). Zagreb: Pravobranitelj za djecu. Retrived 7.07.2016. from www.dijete.hr/joomdocs/Zastita_prava_i_interesa_djece_s_problema_u_ponasanju.pdf
4. Breger, D. (2015), *Keeping youth away from crime: Searching for the best European Practices, Findings from a comparative study on youth crime and early prevention strategies*, vol. 1., Belgium: International Juvenile Justice Observatory and Providus-Center for Public Policy. Retrieved 18.06.2016. from: http://providus.lv/article_files/2912/original/Volume_1_-_Findings_from_a_comparative_study.pdf?1428501057
5. Euwema, M. (2015). *The Netherlands in Keeping youth away from Crime: Searching for best European Practices*, Compendium of Ten Best European Practices, vol. 2., p. 367-412. Belgium: International Juvenile Justice Observatory and Providus-Center for Public Policy. Retrieved 18.06.2016. from: http://providus.lv/article_files/2913/original/Volume_2_-_Compendium_of_Ten_Best_European_Practices.pdf?1428501072
6. Görgen, T., Evenepoel, A., Kraus, B., Taefi, A. (2013). *Prevention of Juvenile Crime and Deviance: Adolescents' and Experts' Views in an International Perspective*. In Journal of Criminal Justice and Security, year 15., No. 4., p. 531-550. Varstoslovje. Retrieved 1.07.2016. from: http://www.fvv.um.si/rv/arhiv/2013-4/07_preventionOfJuvenileCrimeAndDeviance_2013_04_05.pdf

7. Greenwood, P. (2008). *Prevention and Intervention Programs for Juvenile Offenders*, In The Future of Children, vol. 18., No. 2., p. 185-210. Retrieved 25.06. 2016. from: http://www.futureofchildren.org/futureofchildren/publications/docs/18_02_09.pdf
8. *HALT Programme*, Retrieved 15.07.2016. from: <http://www.halt.nl/en/>
9. Horvatić, Ž., Cvitanović, L. (1999). *Politika suzbijanja kriminaliteta*. (1st edition). Zagreb: Ministarstvo unutarnjih poslova Republike Hrvatske
10. Junger-Tas, J. (2009). *The Prevention of Delinquent Behaviour*, In Junger-Tas, J., Dunkel, F. (ed.). *Reforming Juvenile Justice* (1st edition). p. 125-145. Springer Dordrecht Heidelberg London New York: Springer
11. Juvenile delinquency, the role of women, the family and the society, (2007), *European Parliament resolution of 21 June 2007 on juvenile delinquency, the role of women, the family and the society* (2007/2011 (INI)), p. 11. Retrieved 11.06.2016. from: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2007-0283+0+DOC+XML+V0//EN>
12. Lipsey, M., Howell, J., Kelly, M., Chapman, G., Carver, D. (2010). *Improving the Effectiveness of Juvenile Justice Programs: A New Perspective on Evidence-Based Practice*, Washington: Center for Juvenile Justice Reform. Retrieved 15.07.2016. from: http://njjn.org/uploads/digital-library/CJJR_Lipsey_Improving-Effectiveness-of-Juvenile-Justice_2010.pdf
13. Nation, M., Crusto, C., Wandersman, A., Kumpfer, K., Seybolt, D., Morrissey-Kane, E., Davino, K. (2003). *What Works in Prevention: Principles of Effective Prevention Programs*. In *American Psychologist*, June/July 2003. p. 449-456. Retrieved in http://www.ncdsv.org/images/AmPsy_WhatWorksInPrevention_6-7-2003.pdf
14. Opinion of the European Economic and Social Committee on The prevention of juvenile delinquency, Ways of dealing with juvenile delinquency and the role of the juvenile justice system in the European Union. (2006). Official Journal of the European Union, 2006/C 110/13. p. 7. Retrieved 25.06.2016. from: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52006IE0414>
15. Recommendation No R(87)20. (1987). Recommendation No R (87) 20 of the Committee of Ministers to member states on social reaction to juvenile delinquency, Adopted by the Committee of Ministers on 17 September 1987. Council of Europe. p. 4. Retrieved 25.06.2016. from: [http://www.coe.int/t/dghl/standardsetting/cdpc/CDPC%20documents/CDPC%20\(2013\)%207%20Compilation%20of%20the%20different%20legal%20instrument%20related%20on%20justice%20for%20children%20and%20juvenile%20delinquency.pdf](http://www.coe.int/t/dghl/standardsetting/cdpc/CDPC%20documents/CDPC%20(2013)%207%20Compilation%20of%20the%20different%20legal%20instrument%20related%20on%20justice%20for%20children%20and%20juvenile%20delinquency.pdf)
16. Recommendation Rec 2000(20). (2000). Recommendation Rec (2000)20 of the Committee of Ministers on the role of early psychosocial intervention in the prevention of criminality, Adopted by the Committee of Ministers on 6 October 2000. Council of Europe. p. 7. Retrieved 25.06.2016. from: [http://www.coe.int/t/dghl/standardsetting/cdpc/CDPC%20documents/CDPC%20\(2013\)%207%20Compilation%20of%20the%20different%20legal%20instrument%20related%20on%20justice%20for%20children%20and%20juvenile%20delinquency.pdf](http://www.coe.int/t/dghl/standardsetting/cdpc/CDPC%20documents/CDPC%20(2013)%207%20Compilation%20of%20the%20different%20legal%20instrument%20related%20on%20justice%20for%20children%20and%20juvenile%20delinquency.pdf)

17. Riyadh Guidelines (1990). United Nations Guidelines for the Prevention of Juvenile Delinquency, Adopted and proclaimed by General Assembly resolution 45/112, 14 December 1990. Retrieved 18.06.2016. from:
<http://www.un.org/documents/ga/res/45/a45r112.htm>
18. Ruderstaller, J., (2015). *Austria*. In Keeping youth away from Crime: Searching for best European Practices, Compendium of Ten Best European Practices, vol. 2. p. 4-94. Belgium: International Juvenile Justice Observatory and Providus-Center for Public Policy. Retrieved 18.06.2016. from:
http://providus.lv/article_files/2913/original/Volume_2_-_Compendium_of_Ten_Best_European_Practices.pdf?1428501072
19. Singer, M., Kovčo Vukadin, I., Cajner Mraović, I., (2002). *Kriminologija*, (3rd edition). Zagreb: Nakladni zavod Globus

PECULIARITIES OF THE FORWARDING CONTRACT

Ratko Brnabic

*Faculty of Law in Split, Croatia
rbrnabic@pravst.hr*

Mario Ivancev

*Faculty of Law in Split / Zagreb, Doctoral researcher,
Croatia mario.ivancev@gmail.com*

ABSTRACT

Business of forwarding is a specialized economic activity connected with transport of goods. It should provide better and more professional protection of interests of its customers. Legal relations and international traffic are becoming more and more complex as it is not reasonable to suppose that the users of transport can deal with the mentioned challenges alone. That is why they use the services of professionals. On the other hand, the process of integration of different means of transport may lead to subordinate economic position of the customers so we need a person who has special knowledge and experience in this area: a forwarding agent. The forwarding agent has a better position towards the carriers since he disposes with large quantities of cargo and can negotiate lower prices of transport and other connected services. The user of this service alone does not have such negotiation power. These advantages are expressed not only in cheaper transport, but often in a faster and safer form of transport for cargo customers. It becomes clear that economic benefits lead to the more frequent engagement of forwarding agents. Services of forwarding agents are extremely diverse and heterogeneous at first glance, but ultimately they represent a unity of interests of users in the field of transport. Forwarding agent primarily protects the economic and legal interests of the customers and employs the methods and means of transport that are the best and of the highest quality. The basic purpose of the forwarding contract is the organization of transportation and not a direct implementation of particular services during its realization. For the purpose of carrying out certain services and forwarding agent enters into contracts with a number of specialized organizations. In the first instance it is a contract of carriage with a carrier, but it can be a number of other contracts with other forwarding agents, contract of storage, contracts with brokers, control of cargo, insurance etc. In principle, forwarding agent must perform these tasks with the care of an expert / professional as it is the case of the enhanced professional liability. Forwarding agent could sometimes ignore the interests of his customer and therefore the Law provide for special conditions to be met by forwarding agent to be able to operate. The aim of this article is to explain legal positions of all the parties and to provide answers about some open issues on liability of the forwarding agents.

Keywords: *Forwarding contract, Duties and liabilities of the Parties, Carriage of Goods.*

1. INTRODUCTION

Contract of forwarding consists of forwarding agent's obligations to arrange shipment or delivery of things (goods). In wider circles the term of the contract of forwarding often creates an idea of the contract of carriage. Although the contract of carriage is concluded for the purpose of performing the forwarding, they are two different contracts.

Forwarding is an activity carried out in connection with the sale of goods. Therefore, this activity began to develop in parallel with the development of trade. Commodity-money exchange in the early stages of development has not been suitable for the development of

forwarding activities. Only with the development of transport activities in the trade, there arised a greater need for performing forwarding activities, because the forwarding agent engaged between sellers, the carrier and the customer. This was necessary especially with the development of international trade, which began to carry out through international carriers. Today's international trade is carried out through international carriers, but international forwarding agents are the ones who organize that transport. It is observed that transport over 90% of goods in international trade of countries of all continents is organized by international forwarding agents (Bukljaš, Vizner, p. 2448).

Determining the legal concept of forwarding (freight forwarding) necessarily requires an explanation of the economic importance of this institution. Today, the forwarding is referred as a separate economic activity without one can not be imagined the effective functioning of the traffic of goods, as an important part of the economy of each country. Forwarding is a professional and highly specialized activity, which is, otherwise, an increasingly frequent feature of the large number of agreements covering trade of goods. On the basis of such specialization lies, on the one hand, the needs of users of transport to protect their interests in the best possible way, primarily with professional and efficient performance of activities of transportation and their previous organization and income generation. Forwarding has in terms of values, a subjective and an objective component. Subjective value stems from the interests of the parties - the customer and forwarding agents, while the objective is manifested in a real contribution of forwarding to the development and performance of the traffic of goods in each country, and beyond that, in the development and functioning of the economy in general. In this sense, the economic starting point, forwarding and transportation are perceived as a single economic activity, which is an intermediary function indispensable in every socio-economic system (Perović, Stojanović, p. 661).

In complex modern conditions of business transport and forwarding, or their legal terms - a contract of carriage and contract of forwarding (shipping(/ despatch) are even more important. The relations in the modern international trade of goods put more and more complex demands in front of forwarding agents, as the organizers of the transport, and that is why is expected of them to be highly trained and to have specialized skills. Therefore, professional activities related to transport more rarely perform carriers or users of transport, because the better solution is to hire professionals. On the other hand, strict market conditions and the increasing need for professionalism and specialization, have resulted in the creation of large and economically powerful forwarding organization, their business cooperations and connectivity, normative regulation of business conditions and other actions aimed at maximum development of benefits from forwarding agent's work. Because of these multiple advantages, which brings forwarding activities, and which have the ultimate goal of the realization of the corresponding economic impact for the customer, it is not valid the conclusion that this was a legal transaction which is the only intermediate-legal nature. At first glance, a variety of services of forwarding agents are based on the unity of the interests of transport users in the trade of goods. On the other hand, essentially protecting the economic and legal interests of the customer, forwarding agent selects and hires the best and highest quality carriers, or choose a form of transport that best suits the specific needs of the customer.

In comparative law and jurisprudence there is no consensus on the legal nature of the contract of forwarding, which is not without significance in the international forwarding, due to the possible application of a foreign law on the contract. Three basic systems of legal regulation of the contract of forwarding are the Anglo-Saxon, French and German system. The above mentioned systems cover practically all countries of the world. In the Anglo-American system Shipper is forwarding agent, which means that he is a representative who is acting on his behalf;

but for customer's account (unnamed principal). In the Anglo-Saxon system the contract of forwarding is taken as a special agent/broker work. In institute *agency* in common law an agent shall act in two ways: as an agent on behalf of others and for an account of others, and also as a commission agent in its own name and on behalf of others (Glass, p.17). States of Anglo - Saxon system find shippers as a kind of agent who operates in the name and for the account of the customer, while the state which applies the French system, contract of forwarding consider as the type of contract on commission or transportation commission. This system is derived from the early 19th century, a time when he passed the French Code de Commerce. The similarity between these two jobs in in it that the commission agent and forwarding agent conclude transactions in their own name and on behalf of the customer. The difference between an ordinary commission work and transport of the goods is that in the first contract an object of the obligation is concluding contract of sale and purchase of goods, and in the second is carriage of goods (organizing the shipment or delivery of goods). This system also includes the Swiss system, because the provision of the contract shipping under this title is classified under the commission agreement. It is evident that the French system does not sufficiently differentiate the concept of the term commissioners and forwarding agents. According to the German system, it is a separate work, in which forwarding agent acts on his behalf and on behalf of the customer (Buecker, Wendler, p. 225).

In the Croatian law contract of forwarding is a named contract whose qualification does not depend on whether an agent appears in its own name or in the name of the customer, but it is important to do so for the account of the customer. The items and contents of contracts concluded with third parties and the actions carried out have a meaning of the organization of transport, and not directly the realization of certain services. Of course, the forwarding agent can for the customer and by himself perform certain services in connection with transport, under certain conditions, but then his responsibility for services performed is judged according to the rules which apply to these contracts (for transport - the legal provisions of the contract of carriage, the provisions on storage on storage, for services that fall under the contract - the relevant provisions of that contract, etc.). In addition to being named, contract of forwarding is two-sided mandatory, always billing, consensual and informal because it does not require a written form for their validity.

However, in business practice contract of forwarding regularly is made by the customer's filling in a special form called dispositions. This pattern prepares forwarding agent because he wants to get as much data as he needs for his services, which are usually standardized. Each party has the right to demand that the contract of forwarding is concluded in written form. It will be necessary in the case of an international agreement for a number of necessary and prescribed actions carried out on the basis of written documents. Since the written statements orally concluded contract of forwarding should be distinguished from shipping certificates, which have a specific function, especially in establishing relations between the customer and their contracting party (Gorenc, p. 1258.-1259.). In the following work will be discussed on the essential features of the contract.

2. KEY FEATURES OF THE FORWARDING CONTRACT

A forwarding agent shall be obliged, under the contract of forwarding, to enter into a contract of carriage of goods in his own name and on behalf of the consignor, for the purpose of organizing a carriage, and into other contracts required in order to perform carriage of goods, as well as to perform other common activities and tasks. The consignor shall undertake to pay a certain remuneration to the forwarding agent. If they are provided by the contract, the

forwarding agent may also conclude the contract of carriage of goods and perform other legal transactions in the name and on behalf of the consignor (Busch, p. 36)

The contract has a great economic importance for a number of functions performed by forwarding agents. These functions are the major and minor, but they are carried out in interconnection and in general keep the scope of economic significance. Forwarding agent takes goods from the consignor, and that is usually the seller. He gives the consignor the instructions on the package if things are not or not sufficiently and properly packaged. If necessary, the agreement performs packaging or repackaging. This is the initial help to the consignor by forwarding agent. Forwarding agent knows and must know the way and the most economical mode of transport. It is required to consider not only transportation costs, but also the safety of transport given the distance and type of transport and means of transport, seasons, climate zones, type of goods and other circumstances. If they are destined for bulk items, forwarding agent will collect items from multiple consignors and make a collective forwarding (shipment), so that they can be dispatched in the wagonload, which is cheaper. In the carriage of cargo by sea it is not unusual to get a ship with a larger ship space than is required for the transport of goods aimed to be dispatched. If the cargo transport is with a partially filled of taken space in ship, the one who took that space must pay part of ship, which is not completed (ie. dead freight). In organizing international shipping it is often necessary that the goods are stored in a customs warehouse or customs of a location. Forwarding agent will be there to act appropriately. The forwarding agent in the international (freight) forwarding facilitates consignors actions that they need to take in connection with customs clearance of goods. He performs professionally and in a shorter time (Bugden, Lamont-Black, p. 37). When organizing shipping of things, forwarding agent concludes contracts with participants in the shipment. These are the carriers, inter-forwarders, insurers, warehousemen and others. He is obliged to pay attention to their solidity in a business, with respect to their choice. And that work will be successfully done than it would be done by consignor. When organizing a shipment there are emerging various expenses. They are usually advanced by the forwarding agent and on that way he also credits the customer, thus it facilitates the tasks of sending goods.

Forwarding agent undertakes, for the transport of certain things in his own name and for the account of the customer, to conclude the contract of carriage and other contracts necessary for the execution of this transport to be carried out, and all the other usual tasks and activities, for a fee. It shouldn't be understood that this contract will state all contracts and other agreements concluded by forwarding agent. It is not necessary to state all the other work he is obliged to do. Assembling all these contracts and jobs is one of the complex tasks that the forwarding agent is obliged to take, in order to achieve the purpose of the contract of forwarding. The purpose of it is to certain things or goods transport in a certain place and deliver to a particular person (the recipient). Forwarding agent is obliged to know what contracts for this purpose is necessary to conclude and what other operations needs to be carried out and that these are concluded and performed with professional care. Therefore, it is often abbreviated say the forwarding agent is obliged to organize the shipping and delivery of certain goods. Shipping and delivery consists of complex tasks requiring organization, particularly in international shipping, so it is usually not possible to specify individually in advance all the operations that would take part in every contract.

In forwarding, with forwarding agent who regularly is a trader, also appears customer (principal or customer) as the counterparty. Both terms are widely used in our country although is more often used the term "customer". A similar term is used in most of the other countries, in particular in order to point to the contracting party for whose account forwarding agent operates, although the contracts concludes in his own name. So, the term "customer" is more common in

commission business, while the term "principal" is spreading because it appears in a variety of other commercial activities. On the basis of the contract of forwarding, forwarding agent assumes the obligation to, because of the work of transport certain things, concludes in his own name and for the account of a customer contract(s) of carriage and other necessary agreements and to perform other common tasks and actions (Hoeks, p. 56). It is important that the forwarding agent under this contract undertakes to provide appropriate professional customer service, which allows protecting the interests of the customer in achieving his interests in relation to transport things. These include jobs of shipment and delivery of goods, contracts of carriage, shipment of goods to the means of transport and vice versa, issuing or obtaining waybills, etc., conclusion of insurance contracts and storage of goods, actions related to customs clearance of goods and control of charging the cost of transportation. Pursuant to the contract of carriage, the customer is obliged to pay the carrier a fee (Blagojević, Krulj, p. 1799).

The contract of forwarding is an informal agreement because it can be concluded and verbally, ie. in any way. Contract of forwarding can be concluded not only verbal, telephone, telegraph, teletype, written and direct by radio but also tacitly. Contract of forwarding is concluded tacitly when forwarding agent receives the goods with the indicated address of the recipient. It should be added that in the general terms and conditions forwarding agents usually stipulate that the contract of forwarding is concluded in written form. Either party may request that the contract is made in written form and it will usually be necessary when it comes to international shipping due to a number of necessary and prescribed actions that are commonly performed on the basis of a written document in which the contract of forwarding (Schramm, p. 23). Jobs of international forwarding are very complex and complicated. If the contract is not concluded in written form, the customer may require that the forwarder issue a certificate confirming the receipt of things. Trade confirmation is often used as a document in the collection of documentary credit (Bukljaš, Vizner, p. 2452). If the statement of a forwarding agent terminates the contract, the customer has the right to charge all the damage that has been caused by both. When the customer cancels the contract, the forwarding agent is entitled to compensation or commission in the part corresponding to the extent of his previous work. Of particular importance is the application of the principle of proportionate forwarder fee.

Loss of confidence in the forwarding agent should not be a general reason for withdrawal from the contract of forwarding, but is primarily due to the economic interests of the customer, it is necessary that such a possibility exists for a particular case. Namely, when the customer voluntarily withdraw from the contract, the forwarding agent shall be entitled to appropriate compensation for his work until then, as well as reimbursement of expenses incurred up to the time of cancellation. In this case, the cost of forwarding agent are considered to be those costs which, based on business practices and policies for forwarding profession, do not constitute part of its overheads and are included in the commission or fee. These are costs which were necessary and useful for the customer, as well as all damages that the forwarding agent, because of customers withdrawal from the contract, had to pay to third parties, such as, part of the compensation to the carrier, unpaid fees, costs related to the termination of certain contracts and so on. If the forwarding agent, in order to meet its contractual obligations under the contract of forwarding, takes a larger number of significant actions and concluded appropriate contracts, these costs can be extremely high (Perović, Stojanović, p. 667).

The forwarding agent is entitled, by the circumstances of the case, require the payment of a proportional amount of fees and the amount of commission is determined by the price list of forwarding or it will be determined based on business practices. The customer is not required to specify an important reason for the cancellation. He is not obliged to explain the reasons for the withdrawal, nor the forwarding agent is entitled to demand it from him even though it affects

the future relationship between these entities. Requirements from forwarding agent for reimbursement and the proportional part of the commission when the customer by his own will withdraw from the contract of forwarding, provided statutory lien to forwarder. Security by statutory lien of this article provides to forwarding agent is relative, because that right is there until the forwarding agent keeps goods/ things in possession. In fact, while forwarding agent keeps goods/ things with him, he has not fulfilled the obligation, but that is why also he does not have the claim, and when given to a carrier to transport, he loses a lien on given goods because it no longer holds them (Gorenc, p. 1282).

3. RIGHTS AND OBLIGATIONS OF THE CONTRACTING PARTIES

The contracting parties of this contract have rights and obligations. The forwarding agent is required to alert the customer to the shortcomings of orders and packaging. It must safeguard the interests of the customer and act according to his instructions. Furthermore, the forwarding agent is responsible to customer for another person who he hired. Forwarding agent shall carry out all formalities and pay customs duties on behalf of the customer. He will perform the transport, possibly also provide insurance and shall give an bill to the customer (Eftestol-Wilhelmsson, p. 24). On the other hand, the customer is obliged to pay compensation, costs and down payment. Also, the customer must allow the forwarding agent to reserve the right to charge him and even in a case when the contract stipulates that the forwarding agent will charge its costs of recipients of things. Also, the customer shall notify the forwarding agent of the characteristics of things that may threaten the safety of persons or goods, or that may cause damage. When valuables, securities or other expensive things are contained in the shipment, the customer shall notify the forwarding agent thereof and communicate their value at the time of presentation for shipment.

3.1. Legal position of the forwarding agent

As already mentioned, the forwarding agent is obliged to warn the customer on deficiencies in his order, especially to those who exhibit higher costs or damage. The offer for the conclusion of a forwarding contract makes customer, which forwarding agent should explicitly refuse if it does not want to conclude the contract. Persons who as a profession perform other people's orders are obliged to, if they do not want to accept the offer or order relating to these activities, shall immediately notify the other party, otherwise it would be responsible for the damage that customer would therefore suffer. Customer's order is in business practice usually in the form of so-called form disposition, in which the forwarding agent preventively influence to avoid incomplete customers orders. Forwarding agent is an expert in the affairs of shipping and can observe defects in customer's order. Defects can be in mode of indication times that goods should be sent, place, and manner of transshipment or reloading from one to another means of transport, etc. Forwarding agent, acting with the diligence of a good businessman must in due course draw attention to ordering party on the shortcomings in the order, if these deficiencies can cause more costs or major damage to the customer. This warning has significance only in cases where there are any major omissions and major damage, and does not apply to liability of shipping companies to lower the damage that the customer suffers because it is not advised of the deficiencies in the order. The customer can change his order in accordance with customer's instructions, and can insist on the fulfillment of the task regardless of forwarding agent's warning. The forwarding agent is considered as the only expert on all issues related to the transport of goods while the customer not. It is considered that the forwarding agent is doing business with necessary care if alerts customer, not only on the tasks on which there was a

conclusion of the agreement on forwarding, but also on any possible anomalies in subsequent instructions. Otherwise it is liable for the damage.

Furthermore, the forwarding agent is obliged to warn the customer on deficiencies in the packaging. This provision has discretionary nature which means it will apply unless otherwise is agreed. In business practice, particularly at longer mutual business relations between forwarding agent and the customer, business cooperation between them realizes even before the conclusion of the forwarding contract or after the conclusion of the contract and before handing things to the carrier for shipment. Given the fact that the forwarding agent is specialized and professional businessman for all questions relating to transport of goods he is bound by the rules of the profession expert to assess whether the well-packaged goods and packaging allows safe and economical transportation. On the contrary, with a customer is exactly the opposite assumption in terms of expertise, i.e. that he is not an expert in these issues because it would not conclude contract of forwarding, ie. it would not hire appropriate professional services in order to protect their interests. All this makes the mentioned obligations of forwarding agents in connection with the packaging. If that fails to comply, the forwarding agent did not act as careful businessmen and then the forwarding agent shall compensate the damage caused by his failure to warn the customer (Lukšić, p. 117.). After the forwarding agent instructed the customer about the absence in the packaging or on the lack of preparation in terms of goods to transport, it is expected that the customer should on its own remove such deficiencies. If the customer fails to do so after the forwarding agent on due course warned him of this, forwarding agent is not liable for damages that may therefore occur. A special case is when there is not enough time for disposal, and when in the specific situation forwarding agent can not wait for the customer to remove specified shortcomings because otherwise it will be caused even greater damage. The forwarding agent is then obliged to remove the shortcomings. If because of remedying defects on the packaging damage has been caused due to the delay, the forwarding agent is not liable for damage because the damage was not caused by forwarding agent than the customer, while the actions of forwarding were taken to protect the interests of the customer (Blagojević; Krulj, p. 1805) .

The shipper shall immediately notify the consignor of the damage inflicted on the thing and of all the circumstances significant for the consignor, and shall take all the measures necessary for the protection of his rights in relation to the responsible person. The things during shipment can be damaged by a variety of causes, for example, by forwarding agent workers, carriers, accidentally or any other cause, by no one's fault or someone else's fault. In any case the customer is interested to be informed without delay. It would not be enough to forwarding agent just to alert the customer about the fact that thing is damaged. Due care requires the the forwarding agent to notify the customer of all the facts that can to the ordering party present the type and size of the damage, its causes, the possibility of repairing the damage and prevent further damage, whether it is undertaken for this purpose, insurance information fact, if there are means of proof the facts on which the customer may pursue a claim for damages and other facts that are the principal necessary to protect its interest. Informing the customer of all the events that are important to him. For the customer the significant events are the ones which have property and business character. Forwarding agent, for example, is obliged to inform the customer if he could not get at the time a means of transportation for shipping items, if he got a larger capacity for transport than is required for the transport of goods and so on. When the measures to be duly and timely taken to preserve the customer's rights to the responsible person can not be taken by the customer, and may by forwarding agent, the forwarding agent is obliged to take them. However, there are no regulations on what the facts regarding the shortcomings of things forwarding agent shall establish (Bukljaš; Vizner, p. 2459).

The shipper shall follow the instructions concerning the route, means and method of transport and other instructions issued by the consignor. If it is not possible to act in accordance with the instructions contained in the order, the shipper shall ask for new instructions, and in the case of lack of time or possibility, the shipper shall act in the best interest of the consignor. The shipper shall immediately notify the consignor of any departure from the order. If the consignor has failed to determine the route or means or method of transport, they shall be determined by the shipper and the best interest of the consignor and the given circumstances. If the shipper has failed to follow the given instructions, he shall also be liable for the damage caused by force majeure, unless it is proved that the damage would have occurred even Wednesday if he had followed the instructions. The shipper shall be responsible for the selection of the carrier and for the selection of other persons with whom he entered into contract (storage of goods, etc.) and executing the order, but shall not be liable for their work, unless this is stipulated and the contract. The shipper who, instead of executing the order himself, has entrusted the execution to another shipper shall be liable for his work (Clarke, p. 24). If the order contains explicit or tacit authorization for a shipper to entrust the execution of the order to another shipper, or if this is evidently in the consignor's interest, the shipper shall be liable only for the selection, unless he has agreed to take responsibility for another shipper's work. Also, unless otherwise stipulated in the contract, the order for shipment of the thing across the border shall contain the responsibility of the shipper for carrying out of the required customs procedures and payment of customs duties and charges are for the account of the consignor. Although shipper performs customs and other actions in its own name and on behalf of the principal, the principal shall not be relieved of the obligation to Shipper give complete and accurate information on which will perform dispatcher customs operations. If the data is incomplete or incorrect, so based on these shipper can not perform customs operations, the shipper is obliged to ask the customer to Supplement data or documents. The shipper may also perform fully or partly and the carriage of goods whose shipment was entrusted to him, unless otherwise agreed. If the shipper has performed carriage or a part of the carriage, he shall have rights and obligations of the carrier. In that case, he shall be entitled to an appropriate remuneration for carriage, in addition to remuneration for shipment and a reimbursement of shipping costs. After the completion of work, the shipper shall render the account to the consignor. At the consignor's request, the shipper shall render the account in the course of the execution of order as well.

3.2. Legal position of the customer

On the other hand, the customer's primary obligation is the payment of compensation. Customer shall remunerate the forwarding agent as agreed in the contract and if this has not been agreed in the contract, in accordance with the tariff or another by-law, or in the absence of these, as decided by the court. Contract of forwarding can be assembled without determining fees, but in this case forwarding agent is entitled to benefits under the law. Forwarding agent usually before concluding the contract gives the principal quotation in which is included the amount of the fee. Quote is necessary to the customer for price calculation, if yet he did not sign a contract for the sale of goods, but it intends to conclude. In the next stage the seller concludes with the customer contract of sale and with the forwarding agent a contract of forwarding. Contract of forwarding, usually, includes the amount of compensation. If the forwarding agent's amount of compensation is determined by the tariff or some other general act, and that was known to the customer, then the customer has accepted the amount of compensation that is so designated. It is not necessary that the amount of compensation, determined by forwarding agent's tariff or some other general act that, was known to the customer. Customer shall pay a fee to forwarding agent so if it was not determined otherwise. If remuneration is not fixed by tariff or other

regulations, it is determined by the court (a common fee). In doing so, the rules of the trade representation apply. At the request of the customer, the court may reduce the amount of compensation, if it is disproportionately high in relation to the committed service dispatch.

The consignor shall reimburse the necessary costs to the shippers, which have been incurred in executing the order for shipment of goods. The shipper may request reimbursement of costs as soon as they have been incurred. The consignor shall, at the shipper's request, make advance payments to the shipper for costs arising from executing the order (Grabovac, p. 75). The consignor shall reimburse the necessary costs to the shippers, which have been incurred in executing the order for shipment of goods. The shipper may request reimbursement of costs as soon as they have been incurred. The consignor shall, at the shipper's request, make advance payments to the shipper for costs arising from executing the order. If it is agreed that the shipper will collect his claims from the consignee, the shipper shall retain the right to demand the reimbursement from the consignor, if the consignee has failed to make payment. Also, the consignor shall notify the shipper of the characteristics of things that may threaten the safety of persons or goods, or that may cause damage. When valuables, securities or other expensive things are contained in the shipment, the consignor shall notify the shipper and communicate their value at the time of presentation for shipment. Dangerous things are things explosive, gases, things in contact with water emit flammable gases, things that can be ignited by themselves, flammable liquids, flammable solid things, things that cause burning (oxidizing), toxic stuff, radioactive items, caustic stuff, infectious things, organic peroxides. The customer shall inform the forwarding agent about the properties of things which can compromise the safety of persons or goods or harmed. In addition to the duty of notification the forwarding agent, the customer is required to properly pack the dangerous stuff, load and unload in the prescribed manner before submitting to forwarding agent. Containers and means of transport must be specially marked. Forwarding agent shall comply with regulations on packaging and delivery on transport, and if himself perform the transportation, he must comply with regulations on transport. Forwarding agent who gives a dangerous thing to transport shall issue a document on the transport and guidance on specific security measures that are in the transport of dangerous things must be taken, and submit them to the carrier. The contracting parties due to a leak in the shipment of dangerous things can have criminal liability (Perović, Stojanović., p. 687).

4. CONCLUSION

A forwarding agent shall be obliged, under the contract of forwarding, to enter into a contract of carriage of goods in his own name and on behalf of the customer, for the purpose of organizing a carriage, and into other contracts required in order to perform carriage of goods, as well as to perform other common activities and tasks. The customer shall undertake to pay a certain remuneration to the forwarding agent.

Forwarding agent is, therefore, a kind of commissioner, so on this contract are properly applying the rules of the contract of the commission, unless otherwise is specified. Forwarding agent is obliged to inform the customer on the defects in his order, as well as deficiencies in the packaging of goods. If waiting for the customer to correct the deficiencies in the packaging would be detrimental to the customer, then forwarding agent himself shall remove them for the account of customer. Forwarding agent must act according to the instructions with regard to the customer direction of the road, means and modes of transport. If the customer has not given these instructions forwarding agent will specify them in his interest. This is especially refers on the road transport of goods, which is required to determine the forwarding agent before handing over the goods to the carrier, if in his order did not specified

customer. If the forwarding agent deviated from the instructions received, he is responsible for damages caused due to force majeure, unless it is proved that the damage would occur and with the guidance provided. The order for forwarding across the border has an obligation to forwarding agent to conduct all the necessary formalities and payments of custom obligations for the account of customer.

The forwarding agent is required to insure the goods only if it is contracted. Unless otherwise specified goods must be ensured by the usual transport risks. Forwarding agent is obliged to act in the interests of the customer with an attention of a good businessman. For any damage that occurs to the goods or in connection with it from the moment of receiving the task to his execution, he generally responds according to the principle of guilt, as his own, but also for the people that he are in his business uses. The forwarding agent is not, however, responsible for incorrect customs charges, freight charges and other charges, but is obliged to carry out control and about possible irregularities inform the principal and ask for his further instructions.

The forwarding agent is responsible for the selection of carrier and for the selection of other persons with whom for the execution of orders he entered into an agreement (the storekeeper, etc.), But is not responsible for their work, unless the liability is assumed by contract. If he entrusts the execution of orders to another forwarding agent (forwarding sub-agent) will be responsible and for a work of that agent.

When forwarding agent perform his contractual obligations, the customer is obliged to pay the agreed, usual, or by the court defined fee. This duty is charged to customer and when it is agreed that the compensation will be paid by the recipient, and this is deducted to pay off. The forwarding agent shall also be entitled to a remuneration which is filed to enforce forwarding. He may claim reimbursement of expenses immediately when they are done, and may ask the customer an advance payment for them.

In order to secure his claims that might arise in connection with the contract of forwarding, forwarding agent has a lien on the things committed to shipping, as long as he holds them in his hands, or while is in the hands of a document by means of which can dispose of them.

LITERATURE:

1. Blagojević, B., Krulj, P. (1983). Komentar Zakona o obligacionim odnosima. 2nd Book. 2nd Edition. Beograd: Savremena administracija.
2. Buecker, J., Wendler, M., Tremml, B.(2008). Key Aspects of German Business Law: A Practical Manual. 4th Edition. Berlin: Springer.
3. Bugden, P., Lamont-Black, S.(2013). Goods in Transit and Freight Forwarding. 3rd Edition. London: Sweet & Maxwell .
4. Bukljaš, I., Vizner, B. (1979). Komentar Zakona o obveznim (obligacionim) odnosima. 4th Book. Zagreb, Rijeka: Riječka tiskara.
5. Busch, D. (2005). Indirect representation in European contract Law: An Evaluation of Articles 3:301-304 of the Principles of European Contract Law Concerning Some Contractual Aspects of Indirect Representation Against the Background of Dutch, German and English Law.The Hague: Kluwer Law International.
6. Clarke, M. (2014). International Carriage of Goods by Road: CMR. 6th Edition. New York: Routledge.
7. Eftestøl-Wilhelmsson, E. (2015). European Sustainable Carriage of Goods: The Role of Contract Law. New York: Routledge.

8. Glass, D. (2012). Freight Forwarding and Multimodal Transport Contracts. 2nd Edition. New York: Routledge.
9. Gorenc, V.(2005). Komentar Zakona o obveznim odnosima. Zagreb:RRiF.
10. Grabovac, I.(1995). Hrvatsko pomorsko pravo i međunarodne konvencije. Split: Književni krug.
11. Hoeks, M.(2010). Multimodal Transport Law: The Law Applicable to the Multimodal Contract for the Carriage of Goods. The Hague: Kluwer Law International.
12. Lukšić, B.(2001). Trgovačko pravo. 2nd Edition. Split: Veleučilište u Splitu.
13. Perović, S., Stojanović, D. (1980). Komentar Zakona o obligacionim odnosima. 2nd Book. Gornji Milanovac: Kulturni centar.
14. Schramm, H.J. (2012). Freight Forwarder's Intermediary Role in Multimodal Transport Chains: A Social Network Approach. Berlin: Springer.

THE RELATION OF HUMAN RIGHTS AND MARKET FREEDOMS IN CJEU CASE LAW

Tunjica Petrasevic

*Josip Juraj Strossmayer University of Osijek, Faculty of Law, Croatia
tpetrase@pravos.hr*

ABSTRACT

The aim of this paper is to analyse human rights standards in the case law of the Court of Justice of the EU (hereinafter: CJEU) in relation to market freedoms. It is interesting to track the development of human rights in the EU: from utter sidelining of human rights to its own Charter of Fundamental Rights. This paper is divided into four parts. The first part reviews in short the historical background of Human Rights in the EU and explains the importance of the CJEU in the human rights development in the EU. The second part presents the idea of accession of the EU to the European Convention of Human Rights and also briefly addresses the question of whether the EU should access the Convention at all; intriguing at that and one that could be the topic of a separate independent paper so the author will only voice some doubts and concerns. The third and central part of the paper analyses the case law wherein the CJEU dealt with the relation of the human rights and market freedoms. In the final part the author will give concluding remarks and outline the general attitude of the CJEU from the analysed case law.

Keywords: *Court of Justice of the EU (CJEU), market freedoms, human rights, European Convention on Human Rights, European Charter of Fundamental Rights, general principles of law.*

1. HISTORICAL BACKGROUND OF HUMAN RIGHTS IN THE EU

The Founding Treaties contained no provisions on Human Rights Protection. Human rights as a notion were recognized for the first time in Article 6 to the Maastricht Treaty (1993). The reasons behind this lie in the fact that the European Communities¹ (today the EU) were founded primarily as an economic integration. Also, the protection of human rights in Europe was the task of a different international organization – the Council of Europe. It is also the reason why the CJEU in a series of early cases refused to recognise fundamental rights in the least (e.g. *Stork*, *Geitling*, *Sgarlata*).² Because of that, some national courts reserved the right to declare Community law inapplicable if they deemed it incompatible with domestic constitutional provisions on the protection of human rights (Petrašević/Duić, 2016, p. 252.).

The best-known case is the German case *Solange I* (1974) before the Bundesverfassungsgericht (The Federal Constitutional Court of Germany, hereinafter: BvG).³ The German BvG concluded that European law couldn't take precedence over constitutional provisions of the Member States in matters of fundamental rights.

It is precisely the development of the common market of the EU that the violation of human rights comes with, especially in terms of economic and social rights. The Court recognized this later on and developed a thesis on fundamental rights and their being embodied in the general principles of law that are protected by the Court (case: *Stauder v. Ulm*).⁴

¹ European Coal and Steel Community (1951), European Economic Community (1957) and EURATOM (1957).

² *Stork v. High Authority*, 1/58, ECLI:EU:C:1959:4, *Geitling and others v. High Authority*, joined cases 36, 37, 38-59 and 40-59, ECLI:EU:C:1960:36, *Sgarlata v. Commission*, 40/64, ECLI:EU:C:1965:36.

³ *Solange I* BVerfGE 37, 271, 2, BvL 52/71.

⁴ In 1963, in the case *Stauder v. Ulm*, the CJEU clarified that: "fundamental human rights are enshrined in the general principles of Community law and protected by the Court." See case: *Erich Stauder v City of Ulm – Sozialamt*, 2/56, ECLI:EU:C:1957:4, par. 7.

Since the EC did not have its own catalogue of human rights, the ECJ was compelled to seek inspiration elsewhere: "*the constitutional traditions common to the Member States*" and "*international treaties for the protection of human rights, on which the Member States have collaborated or of which they are signatories*". (Kuijer, 2011, p. 18).

After that, the CJEU had a series of "human rights cases"⁵ and this case law was later enshrined in EU law, more precisely in the Maastricht Treaty (TEU). Article F (later Article 6 TEU) states that "*the Union shall respect fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms*" (Petrašević/Duić, 2016, p. 254).

As a consequence of the recognition of human rights by the CJEU, the BvG changed its attitude in the case *Solange II* (1986).⁶ But the sense of unease caused by an organization as powerful as the European Union not having its own binding catalogue of human rights persisted. This led to the proclaiming of the European Charter of Fundamental Rights during the German presidency of Council on 7 December 2000 at the European Council in Nice. The Lisbon Treaty invested the Charter with this legally binding status. On 1 December 2009, the Charter acquired the same legal status as the Treaties (Petrašević, Duić, 2016, p. 254). The Lisbon Treaty is thus a turning point in the development of human rights in the EU. Lisbon expressly prescribes that the Union will accede to the Convention (Article 6(2)). The idea of accession shall be presented below.

2. THE IDEA OF ACCESSION OF THE EU TO THE ECHR

This part shall address the idea of accession to the ECHR and critically analyse the question of whether the EU should accede to the ECHR at all.

The idea of accession of the EU to the Convention is not a new one. The Commission was the first to propose the accession in 1979 and again in 1990. On 30 November 1994, the Council decided to seek advice from the Court of Justice. The result was Opinion 2/94, in which the CJEU advised against accession. The Court observed that accession was impossible in the light of Community law since there was no firm legal basis for it (Kuijer, 2011, p. 20).

Since then, things have significantly changed. Firstly, the new Treaty basis was introduced by the Lisbon. Article 6(2) TEU states: "*The Union shall accede to the European Convention for the Protection of Human Rights and Fundamental Freedoms. Such accession shall not affect the Union's competences as defined in the Treaties*".⁷ There is also Protocol 8 that regulates aspects of the accession, as well as a Declaration requiring that accession to the ECHR comply with the 'specific characteristics' of EU law. Furthermore, Article 47 TEU explicitly recognizes the legal personality of the EU and as an integral part *ius contrahendi*. Apart from EU legal regulation in the legal order of the Council of Europe (hereinafter: CoE), a new Protocol 14 in Article 59(2) introduced that: "*The European Union may accede to this Convention*". All obstacles have thus been removed and formal prerequisites for accession created on both sides – the EU and the CoE.

After the entering into force of the Lisbon Treaty and based on the recommendation of the Commission, the Council adopted a decision on 4 June 2010 authorising the opening of negotiations for an accession agreement. Draft Accession Agreement of the EU to the ECHR

⁵ See cases : *Roland Rutili v Ministre de l'intérieur*, C-36/75, ECLI:EU:C:1975:137, *Defrenne v. Sabena*, C-149/77, ECLI:EU:C:1978:130, *Hauer v. Land Rheinland-Pfalz*, C-44/79, ECLI:EU:C:1979:290.

⁶ The BvG said: "*In the sphere of competence of the European Communities, a standard of protection of Fundamental rights had arisen that had to be deemed **equal in substance** to that provided by the German Constitution.*" BvG would no longer review secondary Community law on the basis of fundamental rights under the German Constitution, **as long as** the European Communities, and in particular its Court, generally ensure an efficient protection of fundamental rights...". See: BVerfGE 73, 339 2 BvR 197/83.

⁷ Article 6(2) TEU.

was adopted on 5 April 2013.⁸ Based on the legitimacy under Article 218(11) to obtain the Opinion of the CJEU, the Commission requested an Opinion on the compatibility of the Accession Agreement with the Treaties. Ultimately, the CJEU published its negative Opinion on 18 December 2014. If the opinion of the Court is negative, the agreement envisaged may not enter into force unless it is amended or the Treaties are revised. The Court's Opinion was the target of criticism of many EU law bloggers⁹ and it has been analysed from a number of different viewpoints by academics¹⁰ (Duić/Petrašević, 2015, p. 252). I will not get into elaborating neither the Court's opinion nor the "comments" on the Opinion seeing as how it would fall out of the framework of this paper. There is no doubt that the accession would undermine the integrity and the autonomy of the CJEU and this might just be one of the "hidden" reasons behind the negative Opinion. The obvious question here is: should the EU accede to the ECHR at all? Some authors justifiably made the accession very questionable. Above all, they point out that EU law and CoE law form two different legal systems. (Jakir, 2012, p. 4). But are the two systems of protection of fundamental rights compatible at all? If yes, then the accession makes sense. If not, should they be formally linked with one another?

The two legal systems were initially established with different goals. The Union and principally the CJEU started protecting human rights "in passing" mainly to eliminate the objections of some Member States that refused to recognize the supremacy of EU law until the level of protection of human rights in the EU was at a level guaranteed by national constitutions (*Solange I*). Today the Union is far more evolved in terms of human rights protection to the point that they take up the central position and have been raised to the level of primary EU law. However, while the task of the ECtHR is to take care of the protection of fundamental human rights and freedoms, the task of the CJEU – other than respecting human rights – is to take care of conserving EU objectives and especially the functioning of the common market of the EU. This is reason for the CJEU to protect human rights but in the light of the objectives of the EU, which will be evident from the case as analysed in the fourth part of the paper. Aside from the fact that by acceding the EU will become formally bound by the Convention, the CJEU's decisions will become subject to external review from the ECtHR. Furthermore, the ECtHR will be allowed to find a violation wherein the CJEU falsely interpreted or applied the Convention. Thus, the ECtHR would become a hierarchical superior to the CJEU when it comes to human rights protection. This further raises a series of complex questions in terms of their relationship. (Jakir, 2012).

Although the primary idea of accession is to strengthen human rights protection in the EU and to harmonize standards of protection provided by the two courts (the CJEU and the ECtHR), in

8 Council of Europe, cooperation with other international organisations

http://www.coe.int/t/dghl/standardsetting/hrpolicy/Accession/default_en.asp accessed 20 July 2016.

9 Steve Peers, The CJEU and the EU's Accession to the ECHR: A Clear and Present Danger to Human Rights

Protection, EU L. ANALYSIS BLOG <http://eulawanalysis.blogspot.com.es/2014/12/the-cjeu-and-eus-accession-to-echr.html> accessed 20 July 2016; Sionaidh Douglas-Scott, Opinion 2/13 on EU Accession to the ECHR: A Christmas Bombshell From the European Court of Justice, U.K. CONST. L. BLOG <http://ukconstitutionallaw.org> accessed 20 July 2016; Georgi Gotev, Court of Justice rejects draft agreement of EU accession to ECHR

<http://www.euractiv.com/sections/eu-priorities-2020/court-justice-rejects-draft-agreement-eu-accession-echr-310983>. Accessed 17 June 2015; Aidan O'Neill, Opinion 2/13 on EU Accession to the ECHR: the CJEU as

Humpty Dumpty, EUTOPIALAW <http://eutopialaw.com/2014/12/18/opinion-213-on-eu-accession-to-the-echr-the-cjeu-as-humpty-dumpty/> accessed 20 July 2016; Walther Michl, Thou Shalt Have No Other Courts Before Me <http://www.verfassungsblog.de/en/thou-shalt-no-courts> accessed 20 July 2016; Tobias Lock, Oops! We did it again – the CJEU's Opinion on EU Accession to the ECHR, <http://www.verfassungsblog.de/en/oops-das-gutachten-des-eugh-zum-emrk-beitritt-der-eu/> accessed 20 July 2016;

¹⁰ For an academic appraisal see inter alia A. Łazowski and R.A. Wessel Steve Peers; Daniel Halberstam; Stian Øby Johansen; and Christoph Krenn in German Law Journal Vol. 16. Issue. 1 (2015) Special Section: Opinion 2/13.

observing the "accession" from the angle of the Court to Court relation, it might be better to leave things as they are, to work on an even better relationship and cooperation between the two courts instead of creating a hierarchical relationship between them (which would happen in case of accession). Maybe there is not enough "systemic identity"¹¹ between the two legal systems after all in which the CJEU and the ECtHR do function and maybe they should not even be formally linked.

3. CASE STUDY – HUMAN RIGHTS IN THE RELATION TO MARKET FREEDOMS

In this part, we will analyse selected cases brought to the CJEU regarding the relation of fundamental human rights and market freedoms. As explained in the previous section, human rights have developed owing to the CJEU. Human rights and market freedoms can interact in multiple ways. There is however the open question of their hierarchy and which rights prevail. The relation between them becomes more complicated if fundamental market freedoms are materially categorised as fundamental rights, in which case there is conflict between fundamental rights (Perišin, 2006, p. 70-71). How does the Court balance these two rights? This chapter shall try to answer these question by analysing the CJEU case law. It is impossible to analyse all cases and unnecessary to outline the position of the CJEU on it. The following cases have therefore been selected for analysis: Carpenter¹², Schmidberger¹³, Omega¹⁴, Viking¹⁵ and Laval¹⁶.

3.1 Carpenter

Merry Carpenter is a Philippine national who was given leave in 1994 to enter the UK as a visitor for six months. She overstayed that leave without seeking an extension and in 1996 got married to Mr Carpenter, a UK national. In July 1996 Mrs Carpenter applied to the Secretary of State for leave to remain in the UK as the spouse of a UK national. The Secretary of State refused the application, and decided to make a deportation order against her because she had overstayed her original leave to enter. In short, the national authorities wanted to deport her for reasons of protecting the public interest i.e. public policy. She lodged an appeal and the national court referred the case to the CJEU. The Court ruled that: "*MS may invoke reasons of public interest to justify a national measure which is likely to obstruct the exercise of the freedom to provide services only if that measure is compatible with the fundamental rights whose observance the Court ensures*" (par. 40).

The Court took into account the fundamental human right to respect for one's private and family life and said that: *The decision to deport Mrs Carpenter does not strike a fair balance between the right to respect for her family life and the maintenance of public order and public security* (par. 43). This is an example of the line of cases where fundamental rights go hand in hand with fundamental freedoms. Here the Court used the human right to respect for one's private and family life as an additional argument to ensure to Mr Carpenter the freedom to provide services. The logic of the Court was that the deporting of Mrs Carpenter for reasons of protecting public

¹¹ Term used by Miguel Maduro. See: Maduro, 2008, p. 13; referenced by Jakir, 2012, p. 9, n. 36

¹² Mary Carpenter v Secretary of State for the Home Department, C-60/00, ECLI:EU:C:2002:434.

¹³ Eugen Schmidberger, Internationale Transporte und Planzüge v. Republik Österreich. C-112/00, ECLI:EU:C:2003:333

¹⁴ Omega Spielhallen- und Automatenaufstellungs-GmbH v Oberbürgermeisterin der Bundesstadt Bonn, C-36/02, ECLI:EU:C:2004:614.

¹⁵ International Transport Workers' Federation and Finnish Seamen's Union v Viking Line ABP and OÜ Viking Line Eesti, C-438/05, ECLI:EU:C:2007:772.

¹⁶ Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet, Svenska Byggnadsarbetareförbundets avdelning 1, Byggettan and Svenska Elektrikerförbundet, C-341/05, ECLI:EU:C:2007:809.

policy would imply restriction of the freedom to provide services. Such decision of the Court may be read as the respect of private and family life not being reason or ground enough *per se* to be preventing deportation of Mrs Carpenter. Here the Court used a fundamental human right as an additional argument in support of strengthening the freedom to provide services. This is an example from the line of cases where fundamental rights go hand in hand with fundamental freedoms or as Perišin put it: *where human rights and market freedoms work to each other's advantage and there is a positive synergy between them* (Perišin, 2006, p. 72).¹⁷

4.2 Schmidberger

This is one of the first cases that dealt with the direct conflict of fundamental human rights: freedom of expression and freedom of movement of goods. Herein Member States directly invoked human rights as a justification for the restriction of freedom of movement (Perišin, 2006, p. 88).

Transitforum Austria Tirol, an association 'to protect the biosphere in the Alpine region' organized a demonstration on a section of the Brenner motorway in Austria. The motorway was closed to traffic for nearly 30 hours. The demonstration was legal under Austrian law and organized at a prearranged place and time. Permission for this demonstration was (implicitly) granted by the Austrian authorities to protesters. Schmidberger is an Austrian transport company that frequently transports goods via Austrian highways between Germany and Italy. Schmidberger brought an action before the Landesgericht Innsbruck (Innsbruck Regional Court) seeking damages of ATS 140 000 against the Republic of Austria on the basis that five of its lorries were unable to use the Brenner motorway for four consecutive days. It should be noted at this point that the demonstration stretched over the weekend as well when the movement of lorries is prohibited.

Austria contended that the claim should be rejected on the grounds that the decision against banning the demonstration was taken following a detailed examination of the facts, that the information on the date of the closure of the Brenner motorway had been announced in advance in Austria, Germany and Italy, and that the demonstration did not result in substantial traffic jams or other incidents. The Austrian court before which the action for damages was brought referred the above question to the CJEU. The question was whether the Austrian authorities could be held liable for an infringement of EU law under Article 34 TFEU (free movement of goods, ex. Art. 28 TEC). The CJEU ruled that demonstrations as such do not constitute a breach of free movement. Thus, the Republic of Austria is in no breach nor is it liable for the damage. This is a case in which a fundamental human right served as a justification for restricting a fundamental economic freedom. The court first concluded that granting demonstration is in itself a measure that is contrary to art. 28 TEC, but that can be objectively justified by the protection of human rights of the protesters: "*Thus, since both the Community and its Member States are required to respect fundamental rights, the protection of those rights is a legitimate interest which, in principle, justifies a restriction of the obligations imposed by Community law, even under a fundamental freedom guaranteed by the Treaty such as the free movement of goods.*" (par. 92).

Perišin states that the CJEU did not specify the "legitimate interest" or the type of justification at stake. She also states that there are different understandings and interpretations of the judgement, one being that of Barnard, who is of the opinion that in this case the CJEU used human rights protection as mandatory requirement with which Perišin generally disagrees but believes that even if it was so, in this case human rights are a special mandatory requirement (MR), distinct from all others because they are also general principles of EU law. All other MRs should thus have to be assessed in their light, as it was ruled by the ECJ in the Familiapress

¹⁷ Other examples of this type of cases are Grogan, ERT etc.

case. Perišin further warns of the problems that may arise if human rights are perceived as MRs, more precisely that an MR can be used as a justification only for indistinctly applicable restriction (i.e. non-discriminatory measures) (Perišin, 2006, p. 90). I would side with the opinion that the Court accepted human rights as an independent justification.

Even though the CJEU gave primacy to protecting the freedom of expression as a human right, the Court did not say that human rights are above economic freedom but rather that it depends on the circumstances of a particular case: *"In those circumstances, the interests involved must be weighed having regard to all the circumstances of the case in order to determine whether a fair balance was struck between those interests"*(par. 81). In this sense, the proportionality test is very important.¹⁸

So, the CJEU did not give a clear answer on the question of the relation between human rights and market freedoms. Perišin believes that in this way the Court left more space both for the member states and for itself to decide this issue on a case-by-case basis but that it also puts more responsibility on the national courts which will in cases of doubts send more references to the ECJ (Perišin, 2006, p. 91).

4.3 Omega

In this case, the Court was given another opportunity to explain the relationship between fundamental rights and fundamental freedoms seeing as how it did not give a clear answer or the solution for future conflict cases in the previously analysed case (Perišin, 2006, p. 91).

The present case concerns the prohibiting of a game that involves simulated killing. Omega is a German company that operated a laserdrome, an installation for practicing laser games. Players shoot at stationary and moving targets (other players) equipped with so-called sensory tags, which are normally placed on stationary targets and on jackets worn by the players. The cross-border element is present due to the equipment and technology supplier being the British company Pulsar. The police authorities ordered a prohibition of these games, as they constituted a danger to public order: *"Acts of simulated homicide and the trivialization of violence were contrary to fundamental values prevailing in public opinion"* (par. 7).

Omega inter alia argued that the order was contrary to EU law, in particular the free movement of services. The Court applied the proportionality test and concluded: *"(...) the contested order did not go beyond what is necessary in order to attain the objective pursued by the competent national authorities"* (par. 39). [...] *Community law does not preclude an economic activity consisting of the commercial exploitation of games simulating acts of homicide from being made subject to a national prohibition measure adopted on grounds of protecting public policy by reason of the fact that that activity is an affront to human dignity*" (par. 41). Thus, the conclusion of the Court was that the German police authorities had not violated any EU law.

Interestingly, the Court did not deem human dignity that is a human right per se to be an independent human right but rather subsumed it under the term public policy protection, a reason stated directly in ex art. 46 TEC. What was unclear after the decision in the Omega is whether the Court would continue to subsume human rights under the term public policy in future human rights conflict cases. However, looking at the Opinion of Advocate General Stix-Hackl, it becomes clear that the approach of the Court will depend on whether the human right

¹⁸ The CJEU took into consideration a few important facts: First of all, the demonstration took place following a request for authorization from the national authorities. Secondly, the demonstration took place on a single route, on a single occasion and during a limited period and was thus limited in comparison with the geographical scale and intrinsic seriousness. Thirdly, the purpose of the demonstration was not to restrict trade in goods of a particular type or from a particular source. Fourthly, the supportive administrative measures were taken to limit the implications of the demonstration. Finally, an outright ban on the demonstration would lead to unjustifiable interference with the fundamental rights of the demonstrators – right to strike and protest. See judgment, par. 84-89.

is Member State-specific (as it is in this case) or common to all Member States (Perišin, 2006, p. 93).

Furthermore, it can be derived from this case that the fundamental rights protection standards that the Court will take into account do not have to be equal in all Member States provided that the national measure for the protection of such fundamental right passes the proportionality test.

4.4 Laval

Laval is a Latvian construction company. They established a subsidiary (L&P Baltic Bygg AB) and posted Latvian workers to that subsidiary in order to carry out the work in Sweden. The Swedish construction unions tried to get Laval to sign up to collective agreements in the construction sector covering pay, holidays, insurance arrangements and other terms, but Laval refused. Consequently, the Swedish construction unions “blockaded” Laval’s sites in Sweden. Laval brought proceedings before Swedish courts arguing that its freedom to provide services had been infringed. The national court referred a few questions to the CJEU. In this case the CJEU recognized the right to take collective industrial action as a “fundamental” right. The conclusion of the CJEU was that industrial action constitutes a breach which could not be justified in the light of public interest to protect workers and social dumping. The action was deemed discriminatory because it forced a Foreign Service provider to enter into negotiation while disregarding the one in the state of origin.

The ECJ held that trade unions, ‘*not being bodies governed by public law, (...) cannot avail themselves of that provision by citing grounds of public policy in order to maintain that collective action such as that at issue in the main proceedings complies with Community law*’

(par. 84.) (De Vries, p. 189).

4.5 Viking

Viking is a Finnish passenger ferry operator whose ship "Rosella" operated under the Finnish flag. As it was making a loss, the company decided to re-flag the ship to operate under a (so-called) "flag of convenience" in Estonia in order to avoid collective agreements with Finnish trade unions and cut jobs and terms and conditions. Following a request from the Finnish Seamen’s Union (FSU), the International Transport Workers’ Federation issued an instruction to affiliates to boycott Viking’s activities. The FSU also called for strike action by its own members. Viking brought proceedings to the High Court in London, arguing that its right to freedom of establishment and of providing services were infringed. The national court referred a number of questions to the CJEU regarding the extent to which trade unions are able to use industrial action to resist social dumping in the EU.

The Court confirmed that the right to take collective action and the right to strike is a fundamental right forming an integral part of the general principles of Community law. Interestingly, here the Court referred to other international treaties as a source of inspiration for human rights protection: the European Social Charter and the ILO Convention (par. 43) by stating that the EU not only has an economic, but also a social purpose and that social policy interests must be balanced with free movement rules (par. 79).

The CJEU said that industrial action represents a restriction on the right of freedom of establishment if it makes the exercise of that right “less attractive” (par. 72), but is acceptable if it pursues a legitimate aim and is justified by overriding reasons of public interest (such as the protection of workers and jobs that are “under threat”) (par. 75). But it also said: “*it is for the national court to examine, in particular, first, whether, under the national rules and collective agreement law applicable to that action, FSU did not have other means at its disposal which were less restrictive of freedom of establishment in order to bring to a successful conclusion the collective negotiations entered into with Viking Line, and, secondly, whether that trade union had exhausted those means before initiating such action*” (par. 87). In the end,

the Court passed it to the national judge to carry out a proportionality test. The factors to be considered by the national judge include the seriousness of the threat to the jobs or conditions of employment at issue, the proportionality of the collective action, and the exhaustion of other possible means before the initiation of collective action by the FSU (Zahn, 2008, p. 5).

5. CONCLUDING REMARKS

The first part presented the development of human rights within the EU and how they evolved from being fully sidelined to the proclaiming of the Charter of Fundamental Rights, which was done under the pressure of national constitutional courts (primarily by the German BvG). In the second part I addressed the idea of accession of the EU to the Convention. The conclusion: there is not enough "systemic identity" between two legal systems in which the CJEU and ECtHR operate and they should not be formally linked to each other. The CJEU's case law was analysed in the third part with regard to the interrelation of human rights and market freedoms. Firstly, the analysis has demonstrated that fundamental rights issues are most often found in cases relating to market freedoms. That is because the CJEU is not a human rights court and it does not have general jurisdiction to decide human rights cases as the ECtHR does. Secondly, the analysis has shown that there are two types of cases where fundamental rights interact with fundamental freedoms: cases where fundamental rights go hand in hand with fundamental freedoms (e.g. ERT, Grogan, Carpenter) and cases where human rights contravene the free movement rules (e.g. in Schmidberger, Omega). The first type is not problematic for the CJEU, but with the second type the Court has to engage itself in a delicate balancing test to balance conflicting economic freedoms with fundamental rights. This led to the third conclusion: the CJEU adapts its approach to fundamental rights protection so that the functioning of the internal market also becomes a relevant factor in the equation (Jakir, 2012, p. 18). Fourthly, to date the Court has not established a clear relation or an a priori hierarchy between fundamental rights and economic freedoms. In doing so, the Court has left more space both for the Member States and for itself to decide these issues on a case-by-case basis. Some authors highlight that in having to decide thereon, it also puts more responsibility on national courts, which in turn have the option of referring their doubts to the Court, but with the consequence of causing an increase in the Court's workload (Perišin, 2006, p. 91).

LITERATURE:

1. Weis, Wolfgang, EU human rights after Lisbon, in *The Treaty of Lisbon and future of European Law and Policy* (eds. Trybus, Martin; Rubini, Luca), Edward Elgar Publishing, 2012.
2. Perišin, Tamara, Interaction of Fundamental (Human) Rights and Fundamental (Market) Freedoms in the EU. // *Croatian Yearbook of European Law and Policy*. 2 (2006)
3. Jakir, Vanda, Human Rights – With or without the internal market, Master thesis, University of Zagreb, Law Faculty, 2012 (https://www.pravo.unizg.hr/_download/repository/JAKIR_FINAL_MASTER%5B2%5D.pdf).
4. Kuijer, Martin, 'The accession of the EU to the ECHR: a gift for the ECHR's 60th anniversary or an unwelcome intruder at the party?' (2011) 3 *Amsterdam Law Forum*, 4, 17-32.
5. Lazowski, Adam, Ramses A. Wessel, 'When Caveats Turn into Locks: Opinion 2/13 on Accession of the European Union to the ECHR' (2015) *German Law Journal* 16, 179 – 212.

6. P Eeckhout, 'The European Convention on Human Rights and Fundamental Freedoms as an Integral Part of EU Law – Some Reflections', in I. Govaere, E. Lannon, P. Van Elsuwege, S. Adam (eds.), *The European Union in the World: Essays in Honour of Marc Maresceau* (Martinus Nijhoff Publishers, Leiden/Boston 2013), 87-99.
7. Petrašević, Tunjica, Primjena općih načela prava u praksi Europskog suda pravde, Zbornik radova "Načela i vrijedosti pravnog sistema - norma i praksa" / Marković, Goran i dr. (ur.), Pravni fakultet u Istočnom srajevu, Pale, 2012. 793-807.
8. Duić, Dunja; Petrašević, Tunjica, Opinion 2/13 on the EU accession to the ECHR, *New Developments in the EU Labour, Equality and Human Rights Law* / Mario Vinković (ur.). - Osijek : J J Strossmayer University of Osijek Faculty of Law, 2015, pp. 251-267.
9. De Vries, Sybe A., Balancing Fundamental Rights with Economic Freedoms According to the European Court of Justice, *Utrecht Law Review*, Vol. 1, Issue 1, 2013.
10. Michalek, Marta, Fundamental Freedoms v. Fundamental Rights – how the European Court of Justice created a new "fundamental hierarchy", academia.edu.
11. Tzanou, Maria, Balancing Fundamental Rights: United in diversity? Some Reflections on the Recent Case Law of the European Court of Justice on Data Protection, *CYELP*; Vol 6 (2010).
12. Gregor, Stephan, Why Market Freedoms are no Fundamental Rights: A Competence Approach, *CYELP*; Vol 6 (2010).
13. Defeis, Elizabeth F., Human Rights and the European Court of Justice: An Appraisal, *Fordham International Law Journal*, Vol 31, 5 (2007).
14. Morijn, J., "Balancing Fundamental Rights in Union law: Schmidberger and Omega in the Light of the European Constitution", *European Law Journal*, 12 (1): 15-40 (2006).
15. Zahn, Rebeca, The Viking and Laval Cases in the Context of European Enlargement, *Web JCLI*, 3 (2008)
16. Maduro, Miguel, Interpreting European Law - Judicial Adjudication in a Context of Constitutional Pluralism, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1134503

PRODUCTION SHARING CONTRACTS IN THE OIL AND GAS INDUSTRY

Ratko Brnabic

*Faculty of Law in Split, Croatia
rbrnabic@pravst.hr*

ABSTRACT

When dealing with the issues of gas and oil exploration and production, international investors and host countries can use different types of agreements: concession contracts, production sharing agreements, joint operating agreements or contracts services. Production Sharing contracts come in a variety of styles. There are two parties to the contract, a foreign oil company and a government representative which can be a head of state, a ministry or a national oil company. The latter is the more common case. On the side of the foreign contractor we frequently find joint ventures or consortia rather than an individual firm but they all are considered to be one party to the contract so they must agree on the details of their cooperation because, in the end they as partnership assume all costs and risks associated with the exploration and production of oil and gas. In the event that a commercial discovery is made, the international oil company is entitled to a share of the production in order to recover all costs as well as to have a return on the investment. One of the main objectives of the Contract is to attract multinational companies in the sector of oil and gas that are interested and willing to risk capital and utilize technological expertise to develop the reserves in the Country. Namely, most of hydrocarbons reserves are located in developing countries without technical skills (seismic surveys, drilling wells, production techniques) nor financial means (low access to capital markets) to efficiently exploit natural resources. Hence, governments often delegate the exploration and production activities to international extractive companies. Under the Concession regime the international oil company is the owner of the petroleum extracted from the soil. For the Production sharing Contract, on the other hand, the country is the owner of the oil. In this way, the contributions to the state are no longer through taxes and royalties, but the extracted oil is passed on to the state directly. Part of the petroleum is then given to the international oil company as a compensation for its activities and the risks involved with the exploration. Although the oil belongs to the State, the companies take the risks. However, the State can also take risks by allowing part of its profit to be used to develop the area.

In the paper special emphasis is given to the following questions: Parties and Instruments of Contracts, Ownership of Production, Ownership of Installation, Responsibilities of International oil companies and the Government.

Keywords: *Production Sharing contract, Liabilities of the Parties, Production of Oil and Gas.*

1. INTRODUCTION

In recent times the Government of the Republic Croatia launched a whole series of measures to stimulate investments into research and exploitation of hydrocarbon. The new research campaign is for sure the main energy event in our country in this decade. On one side, the legal framework had to be regulated in more detail so that the mentioned operations could be executed smoothly. Earlier this issue was covered by the Mining Act that specified research and exploitation of all types of mineral ore, including hydrocarbon. Due to changes in the economic environment and the increasing interest of foreign investors, it was now necessary to secure all these entrepreneurs a higher level of legal safety and flexibility in accomplishment of their business goals. Accordingly and during a rather short period of time a series of Laws and By-laws for this specific field has been enacted, like: Hydrocarbon Research and Exploitation Act, Act on establishment of the Agency for Hydrocarbon, Regulation on

compensation for hydrocarbon research and exploitation, Decision on establishment of an expert panel for execution of public tenders for hydrocarbon research and exploitation, Decision on contents and terms and conditions for public tenders for hydrocarbon research and exploitation in the Adriatic and criteria for selection of most favorable bidder and Decision on execution of the public tender for issuing permits for hydrocarbon research and exploitation in the Adriatic. The most important issue is covered by the Act on hydrocarbon research and exploitation. By scope, the provisions of this Law govern the research and exploitation of hydrocarbon underground or under the sea and territorial waters of the Republic of Croatia, i.e. in the underground of the epicontinental zone of the Adriatic up to the borderline with neighboring countries, over which territory the Republic of Croatia – according with international Laws – has jurisdiction and sovereignty rights.

On the other side, along with establishment of the legal framework, the research and exploitation of hydrocarbon represents a risky undertaking in the economic sense, demanding significant financial investments. By estimates of experts, only during the research phase on one field (in the sea) of a surface area of 2000 square kilometers, 50 million Dollars per year have to be invested. Research in general lasts over a period of four years, which totals to some 200 million Dollars. In the exploitation phase of oil that starts following research, the investment is significantly higher. Also, research might indicate non-existence or insufficient quantities of hydrocarbon to justify a profitable exploitation. We had such a case in the south part of the Adriatic, where test holes were drilled at depths exceeding 1000 meters.

If, on the other hand research verifies that the reserves are sufficient for profitable exploitation, a whole series of preliminary actions has to be taken: a Study on reserves must be produced, the Decision on verification of the quantities and quality of hydrocarbon reserves has to be obtained, the Study on impact of the mining works onto the environment must be drafted, the Decision on acceptability of the mining – exploitation works must be obtained, the Location permit for the mining works must be obtained, the Mining project of exploitation of hydrocarbon has to be submitted for review and all legal – ownership issues have to be solved for the approved exploitation plot on which the mining will be done if on land.

The above clearly shows that the key issue is the way the host state regulated its legal relationship with a foreign investor. In practice, Concession contracts, Production Sharing contracts, Service contracts and Joint venture contracts are in use (Barbić, p. 266.). No matter which model of contracting the state selects (it is possible that on the territory of a state several different contract models are combined), during the business relationship some of the contractual provisions will have to be changed or amended or even excluded, because all these contracts are generally long-term contracts, subject of the balance of powers held by the negotiating parties and their possibilities during the execution of the contracts. The host state wants to maintain its sovereign powers and rights over the own non-renewable energy sources in the epicontinental zone. A coastal state executes its sovereignty rights over the epicontinental zone for research and exploitation of the own natural resources. The rights of such coastal state are exclusive in the sense that if the coastal state doesn't research its epicontinental zone or doesn't exploit its natural resources, nobody else is entitled to execute these activities without explicit approval by such coastal state. The rights of a coastal state over its epicontinental zone are independent from the real or fictive occupation or any explicit decree (opposed to the exclusive economic zone a coastal state may declare). Natural resources that are subject of rights of a coastal state also include ore and other non-living wealth of the sea bottom and underground, as well as all living beings that are part of the species from the bottom, i.e. species in a state where they can be hunted either as not-moving on the sea bottom or under it or which cannot move if not in permanent physical contact with the sea bottom or underground. The state may dispose over its sovereign rights in the epicontinental zone based on contracts on exploitation of hydrocarbon. Such attempts of the host state to maintain such sovereign rights

are actually opposed to the interest of multi-national companies which mainly work in exploitation (processing and production) of hydrocarbon. Such companies are often part of large corporations and groups and have usually negotiated a contract with a state, when such companies were in a good negotiating position. This means that they are not willing to waive their contractual rights »without a fight«, whereas their main claim is the principle of duty to comply with accepted contractual obligations – *pacta sunt servanda*. Below we will speak more about the significant properties of a PSC (Production sharing contract).

2. SIGNIFICANT PROPERTIES OF PRODUCTION SHARING CONTRACT

As already mentioned, states have a variety of options to define the legal relationship with an investor. The subject of this work is the PSC, which means that the specific properties of this type of contract must be presented. But it first needs to be emphasized that an existing PSC doesn't prevent the establishment of a Joint venture. In international legal literature and practice several classifications of a Joint venture contract are described, so that there are Joint venture contracts with equity and contractual joint ventures, horizontal and vertical, *pari* joint ventures and joint ventures with majority and minority participation, etc. A Joint Venture Contract is considered to be a favorable option for the host state (Ghadas & Karimsharif, p. 39).

Joint venture contracts with equity are those where the contracting parties enjoy the rights vested in their equity in the joint venture and when they decide to incorporate a separate legal entity in order to accomplish their goals. In such undertakings common assets are formed, consisting of equities by each party. In such a contractual relationship the partners have no more title over their equity, but they establish managerial and ownership rights in such a legal person.

On the other side, in so called »contractual« joint ventures no legal person is incorporated in which the parties invest their equities, but the contracting parties agree to follow the same and common goal, all under a certain mutual risk, common management and common control. In this case the venture remains within the domain of the binding relationship established by such contract. Since in contractual joint ventures no legal person is incorporated, such relationships cause numerous legal effects. The equity invested by the members into this union does not become asset of this union. Towards third persons the carriers of rights and duties are the members, so they commonly execute contracts with third persons. Also, all entered equities must be either in cash, material assets and rights, but can also be invested in form of labor, which is not permitted in »equity« joint ventures. A contractual joint venture, by its nature, cannot be a party in a proceeding, since it lacks legal personality. This union can also not be carrier of patents, licenses or land registry rights (Vukmir, p. 31).

A Production Sharing contract (PSC) is a contract between either a host country or its state oil company (NOC) and an international oil company (IOC) by which the latter assumes all costs and risks associated with the exploration and production of oil and gas. In the event that a commercial discovery is made, the international oil company is entitled to a share of the production in order to recover all costs as well as to have a return on the investment. A PSC could conceivably be one of the following: a contract pure and simple, a form of normative act by being a contract given the force of law, a law in itself or an international treaty. (Bati, p. 166).

With such contracts states attempt to attract investors, at the same time trying to better protect own interests. Namely, the past showed that classic concessions as a contracting model often placed the investor into a significantly more favorable position. On the other side, we have to take the previous statement with reserve, because in case of Norway and the USA such goals can be accomplished even in form of classic concessions. Host states can adapt an individual contract model to their specific situation, environment and needs. The PSC has a built-in tension, between the desire by the host country to dominate and maintain control over its very important assets, and the need of the oil company to maximize the net present value of its

investments. This expresses itself in a tendency of the host country to over-regulate, like the participation of nationals in the workforce from labor to management positions, and the enforced use of national products and services. On the other hand, the government may be justified in the assumption that unless sanctions are applied, private industry will tend to circumvent regulations that do not suit its immediate needs to the detriment of the Government's long term objectives. The truth lies in the middle. (Machmud, p. 184).

Within a concession, the investor becomes owner of the exploited quantity of hydrocarbon, whereas in a PSC the state remains such owner and then assigns a part of the product to the investor as compensation for costs and a part for profit, because the investor is then enabled to place the product in the market. The state will either directly or through the Agency execute a contract with the investor for a specified potential exploitation field (a block). The investor carries the risk of failure of the commercial undertaking of oil exploitation, which risk can be significantly decreased if the specified field – block is properly and thoroughly researched and explored. Also, after expiration of a contract that is not prolonged, the investor must hand over all constructed infrastructure to the state, without any compensation. The investor also has to warrant that such handed over equipment is in proper order. If the parties deliberate on a new PSC, the investor that constructed the infrastructure has priority (Brown, p. 89).

Speaking of rights and duties of the contractual parties, the right of control, supervision and management lies with the state (primarily through the Agency or a separate state owned company), whereas the investor is in charge for the day-to-day operations of exploitation and processing of oil. If the state incorporates a separate company, it will clearly act like any other trading company and in general doesn't have a special status. States mainly do act through companies, because this highlights the role of the state as a participant in the entrepreneurial undertaking that is of special state interest, since the profit earned by this company may be utilized for the overall improvement of the living standard of the own citizens. This is where the political dimension of the PSC is emphasized, when the state shows the citizens that national interests will be of priority. Still, the conclusion that such a goal cannot be established through the concession model is not true. Also, incorporating a state owned company does carry certain risks, because the company is liable with its own assets and sometimes won't be able to offer adequate financial warranties. Also, such a company must have highly qualified and educated employees to accomplish the set goals and in such companies there is a major exposure to conflict in interests between the managers and other forms of corruption. In general, it can be concluded that PSC finds application in states with political instability and without established rule of law. In such contracts the changes and amendments of relevant Laws have no impact onto the contract, which is significant for the investor.

With a PSC the state grants the investor a part in exploited oil and in principle, opposed to concessions, the investor is not charged a concession fee, but has to pay classic taxes, like any other trading company. On the other hand, the advantage of the concession model lies in the fact that it gives more security to the investor in the initial phase.

Hence, the three main segments of the PSC are compensation of costs, distribution of produced (exploited) quantity of hydrocarbon and paying of income tax. Speaking of compensation of costs, i.e. cost oil, the state assigns the investor a part of the production exclusively for the purpose to cover the investor's costs from the research phase and the construction of infrastructure in a certain area. These costs can be compensated in two ways: in accordance with the so called Indonesian model, the contracting parties regularly separate a part of the exploited oil for compensation of costs, whereas the remaining quantity is divided at a certain percentage between the contracting parties. Based on the Peruvian model, the investor is given the agreed part of products representing compensation of costs and profit and there is no subsequent division of produced quantities like in the previous model. Clearly, the contracting

parties must define the situation when the state has fully compensated the investor for his research costs and production preparation costs.

When dividing the produced quantities of hydrocarbon, for which the term profit oil is used in practice, several contracting models can be applied (Brannsten, p. 33.). By first model, the contracting parties are allocated a fixed portion of production, for instance the state has 80% of production and the investor 20%. Also, the parties can contract that the percentage of the produced oil allocated to the investor increases in case the investor accomplishes very high production rates. According to the third model, the ratio in distribution of the product is made dependent on a variety of factors – profitability of undertaking, is the oil exploited on land or under water, is gas exploited along with oil and so on. Therefore, key role in negotiations is the power and position of the negotiating, future partner. More on this issue will be discussed in the third chapter of this work.

2.1. The relation between Production Sharing Agreements and other contracting models between states and investors

Below we will try to shed light into the relation between PSC and other legal models applied in the field of research and exploitation of hydrocarbon. These are primarily concessions and Service contracts.

A PSC, compared to a concession gives the host state in general better control over the production and based on such contract, the state defines whether certain preconditions of the contract have been met or not. Here we mean the decision on assigning a part of the product to the investor for compensation of costs and distribution of the remaining quantity between the contracting parties. Even this issue is specified by contract, the state gives interpretation of individual contractual provisions and the investor can either accept such interpretation or launch a legal/arbitration proceeding that in general is very time consuming. In these contracts the existence of a regulating agency is not mandatory, as it is the case with classic concession models. PSC is more complex to be supervised and monitored and the main challenge for the state is how to calculate the ratio for distribution of product in case of multiple variables (Brannsten, p. 52.) If on the other side the distribution ratio is set at fixed rates, one of the parties might easily claim changes in circumstances (force majeure). Also, the statement that a PSC is more profitable for the state is doubtful, since practice showed that even a concession model can be equally successful, under the condition that the state is a stable and developed state.

Also, for the benefit of legal safety and security, it isn't the best solution to have several different legal models for exploitation of hydrocarbon in one state.

In comparison with a PSC, in a Service contract the investor contracts in advance the defined amount of compensation that is to be paid to him for the services of exploiting oil. In an SC the investor holds no managerial rights, whereas in an PSC a part of such rights might be assigned to him. Also, the Service contract contains the potential risk of major losses. Therefore the PSC has many advantages over an SC. Under the PSC, the Investor has an enhanced control over the operation either directly or through a joint operation body to which it has representation as stipulated under the contract. This is likely to minimize government interference and reduce conflicts in the parties' interest in the operations. Whilst both regimes run a degree of risk since return is dependent on viable discovery, in a PSC arrangement, the risk is shared between the Investor and the host country. The host country may contribute directly to the venture or in the alternative. Payment to the Investor on the basis of its share in the profit oil under a PSC is a more secure mode of payment compared to payment on the basis of a fixed fee. The fact that an Investor has a stake in the outcome of the PSC venture both in recovery on cost oil and share on profit oil is itself an incentive for optimal operations. On the other hand the position of the IOC in SC as a mere service contractor with no equity in the resulting oil is itself a disincentive to innovation and optimal effort towards success of the operation. (Ataka, p. 8)

3. NEGOTIATIONS AS MAJOR ELEMENT OF THE PRODUCTION SHARING CONTRACT

Despite the current power leverage during negotiations, a PSC for exploitation of hydrocarbon should contain provisions in relation to a possible re-negotiation, a periodic revision and harmonization with current market situation and other provisions taking into consideration the dynamics of development in this industry. Such provisions would achieve accomplishment of the necessary measure of adaptation of exploitation of hydrocarbon within the contractual regime and all these are solutions acceptable to both parties. Namely, looking from a long-term perspective the investor won't be overly satisfied to be protected by contract whereas the impossibility of changes or amendments of individual provisions causes major dissatisfaction with the host state and its citizens as other party. (Faruque, p. 330). This issue is the more important when the contract is signed by one government, from one political option and the negative impact is suffered by a new elected government, which could cause unforeseeable economic, as well as socio – political consequences, even the fall of a government. The adaptability of a contract decreases the risk of a one-sided breach of contractual duties. The hurdles to the adaptability of a contract under new circumstances are the so called stabilization clauses, based on which investors are guaranteed that the contractual provisions will remain unchanged during the whole contract term (Salih, p. 172). There are many reasons that speak in favor of the approach towards a flexible – adaptable contract. First, when a contract is drafted to be flexible, then the mandatory demands for re- negotiations are focused onto the previously defined procedure of its amendments, thus avoiding any disputes and unnecessary costs that will emerge if such defined procedure has not been set for these cases. Secondly, such contract can in advance define the preconditions for gradual taking over of the entrepreneurial undertaking of hydrocarbon exploitation by the contracting state, all based on previously specified rules and regulations of a defined procedure, when such taking over would be done in phases and accompany the economic growth of the host state and the ability of the state to effectively perform managerial and business operation in the undertaking (marketing, finances, management). Thirdly, the circumstance of a contract being adjustable and flexible prevents risks against possible negative impacts for the state in case of a nationalization: negative marketing, financing problems that need to be solved immediately and fully, reservation on side of potential new investors to participate in the undertaking, duty of settling high amounts for indemnification of damages. Forth, the adaptability – flexibility of a contract opens to both parties the possibility to apply new forms of contracting and specification of their mutual rights and duties in this industry of exploitation and processing of hydrocarbon. The above clearly indicates that sooner or later the need will appear to revise long-term contracts relating to exploitation of hydrocarbon.

When speaking of negotiations, the question has to be asked if the principles of good management and rule of law have any importance in the cyclical changes in the market of commercial hydrocarbon exploitation. We are witnessing the trend of permanent changes of prices of hydrocarbon, which means that the states of the producing countries are permanently included in the change and amendment of the basic provisions of execution of these contracts. These changes are subject of discussion in cases when the first versions of contracts have been executed at a time when the price of products made of hydrocarbon has been relatively low (for instance, between 1985-1999). Also, changes in contract are demanded under significant political changes, when a new government of a contracting state has a different view onto foreign and in general private investments and in cases when governments, following an initial wave of privatization of companies, try to introduce an opposite procedure: Nationalization of companies. These problems will occur when a contract on exploitation of hydrocarbon doesn't contain any possibilities for automatic amendments in case when certain, precisely defined preconditions are met. Practice showed that it is insufficient for a contract to contain provisions

on changes of compensation amounts paid by the investor based on profit earned from the undertaking, because the contract is usually the product of unequal negotiating positions among the contracting parties. Contracts signed by inexperienced governments of countries established following the disintegration of the USSR often contained provisions in favor of the foreign investor. As result, such countries wouldn't earn any major profits from their reserves of hydrocarbon, despite the fact that the market price for these products in the meantime grew several times (Wälde, p.183). As the market price of products grows, the question appears if these are not new, changed circumstances enabling the contracting state to either terminate or amend the contract (Sornarajah, p. 84.). In such cases we have the danger that the contracts cease to be binding contracts for both parties, but rather become »general political agreements«.

Such a viewpoint could even be acceptable in some cases, but at the same time an important factor must not be let out sight: the foreign investor invests a lot of money into such projects with return of such investment in some later, future period. If a state by itself changes the rules to the game by amending regulations (especially tax regulations), the balance between the contracting parties is disturbed. To avoid the situation when a foreign partner – investor becomes »hostage« of the host state, the contract must also contain securities that enable the investor to hold up such relative balance. Such securities may be provisions on changes to laws on international investments, the necessity of internationalization of laws applicable to such contracts, introduction of a clause on stabilization of provisions, the clause on jurisdiction by an international arbitration and provision that clearly specifies the arbitrating body that will be decisive in case of a dispute. Application of the principle »rule of law« targets the conversion of legal business actions from political agreements to contracts that are executed based on legal norms and executable, procedural provisions of international importance, all contributing to the security of the investment. Still, the host state must take into account what message it sends to other potential and international investors with its actions.

Former contracts on exploitation of energy resources, executed between states in the Middle-east and investors, were often signed for a term of 99 years (Fischer, p. 400). During the course of time the situation in the world market changed, in favor of investors, so such legal deals became almost damaging to the host states. It was realized then that it was time for changes to these contracts, thus enabling continuity in accomplishment of the economic goal, at the same time avoiding situations where a host state is forced to take radical, legal measures. More recently, contracts on exploitation of hydrocarbon are signed for terms of 25 – 35 years, depending on the date of contract being the date of signing it or the date of commercial production. In practice there are cases when such contracts had even significantly shorter terms. These differences result from the fact that when exploiting hydrocarbon the period from research and exploration to the time when the initial investment pays off through production is relatively shorter. It is important for the host state to define the time sequence for research work, production of the Profitability study, construction and production, otherwise the investor will practically only »reserve- keep on hold« his right onto a resource by such contract, if nothing, to prevent any competition and must not hurry with the undertaking. On the other side the state will try so sign contracts for a maximum short period of time, because the reserves of hydrocarbon won't be exhausted entirely (Beredjick, p. 231).

Because of the time term of such contracts and where the business risk already has been unevenly distributed between the contracting parties and the fact that in the meantime unforeseen or changes in circumstances may emerge, new contracts in this industry contain provisions enabling easier amendment and change to such contracts. In finding a solution to this issue, there is three viewpoints: First, contracts can be signed that relatively clearly define circumstances resulting in the duty on side of the contracting parties to re-negotiate (one of such circumstances usually is the expiration of time). Secondly, in some contracts it is defined that along with expiration of time, changes in fiscal system of a contractual state is a main condition

for re-negotiation changes (tax rates and various fees and duties, model of their calculation) or a significant change in price of the final product on the market. Third, contracts that define an increased tax burden at a certain growth rate during the course of time and those containing provisions on the duty of the investor to vacate, waive parts of the exploitation field in case when some conditions are met, when the process of amendment of such contracts would happen automatically. Especially in this latter case a dispute will definitely arise and the contracting parties will discuss whether they have complied with the contractual duty that the investor has to vacate a part of the exploitation field, so that new negotiations will result from this.

3.1. Significant negotiating points

During the negotiation process attention must be paid to a number of questions that we already mentioned above. The contracting parties must clearly and in legal – technical terms describe the exploitation site. The question of fitting out and designation of the area where the exploitation field lies must be specified (in particularly when on land). The contract must contain a provision on designation of product (export or domestic usage), the labor employment program, forecast on production quantities, rights and duties of contracting parties, procedure for appraisal of market value of product, procedure and methods of distribution of product between the state and the investor, procedure of supervision and control of oil exploitation, procedure for emending and changing the contract, environmental protection and solution of disputes between the parties.

The relationship must be very carefully specified when several investors act unified. Then all investors are together, in equal parts liable towards the contracting state. A significant provision of the PSC is the issue of termination of contract. The termination can be declared by a contracting state in case of direct threat for the health and safety of citizens and the environment. Therefore it is very important to specify in the phase of negotiations of contract the ratio of distribution of produced oil, as well as the method on which such ratio is based, in case of multiple variables. The investor becomes owner of a part of produced oil only after completed division based on such ratio. The contracting parties also need to define the question of assignment of contract onto a third party. For this provision, it is wise to apply the rule on silence of administration: if the state doesn't react onto the investor's notice on his intention to assign the contract onto a third party within a reasonable time, it will be considered that the contracting state has silently approved such assignment. In case the contracting state refuses such assignment, in justification of such decision all important reasons must be specified. This might become a subject to a dispute, because the contracting parties might not consider the specified reasons as important.

4. CONCLUSION

PSC seems to be the most accepted model of regulation of mutual, legal relationships among the contracting parties. Such a contract contains many favorable properties. With this contract the goal is established for the host state to attract investors, when the state doesn't have sufficient assets to finance such undertaking by itself, while at the same time sustaining full ownership over its energy resources. The state may additionally motivate an investor by offering an increased portion in the overall produced quantity of oil, for instance if the investor exceeds the defined production plan. It is crucial that the contracting parties, during the negotiation process, clearly establish which formula will be applied to define their individual portions in production. If a research shows that a potential exploitation field has insufficient reserves to launch commercial production, the state doesn't face any loss. With such contracts the host state (or its company) manages the business undertaking and controls it, while the investor manages the day-to-day business operations. This enables domestic experts to gain new know-how and skills within a cooperation with the investor in the field of exploitation of

hydrocarbon. The state will charge the investor income tax, so it earns multiple benefits from this undertaking. The investor has also benefits from the Production Sharing Contracts. In the beginning investors were unsatisfied that economically undeveloped states rich in such natural resources refused to execute concession contracts, that until that point were mirror of the dominating negotiation status of multinational companies as investors. The PSC finally showed that it has a relatively simple payment model, opposed to the complex system in the concession contracts (concession fee, taxes, various levies and duties). In a concession contract a state assigns an investor part of its sovereign rights, so this state has clear interest in maximizing its profit through fees and duties. Before a contract is executed the negotiation procedure must be completed. Despite the current power leverage during negotiations, a PSC for exploitation of hydrocarbon should contain provisions in relation to a possible re-negotiation, a periodic revision and harmonization with current market situation and other provisions taking into consideration the dynamics of development in this industry. Such provisions would achieve accomplishment of the necessary measure of adaptability of exploitation of hydrocarbon within the contractual regime and all these are solutions acceptable to both parties. Namely looking from a long-term perspective the investor won't be overly satisfied to be protected by contract whereas the impossibility of changes or amendments of individual provisions causes major dissatisfaction with the host State and its citizens as other party. The contract must contain a provision on designation of product (export or domestic usage), the labor employment program, forecast on production quantities, rights and duties of contracting parties, procedure for appraisal of market value of product, procedure and methods of distribution of product between the state and the investor, procedure of supervision and control of oil exploitation, procedure for amending and changing the contract, environmental protection and solution of disputes between the parties, the legal relationship in case of multiple investors in the undertaking, termination of contract, ratio of distribution of produced oil between the contracting parties, as well as the method based on which this ratio is calculated, assignment of contract onto another investor. The Republic of Croatia accepted the concession system, even there is no obstruction to accepting the good solutions from PSC and implement this in our system, to the maximum possible scope. In the recent time we are noticing an increase of combining several different models of contracts, which might be a good solution, especially for those states that attempt to attract foreign investors, because these are able to finance such commercial undertakings under more favorable conditions than a state.

LITERATURE:

1. Ataka, V., Production Sharing Contracts vs Service Contracts from the View Point of an IOC, https://www.academia.edu/3300791/Production_Sharing_Contracts_vs_Service_Contracts_from_the_View_Point_of_an_IOC, 25.7.2016.
2. Barbić, J. (2002). *Pravo društava - Društva osoba*. 3rd Book. Zagreb: Organizator.
3. Bati, A. (2003). Legal Status of Production Sharing Agreements in Azerbaijan, *Journal of Energy & Natural Resources Law*, Vol. 21, Issue 2, pp. 153-167.
4. Beredjick, N. (1988). *Petroleum Investment Policies in Developing Countries*. Berlin: Springer.
5. Brannsten, E. (2010). *Production Sharing Contracts and Concessions in the Brazilian subsalt region: Thesis*. Oslo: University of Oslo.
6. Brown, S. (2004). Law on Production Sharing Agreements in Ukraine, *Journal of Energy & Natural resources Law*, Vol. 22, No.1., pp. 80.-93.
7. Faruque, A. (2006). Validity and Efficacy of Stabilisation Clauses, *Journal of International Arbitration* Vol. 23, 4, p. 317.-336.
8. Fischer, P. (1974). *Die Internationale Konzession*. Berlin. Springer.

9. Ghadas, Z.A; Karimsharif, S. (2014). Types and features of International Petroleum Contracts, South East Asia Journal of Contemporary Business, Economics and Law, Vol. 4, Issue 3, pp. 34-41.
10. Machmud, T. N. (1993). Production Sharing Contracts in Indonesia: 25 Years' History [notes], Journal of Energy & Natural Resources Law, Vol. 11, Issue 3, pp. 179.-185.
11. Salih, M.S. et al., Strategy of Oil Contract Negotiation, International Journal of Business and Social Science, vol. 6., no. 9, 2015. pp. 168.-175.
12. Sornarajah, D.M. (2004). The International Law on Foreign Investment. 2nd Edition. Cambridge: Cambridge University Press.
13. Vukmir, B. (1994). Ugovori o zajedničkim ulaganjima. Zagreb: Informator.
14. Wälde, T. (2005). Managing the Risk of Sanctions in the Global Oil & Gas Industry: Corporate Response Under Political, Legal and Commercial Pressures, Texas International Law Journal, Vol. 36., 1, pp. 183.-230

SAFETY OF ELECTRONIC COMMUNICATION AND COMPUTER CRIME

Slavko Simundic

Faculty of Law, University of Split, Croatia
slavko.simundic@pravst.hr

Danijel Barbaric

Faculty of Law, University of Split, Croatia
danijel.barbaric@pravst.hr

Sinisa Franjic

Croatia
sinisa.franjic@gmail.com

ABSTRACT

In today's world it is important to undertake all necessary measures in order to ensure the protection of electronic communication. Computer networks which make up a constituent part of human lives have also brought with them problems related to safety and have raised the issue of their safety. In the first part of this paper the protection of data and electronic data protection is analysed along with their legal regulation in the Republic of Croatia. The second part is dedicated to cyber crime and its influence on today's modern times digital and computer technologies.

Keywords: *computer crime, computer networks, data, electronic communication, safety.*

1. INTRODUCTION

Public communication service operators must undertake appropriate technical and organisational measures in order to protect the safety of their services and together with operators of public communication networks undertake the necessary measures to ensure the safety of electronic communication networks. The undertaken measures must ensure a suitable level of safety for the existing level of danger to network safety, while taking into account the available technical and technological solutions and the costs of these networks. In cases of particular danger to network safety, the operator must notify its service users about this danger. If the danger is outside the scope of measures undertaken by the the operator of publicly available electronic communication services, service users must also be notified of the available measures for eliminating the dangers or consequences thereof, including an indications about the possible costs of such steps. The operator of publicly available electronic communication services is obliged to nominate a responsible person for the implementation of these measures (Šimundić, S., Franjić, S. 2015, p.233.).

Computer networks have become an integral and everyday part of human life and today it is difficult to imagine life and work without computer networks (Bača, 2004, p.153.). However, computer networks have also brought safety problems with them, precisely because of the fact that they enable users to very easily exchange information and means and due to the loss of user personality (computer networks allow users who have never met the other user to "touch" them and in the meantime delete all documents). Computer networks have enabled individuals to launch sophisticated computer programmes and attack the largest corporations and anonymous individuals (Šimundić, S. Franjić, S. 2015, p. 233.).

In a society where communication and informational technologies represent the base of modern business and social life, many people believe the supervised personal rights are deeply interwoven with the concepts of autonomy and freedom (Henderson, 2006, p. 4).

2. ELECTRONIC COMMUNICATIONS

In the aim of ensuring the privacy of electronic communications and mobile data belonging thereto in public communication networks and publicly available communication services, it is forbidden to listen to, eavesdrop, store or in any other form to reach or supervise electronic communication and mobile data belonging thereto apart from cases from article 108 of the Electronic Communications Act and in cases determined by specific laws. This ban applies to technically stored data which is essential for communication transfer while not interfering with the principle of protecting data privacy. The provisions do not apply to the legally authorised noting of communication and mobile data belonging thereto in the aim of legal business activities with the aim of providing receipt of business transactions or other business communication. The use of electronic communication networks for data storage or for data access by storing in the subscriber's or service user's terminal equipment is only allowed in the case where the subscriber or service user has received a clear and complete notification pursuant to certain regulations on personal data protection and for the purposes of data processing and if the person responsible for the supervision of data has provided the right to refuse such data processing. By this, the technical storage of data or access to data exclusively for the purposes of notification or easing the transfer of communication via electronic communication networks cannot be prevented, or, if necessary, for providing services of an information society at the direct request of the subscriber or service user. (Šimundić, S., Franjić, S. 2015, p. 234).

2.1. Mobile data

Mobile data related to subscribers or service users which the operator of public communication networks or publicly accessible electronic communication services has processed or stored must be deleted or made unnamed when they are no longer needed for the transfer of communication except in special cases as described in the Electronic Communications Act. Mobile data needed for settling the costs of electronic communications of subscribers or service users and the costs of interconnection can be processed until statute of limitations on claims, pursuant to general regulations on contractual legal obligations.

In the aim of promoting and selling electronic communication services or providing services with valued added tax, the operator of publicly accessible electronic communication services can process mobile data in a way and over a period necessary for the advertising and sale of these services if the subscriber or service user, to whom the data is related, gives his/her consent. Subscribers and service users can withdraw their consent to the processing of mobile data or withdraw it at any time.

The operator must notify the subscriber or service user about the types of mobile data being processed and about the duration of data processing and, before registering the subscriber's or service user's consent must inform about the types of processed mobile data regulated by the Electronic Communications Act.

Access to the processing of mobile data is only allowed for authorised persons operators of public communication networks and publicly accessible electronic communication services who work in the areas of accounts settlement, administering the electronic communication network, processing consumer complaints, uncovering fraud, promoting and selling electronic communication services and providing services with added value. Access to the processing of

mobile data can be limited to minimal activities related to the carrying out of these tasks. These provisions are not applicable to reporting to Ministries, Agencies, courts and other authorised government bodies regarding mobile data pursuant to specific regulations all in the aim of resolving disputes prescribed by the Electronic Communications Act in particular with access and interconnecting or resolving disputes regarding the amount of debt for a provided service.

2.2. Revealing and hiding telephone identification

The public communications services operator who provides the possibility of showing the number of the person who is calling must enable the service user who has called easy and free of charge prevention of showing the number for every individual call or for all calls. The public communications services operator must enable the called subscriber easy and free of charge prevention showing of the called number with reasonable use of this possibility. The public communications services operator with whom the called number is shown before the call is connected must enable the called subscriber an easy way to refuse incoming calls in the case when the showing of the called number is prevented by the subscriber or service user who made the call.. The public communications services operator who provides showing caller identification must enable the called subscriber easy and free of charge prevention from showing the number which is connected to the calling service user. These provisions are applicable to incoming and outgoing calls to other countries. The publicly accessible electronic communications services operators who provide the possibility of showing caller identification and/or connecting number must notify the public about these services and their possibilities in an appropriate and publicly accessible way.

2.3. Data on location without mobile data

Data on location without mobile data related to the subscriber or user of public communications networks or publicly accessible electronic communication services can be processed only when the data on location is rendered nameless or on the basis of subscriber or service user consent in a way or within a period necessary for providing additional value services.

The operator must notify the subscriber or service user, before gaining consent for the type of data on location without mobile data which to be processed, of the aims and duration of processing and whether that data will be given to a third party due to providing additional value services.. The subscriber or service user must at all times provide the possibility of withdrawing consent for data processing on location without mobile data. When subscriber or service user consent is obtained, the subscriber or service user must retain the possibility of simple or free of charge way to temporarily refuse the processing of data on location without mobile data upon every connection to electronic communication networks or transfer of communication. Processing data on location without mobile data is only allowed by authorised persons of public communications services operator and publicly accessible electronic communication services operators or authorised third party persons who provide additional value services and must be limited to most necessary of tasks related to providing additional value services.

2.4. Malicious or harassing calls

If the publicly accessible telephone services subscriber in writing petitions to make possible the acceptance of incoming malicious or harassing calls the publicly accessible telephone services operator must, after receiving the petition, note and store data about the called telephone number, the date and time of such calls or the attempt to make such calls. The operator can note and store this data only upon the receipt of a written petition by the subscriber. In the petition, the subscriber must roughly state the date and time of receiving certain malicious and harassing calls. On the basis of this the publicly accessible telephone services operator

establishes the name and surname and address or the name or headquarters of the subscriber or services user who has made these calls if this data is accessible. The established data on malicious or harassing calls must be kept by the publicly accessible telephone services operator and must deliver them to the police for further proceedings pursuant to certain regulations about which the petition applicant will be informed.

Publicly accessible telephone services operators must cooperate in the aim of following and uncovering malicious or harassing calls and in particular in relation to exchanging data.

2.5. Unwanted electronic communication

The use of the calls system, with or without human mediation, facsimile or electronic mail,, including text messages (SMS) and multimedia messages (MMS), in the aim of direct advertising and sale only allowable with preceding gaining of subscriber or service user consent.

The physical person or legal entity as trader can use data on the e-mail addresses accumulated from buyers only for the purposes of selling products and services by direct advertising and sale of their own products upon the condition that those consumers have clear and definite access to a free of charge and simple complaint system for complaining about that kind of using data about the electronic mail addresses when they are collected in the instance where the consumer has not refused in advance such data use.

It is forbidden for the purposes of direct advertising and sale to send electronic mails, including text messages (SMS) and multimedia messages (MMS), in which the identity of the sender is fraudulently presented or hidden as is the sending of such electronic mails or messages with an incorrect address for which the recipient can apply free of charge to cease any further communication. These provisions do not apply to unautomated calls to legal entities for the purposes of direct advertising and sale.

Electronic mail service operator must allow users of that service to filter the incoming e-mails which contain unwanted electronic messages or harmful contents. Subscribers must be provided a simple way of forming, including and excluding such filters. Electronic mail service operators must appropriately and in a publicly accessible way post the electronic mail address to report it for misuse and to answer every complaint related to electronic mail misuse within 15 days maximum of receipt of that complaint via electronic mail. Electronic mail service operators must by subscriber contract oblige subscribers to refrain from sending unwanted electronic mails pursuant to the provisions of this article and to undertake appropriate measures to prevent misuse of subscribers' electronic mail accounts. When the electronic mail service operator receives evidence that the subscriber has sent an unwanted electronic mail, or that the subscriber's user electronic mail has been subject to misuse, s/he is obliged to establish the facts and undertake appropriate measures. Depending on the level of the kind of harm done, the operator can issue a warning or temporarily disable the subscriber's electronic mail account use, of which the subscriber account user must be notified in writing. If the subscriber again breaches the subscriber contractual obligations, the operator has the right to permanently strike off the subscriber's user electronic mail account and terminate the subscriber's contract according to general business conditions. Ways and means of effectively preventing and combating misuse and fraud in providing electronic mail services ad fulfilling operator and subscriber obligations established by this article are more closely regulated by the Council Agency's rulebook. By bringing in this rulebook, the Agency is in particular cooperating with electronic mail service operators.

2.6. Secret supervision of electronic telecommunication networks and services

Public communication network and publicly accessible electronic communication services operators must at their own cost ensure and maintain the function of secret supervision of electronic communications networks and services as well as of electronic communication installations and operative-technical bodies authorised for the supervision of electronic communications pursuant to certain laws which regulate the area of national security. Public electronic communication network and publicly accessible electronic communication services operators' obligations towards supervisory bodies and bodies authorised for accepting measures of secret supervision of electronic communication networks and services, pursuant to specific laws in the area of national security and criminal proceedings, by these laws and specific regulations establish regulation of operator obligations in the area of national security. Articles of provisions 99 to 104 of the Electronic Communications Act do not apply to the obligations of public communication network and publicly accessible electronic communication services operators, nor do the provisions of certain regulations governing the protection of personal data. Public communication network and publicly accessible electronic communication services operators must enable authorised bodies' current identification of user services.

2.7. Obligation of retaining data

Public communication network and publicly accessible electronic communication services operators are obliged to retain data on electronic communications for the purposes of enabling investigation, uncovering and criminally prosecution pursuant to specific laws from the area of criminal law from the area of criminal procedure for the purposes of protecting defence and national security pursuant to specific laws from the area of defence and national security. Operators are obliged to retain certain data in its original form or as data processed during carrying out electronic communication and network service activities. Operators are not obliged to retain data which they have neither produced nor processed. Operators must retain data within a period of twelve months from the date the data has been posted, regardless of the provisions from article 102 sections 1 and 2 of the Electronic Communications Act. Operators implement the obligation of retaining data in that they retain data together with all other necessary and related data, so it can without delay be delivered to supervisory bodies.

Operators must personally apply the following safety principles for retained data:

1. Retained data must be of the same quality and undergo equal measures of safety and protection as the data in electronic communication networks of operators,
2. Retained data must be protected in an appropriate way from casual and illegal damage, possible loss or alteration, unauthorised or illegal storage, processing, access or uncovering,
3. In the case where retained data have not been used for the purposes established in article 102 of the Electronic Communications Act, access to retained data must be limited exclusively to authorised persons in supervisory bodies,
4. Retained data must be destroyed after the retention date has expired, apart from the data which has been processed and stored for the needs of supervisory bodies.

For the purposes of the application of security principles for retained data, operators must, at their own cost, ensure all necessary technical and organisational measures.

Supervision of the application of security principles for retained data and collecting statistical indicators about retained data and yearly reports by the Commission for access to retained data is prescribed in more detail by special regulations governing operators' obligations in the area of national security pursuant to relevant European Union directives on the retention of data.

2.8. Types of retained data

The obligation to retain data from article 109 of the Electronic Communications Act includes the following types of data: necessary data for following and establishing the destination of communication, necessary data for establishing the date, time and duration of communication, necessary data for establishing types of communication, necessary data for establishing user communication equipment or equipment considered as user communication equipment, necessary data for establishing the locations of mobile communication equipment.

The retained data include data related to unsuccessful calls which are not obliged to retain data on calls which were not connected at all. It is forbidden to retain data which do not uncover contents and communication.

More detailed directions on certain types of retained data are established by certain regulations which govern operators' obligations in the area of national security pursuant to relevant European Union directives on retaining data (Šimundić, S., Franjić, S. 2015, p. 241).

3. COMPUTER CRIME

Today's modern times of contemporary digital and computer technologies is advancing every day. To the satisfaction of numerous users throughout the world, every day that modern technology is becoming more and more accessible and easy to use. This means that from the nineties of the 20th century, when sudden expansion of these modern technologies occurred, till today we can easily call this the period of the scientific-technological revolution which will continue to grow. (Šimundić, S., Franjić, S., 2009, p. 17).

Today's level of technology enables the computer system on the network to be connected as well as their global connection in a single communication-informational system –the Internet. The Internet has very quickly become fertile ground for misuse, that is, for the development and spread of computer related crime. Technological development of the Internet has enabled much misuse due to the non-existent or lacking legal regulation in the area of computer related crime.. The personal computer is today used in financial transactions, and business secrets, personal medical data and employment history can be found in them. Many of these computers are connected to the Internet and accept and send information via the World Wide Web, states Michael R. Anderson, a retired American expert for modern computer technologies, in the preface of his book „Investigating Computer-Related Crime“ (Stephenson, P., 2000, p. 3). At the beginning of the spread of the Internet, experts of its design, that is, for the design of certain pages did not dream that modern computer technology would achieve such great planetary success so they did not take much care about data safety. The huge popularity of personal computers and the Internet throughout the world has brought Internet experts something they had not thought about when they were creating pages and that is the way, from a safety point of view, they could keep data and information from various types of misuse.

With the everyday growing amount of people on the Internet, the world is increasingly becoming a global informational village. Spatial, regional, ethic and other limitations are disappearing and so the world is becoming a global community and the, Internet – an informational super-road! The Internet has therefore become a technological, social, economic, media, political and among other things a legal phenomenon. Given that with today's level of development and that currently it is not possible to achieve absolute safety of informational systems, it is necessary to provide absolute and effective protection should misuse occur. This can only be achieved by coordinating countries which make up the global village (Šimundić, S., Franjić, S., 2007, p. 18).

Even though the emergence of the Internet has enabled the use of much useful information, this practically has enabled the emergence of computer crime. Modern informational technology is easy to use and its prices are becoming more and more affordable so it is subject to various types of criminal activities.

The development of the Internet is being followed by a growth in the number and frequency of attacks. The precise number of attacks cannot be established. Where large informational systems are concerned, the tendency is to cover up attacks due to data secrecy or fear of losing users. Today's estimations state that damage caused by computer crime is immediately after the damage caused by drug and arms trafficking. With the development of the Internet comes a growth in the number of potential perpetrators. Increasing technical knowledge and ever more sophisticated equipment enables the creation of advanced software tools aimed to attack more easily and faster. The most frequent reason is accessibility to original programme codes which enable perpetrators insights into the structure of the programme and its weaknesses which can be used (Šimundić, S., Franjić, S. 2007, p. 22).. Attacks occur as the result of the following: unauthorised access, unauthorised changing of data, unauthorised deletion of data, recording malicious programmes (viruses, worms etc.), use of others' computers to access other systems, creating conditions for causing damage to the system, theft, damaging, destroying hardware bases, media etc.

All of this would be senseless if the perpetrators could not withdraw without leaving any evidence of their unauthorised entry. Autonomy is one of the foundations of computer crime and the basic reason why it is difficult to prevent and combat. Attackers try to remove information on access and the extent to which they are successful depends on how skilful they are at removing evidence of their entry and also on how capable the system is which is the target of their attack . Unfortunately, very quickly after the emergence of the Internet, various forms of misuse started to appear. The world today makes huge efforts to reduce the occurrence of computer crime to a minimum. Certain concrete results have been achieved in this fight. National legislation, which is also sometimes too soft with its sanctions, is prepared to involve criminal legislation. Here, it should be emphasised that regardless of all forms of computer crime, the Internet has brought human kind a lot of good starting from the huge quantity of information which can be found on it to connection with the farthest of places in the world in just a few seconds. Despite all forms of computer crime today many countries in the world adopt and achieve strategies to access the Internet for the simple reason that the Internet represents a modern technological achievement which today is impossible to be without. Given that it wishes to be part of the European Union, the Republic of Croatia is prepared to accept the demands of the European Union to adapt its legislation to modern informational and telecommunication technologies.

At the beginnings of the sudden development of the Internet, the perpetrators of computer crime used the simplest weaknesses of information systems such as codes and incorrect configurations in order to achieve their goals. As the Internet and computer technologies developed, further attacks became more sophisticated which enabled perpetrators to rapidly attack information systems which in this way became even more vulnerable. Simple and accessible equipment and solid computer knowledge enabled perpetrators to uncover systems' weaknesses which were used to achieve their goals.. Therefore, the development of technology enabled the storage of huge quantities of information in a variety of forms in a relatively small space.. This created conditions for materials to be relatively cheaply and quickly transferred and distributed. It should be noted that perpetrators of computer crime use malicious computer programmes. These programmes (for example, Trojan horse) enabled them to identify and access the system in such a way that their presence is not registered as illegal, but as valid. Perpetrators also use cryptographic methods to hide their presence in the same systems so it can happen that the real user sometimes finds traces of such programmes, but is no longer sure whether perpetrators have reached the data they need.. In other words, attacks on computer systems and personal computers depend on the intentions, motives and information knowledge of the perpetrator. (Šimundić, S., Franjić, S., 2009, p. 34).

Perpetrators can be categorised into five groups: persons who commit such acts purely for fun, persons who commit such acts for material gain, persons who commit such acts for achieving ideological aims, mentally ill persons, professional criminals. Perpetrators of computer crime, regardless of the category they belong to, have one thing in common. This is the damaging act they intentionally undertake in order to achieve their goal. Regardless of the goal, the damaging act they undertake represents a danger which needs to be avoided if at all possible. It is because of this that these perpetrators are often called hackers.

Simultaneously, great technological advancements at the end of the 20th century in the sense of strong development of modern informational technologies, the problem of applying the computer in various areas of human activities occurred. That problem includes several significant issues and these are: legal regulation's relation to the development of technical know-how and science, the problem area if protection of human rights which can endanger computer application in the area of collecting and processing personal data and issues of protection of certain legal values in a society from criminal attacks on computer use (Krapac, D. 1992, p. 39). When new technological solutions in the context of national legal regulation are considered, the general impression is that legal regulation is one step behind technological development. This has been the case several times in the past and is so in the case of legal regulation of computer crime. When why this is so is considered it should be borne in mind that the lawyer is merely a human being who is just an observer capable of registering delinquent behaviour within new technological achievements and a large number of issues which that same technological development opens. This means that new technological achievements can be legally regulated only after certain amount of time has elapsed (Šimundić, S., Franjić, S. 2009, p. 37).

Regardless of the huge efforts made in combating computer crime at a global level, the forms of appearances of computer crime occur quite frequently. With criminal offences in the area of computer crime, it frequently happens that there are no physically obvious consequences. A lot of time can pass before it is established that there has been unauthorised hacking of information systems of companies if a legal entity is concerned, or the hacking of a personal computer if a physical person is involved. If unauthorised hacking is not established quickly, there is the possibility that due to the passage of time, the perpetrator cannot be identified. Šimundić in his book entitled „*Pravna informatika*“ (Computing for Law) states that it is necessary to establish the time plan for managing crisis situations such as these (Šimundić, S. 2007, p. 131). He considers the planning of unpredictable events and crises as different names for the same processes: process of planning, uncovering and resolving various forms of catastrophe

(Šimundić, S., Franjić, S., 2007, p. 78). Computer crime is precisely that a catastrophe, so he suggests that care is taken of the following activities: defining various methods of acknowledging how, in the shortest time possible to recognise how the computer crime occurred, creating a team of people capable of responding to any incident from the area of computer crime and defining the reactions of the team to various situations.

Computer crime is its own kind of unavoidable active participant of exponential development of information that is computer technology particularly in digitalised electronic networks in all spheres of life. It is different to known forms of crime to date because often the most frequent object of non-physical, digitalised data, the computer, is the main tool for illegal activity or the aim of its implementation and the invisible computer connections of the specific area of long-distance activity which earlier was practically inconceivable. With the development of an information society, computer crimes takes on more complex forms of appearance and it also extends to other „traditional“ areas of crime. Computer crime today is not a unique phenomenon with easily recognisable forms of appearance through which it can manifest itself, with a certain profile of perpetrator and ways it can be implemented. This gives it a new dimension, makes it much more dangerous and its consequences more harmful and far reaching.

It is because of this that modern society must confront it with all available means and methods among which legal protection is certainly one of the most significant (Šimundić, S., Franjić, S., 2007, p. 211).

4. CONCLUSION

Today, electronic communication represents an unavoidable part of our lives. Together with the many facets to which electronic communication has contributed, there are also drawbacks. For the purposes of developing telecommunications, the need has also arisen for legal regulation of electronic communication and its safety. A particular safety issue is that of computer related crime. In many ways there can be attacks on information systems and electronic communications. Attacks can reach many groups of offenders of computer related crime. The development of electronic communication and the development of computer related crime is growing and so too is the need for seeking a higher level of protection for electronic communication and information systems. All of this leads us to the need to confront all forms of attacks on various information systems which, above all, leads to the need for continuous technical protection and constant updating of regulations governing this problem area.

LITERATURE:

1. Bača, M. (2004). Uvod u računalnu sigurnost. Zagreb. Narodne novine.
2. Electronic Communications Act, NN 73/08, 90/11, 133/12, 80/13, 71/14
3. Henderson, H. (2006). Privacy In the information Age (Revised Edition). New York. Facts On File
4. Krapac, D. (1992). Kompjuterski kriminalitet. Zagreb. Pravni fakultet Sveučilišta u Zagrebu
5. Stephenson, P. (2000). Investigation Computer-Related Crime. Boca Raton, USA. CRC Press
6. Šimundić, S. (2007). Pravna informatika. Split. Sveučilište u Splitu, Pravni fakultet
7. Šimundić, S., Franjić, S. (2009). Računalni kriminalitet. Split. Sveučilište u Splitu, Pravni fakultet Split
8. Šimundić, S., Franjić, S. (2015). Pravna regulativa u elektrotehnici i računarstvu. Osijek. Sveučilište Josipa Jurja Strossmayera u Osijeku, Elektrotehnički fakultet Osijek

CRIMINAL RESPONSIBILITY OF LEGAL PERSONS IN THE LEGISLATION REPUBLIC OF SERBIA AND THE REPUBLIC OF CROATIA

Strahinja D. Miljkovic

*Faculty of Law of the University of Priština,
with the temporary seat in Kosovska Mitrovica, R. Serbia
strahinja.miljkovic@pr.ac.rs*

Vanda Bozic

*Faculty of Law of the University of Zagreb,
Department of Criminal law, R. Croatia
vanda.bozic@pravo.hr*

ABSTRACT

*The subject of this paper is a comparative analysis of corporate liability for offenses in the laws of the Republic of Serbia and the Republic of Croatia. In Croatia, the Law on the liability of legal persons for criminal offenses in 2004, in the Republic of Serbia, the adoption of the Law on liability of legal persons for criminal offenses in 2008, introduced the criminal liability of legal persons thus abandoning the principle *societas delinquere non potest*. The paper made a comparative and historical overview of the development of the Law Institute, and the prescribed criminal sanctions ordered the justification for its existence in the fight against economic crime since the purpose of the punishment can not be achieved only by punishing the responsible person in the legal person. The authors of the analysis will explore the legal provisions and the situation relating to reported, accused and convicted legal persons for specific types of crimes and the structure of reported crime during the period from the beginning of the application of the law to date.*

*A special emphasis will be given to the institute confiscation of proceeds of crime. In his concluding remarks, in accordance with the legal provisions of the two countries *de lege lata*, will try to indicate possible suggestions *de lege ferenda*.*

Keywords: *criminal liability of legal persons, Law on liability of legal persons for criminal offenses in the Republic of Croatia, the Law on liability of legal persons for criminal offenses in the Republic of Serbia, economic crime.*

1. INTRODUCTOIN: PERIOD BEFORE PASSING THE LAW ON THE LIABILITY OF LEGAL PERSONS FOR CRIMINAL OFFENCES

1.1. Republic of Serbia

Until the adoption of the Law on the liability of legal persons for criminal offenses¹ (hereinafter LOLLPCO) criminal legislation on the responsibility of legal persons (mainly refers to business organizations) in Republic of Serbia did not exist, and the only responsibility of legal persons

¹ OG of Republic of Serbia, No. 97/08

that existed was primarily related to the area of misdemeanors² and economic offenses³. Commercial offense as one of the more complete and stricter aspects of responsibility in relation to the offenses made by a legal entity is to sanction violations of the legality of their business in the area of economic and financial operations.⁴ However, although until the moment of the adoption of the LOLPCO, sanctioning economic offenses represented the most rigorous form of "punishment" of a legal person, it should be noted that these types of offenses can neither be characterized nor fall under criminal offenses, on one hand, and under misdemeanors, on the other hand.⁵ Table No.1.shows the number of Criminal charges, indictments and convictions of legal persons for economic offenses in the period from 2005 to 2013.

Table No.1. Criminal charges, indictments and convictions of legal persons for economic offenses from 2005 to 2013⁶

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Charges	6410	5830	3153	3711	2732	2265	2332	1607	1718
Indictments	4729	5161	4347	3444	4377	2796	2461	2250	2500
Convictions	3147	2734	2688	2139	2929	1945	1567	1535	1707

However, despite the fact that the Law on Economic Offences provides liability of legal persons, it should be noted that the expansive and explosive development of the capital market, especially the market arising in the former Yugoslavia, which until the beginning of the nineties was closed (without modern business mechanisms), creates basis for carrying out a series of speculative activities which often tend to be on the border of legally permitted activities. It is in these circumstances, when the legislation is underdeveloped, and often has its source in the business and social environment that is outdated, there is a possibility that the newly established legal entities realizing the weakness of the legal system take part in activities which can be characterized as criminal. Legal norms of corporate liability for criminal acts in the Republic of Serbia made a significant step forward in fuller, more complete and comprehensive legal

² Art. 27. "Legal person is liable for the offense that was committed by an act or omission of due supervision of the management body or person or by an act of another person which at the time the offense was authorized to act on behalf of a legal person. Legal person is liable for an offense if: 1) Managing Authority adopted an unlawful decision or order which enables the execution of offenses or the liable person makes a person to commit an offense; 2) a natural person commits the offense due to failure of the liable person to act as a supervisory or control. Under the terms of paragraph 2 of this Article legal person may be liable for an offense when: 1) misdemeanor proceedings were suspended against the liable person or that person was released from liability in accordance with the provisions of Article 250 of this Act; 2) there are legal or factual impediments to establishing the responsibility of the liable person in the legal entity or it can not be determined who is the liable person is. The liability of the physical or liable person in the legal person for the offense, criminal or civil offense does not exclude the liability of the legal persons for the offense. " Law on Misdemeanors, OG of Republic of Serbia , No. 65/13 and 13/16

³ Art. 6. Par. 1. "Both legal person and a liable person in the legal entity can be held liable for an economic offense". Law on Economic Offences, OG of the SFRY, No. 4/77, 36/77 - corr., 14/85, 10/86 (consolidated text), 74/87, 57/89 and 3/90 and OG No. 27/92, 16/93, 31/93, 41/93, 50/93, 24/94, 28/96 and 64/2001 and OG of RS, No. 101/2005 – second law

⁴ Art. 1. Ibid.

⁵ Under the commercial offense is considered to be "(1) ... socially harmful violation of regulations on economic or financial operations that caused or could have caused serious consequences and that has designated as an economic offense by a regulation of the competent authority. (2) Violation of regulations on economic or financial operations which, although labeled as economic offense by a regulation, represents an insignificant social harmfulness because of little significance and because of the paucity or absence of harmful consequences is not considered an economic offense, " Art. 2.Ibid.

⁶Source: Republic Institute for Statistics of Republic of Serbia

regulations of Republic of Serbia. Although the passing of the LOLLPCO can be seen as a success of the domestic legislature, it should be noted that the passing of this law does not constitute a voluntary legal regulation of these areas by the legislator Republic of Serbia, but it is a result of commitments with the conclusion and ratification of international conventions⁷ by the Republic of Serbia.

1.2. Republic of Croatia

We can say that the Republic of Croatia had a certain tradition concerning the criminal liability of legal persons given that the legal system included the liability of legal persons for economic offenses as specific types of criminal offenses that are neither crimes nor misdemeanors.

In 1991 Republic of Croatia took over the Law on Commercial Offenses⁸ from 1977 that defined economic offenses as "a breach of the economic and financial operations".⁹ However, the punishment of legal persons can not be achieved neither by prescribing economic offenses neither through criminalizing misdemeanors since it is necessary that legal persons are responsible for committed criminal acts that can only be prescribed by the Criminal Code.

Law on the liability of legal persons for criminal offenses (hereinafter LOLLPCO) was adopted by the Croatian Parliament on September 11, 2003 and entered into force six months later, which is a very long *vacatio legis*.¹⁰ The reason for the adoption of this law lies in the fact that more and more crimes are being committed by legal persons who are responsible for criminal activity and who unlawfully acquire material gains,¹¹ which places the natural person as an individual in the background. The most common offenses which may be committed by a legal entity are related to its area of business and activity and thus the most common economic crimes for legal persons are from Title XXIV of the Criminal Code of Republic of Croatia.¹² Accused legal persons are mostly limited liability companies.¹³ Criminal acts that are attributable to legal persons are mostly related to business fraud, violation of obligation to keep business books, causing bankruptcy, bribery in the bankruptcy proceedings, bribery in business operations, abuse in public procurement, misleading advertising, tax evasion and customs, avoidance of customs control, unauthorized use of another person's property, illicit production, trafficking and money laundering.

⁷ COUNCIL OF EUROPE COMMITTEE OF MINISTERS, RECOMMENDATION No. R (88) 18, OF THE COMMITTEE OF MINISTERS TO MEMBER STATES, CONCERNING LIABILITY OF ENTERPRISES HAVING LEGAL PERSONALITY FOR OFFENCES COMMITTED IN THE EXERCISE OF THEIR ACTIVITIES (Adopted by the Committee of Ministers on 20 October 1988 at the 420th meeting of the Ministers' Deputies).

⁸ Law on economic offenses OG of SFRY No. 4/77, 14/85, 74/87, 57/89 and 3/90

ORDER on the promulgation of the Law on takeover of the Law on economic offenses, OG. 53/91

⁹ Law on Offences envisaged the abolition of economic misdemeanors and their transformation into offenses, OG of Republic of Croatia, No 88/02

¹⁰ Law on liability of legal persons for criminal offenses, OG of Republic of Croatia, No.151/03, 110/07, 45/11, 143/12

A longer period has been left between the enactment of legislation and its entry into force on the ground to achieve thorough preparations for its implementation.

¹¹ Government of Republic of Croatia: Final draft of the Law on liability of legal persons for criminal offenses, Zagreb, December 2002, available at:

<https://vlada.gov.hr/UserDocsImages//Sjednice/Arhiva//49022.%20-%201.pdf>, viewed on 01/08/2016

¹² Crimes against the economy, Art.246 - Art.265 Criminal Code of Republic of Croatia, OG No. 125/11, 144/12, 56/15, 61/15

¹³ Derenčinović D., Novosel D.: ACT ON THE CRIMINAL RESPONSIBILITY OF LEGAL ENTITIES – TEMPORARY CHILDHOOD DISEASES OR THE SQUARING OF THE CIRCLE? Croatian Annual of Criminal Law and Practice (Zagreb), vol. 19, No 2/2012, p. 585-613.

Punishing legal persons has its own weight in cases where the share of individual perpetrators is negligible in regards to the overall gravity of the offense as well as in cases where the offender can not be determined. There are also cases when legal entities, whether as companies or as crafts, are established only for the purpose of committing criminal activities, thus there is complete support of the members of the legal entity who benefit from the criminal offense so that the purpose of punishment can only be achieved by punishing the legal person.

Punishing legal persons was proclaimed by the Recommendation of the Council of Europe No. R (88) called "Liability of enterprises for offences,"¹⁴ from 18th to 20th of October 1988 ordering the introduction of corporate responsibility for crimes committed in the context of their activities, or in cases where the criminal act does not fall within the subject of activity of legal persons.

The Convention on Transnational Organized Crime requires prescription of liability of legal persons for criminal offenses of organized crime, corruption, money laundering and obstruction of justice.

Criminal Law Convention on Corruption of the Council of Europe, confirmed by the Croatian Parliament on September 27, 2000¹⁵, commits signatory states to provide in their national legislation for the liability of legal persons for the offenses of active bribery, trading in influence and money laundering.¹⁶ It also states that the responsibility of legal persons does not exclude criminal proceedings against natural persons who are perpetrators, instigators or accomplices to these crimes.¹⁷ The intention of the Council of Europe is that its member states harmonize their national legislation in order to avoid that some of the legal persons evade liability by transferring their activities from the state who acknowledges the criminal liability of legal person to another state that does not acknowledge such responsibility.

And the Convention on Cybercrime¹⁸ in Article 12 obliges each signatory party to adopt the necessary measures to ensure the possibility that a legal person is held accountable for criminal offenses defined in the Convention, which were for its benefit committed by a natural person, acting either individually or as part of the body of the legal person who has a leading position within the legal person.

Although the above mentioned laws of Republic of Serbia and Republic of Croatia represent a significant step forward in fuller, more complete legal regulation of corporate liability for the behavior on the market of goods, services and capital, it should be noted that one can ask a crucial question whether the administration of these laws is in the public interest. The answer to this question can move in two directions: a) that there is a sincere desire to see its application to preventively influence the behavior of legal and responsible persons and b) that the legal act is only in public interest in the field of fulfilling international commitments, and without sincere desire for its implementation. Exactly the possibility of diametrically different responses creates a gap between the theoretical and normative aspects of perceiving the law as an empty legal shell, on one hand, or regardless of the existing legal shortcomings that the application of the law may have in real life, resulting in the formation of certain effects, on the other hand.

¹⁴Council of Europe: Liability of enterprises for offences; Recommendation No. r (88) 18 of the committee of ministers to member states concerning liability of enterprises having legal personality for offences committed in the exercise of their activities; available at:

<https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=09000016804c5d> 71, viewed on 01/08/2016

¹⁵Criminal Law Convention of the Council of Europe Convention on Corruption, the Law on Ratification of the Criminal Law Convention on Corruption, OG of Republic of Croatia - International Agreements, No. 11/00

¹⁶Art.18. Ibid.

¹⁷Art.18, Par.3 Ibid.

¹⁸Convention on Cybercrime; Law on Ratification of the Convention on Cybercrime, OG of Republic of Croatia - International Agreements, No. 9/02

2. ARE LEGAL PERSONS MAY RESPONSIBLE IN TORT

In considering the issue of responsibility, and regardless of whether it is a civil law or criminal liability we always starts from the premise that only a person who possesses reason can be held responsible for undertaken actions. However, the emphasis in this paper is not placed on individuals as holders of responsibility, but the legal entities as persons that have the responsibility for the actions taken. Although legal persons appear as fiction because they do not poses reason they always appear as holders of rights and obligations, and therefore are responsible on a commitment basis. As with natural persons, statements *obligatio est iuris vinculum* and *solus consensus obligat* are also valid for legal persons. Undertaking certain obligations when operating under a contract that should be executed legal person appears as the holder of civil liability. However, as far as the legal person, it is necessary to emphasize the point that the legal person emerges as the bearer of rights and obligations. It is in the context of time of acquisition of opportunities that it is the bearer of rights and obligations¹⁹ that it is necessary to distinguish between the time of acquisition of legal and business capacity. As for the moment of acquiring legal capacity, the legal person acquires it on the basis of the Constitution, the law, or by entering the appropriate register with the competent authority.²⁰ Unlike the legal capacity which is acquired on the basis of positive legal documents or relevant decisions of the competent authority, legal capacity of a legal entity is not the original it is derogated i.e. business capacity is taken out of the ability of their bodies which may be limited.²¹ For reasons that the legal capacity of a legal person is drawn from the ability of its body, which consists of individuals who posses reason, the question arises whether legal persons in general can be held responsible for criminal acts. Although the question of liability of legal persons for criminal offenses can be placed in the context of irresponsibility, because of a lack of original business skills it should be emphasized that it is necessary to make a comparison with civil law liability of legal persons. According to the rules governing the civil law legal capacity of legal persons depends on the ability of their bodies including responsible persons.²² Guided by this attitude, and using analogue methods we believe that there is no valid reason for challenging the view that legal persons with regard to the holders of liability in civil law can not be the bearers of responsibility in criminal law, i.e., that they can not be held responsible for criminal offenses. The fact that bodies carry out actions for legal entities, does not mean that those activities can not be attributed to legal persons, and by the fact that the actions of the body are in fact the actions of the legal person.²³ No matter that the legal capacity of a legal person is limited, it should be noted that responsibility for the crimes is not limited i.e. restrictions relating to the legal capacity can not be analogously applied to responsibility for criminal acts.²⁴

¹⁹ Art. 54. (1) "A legal person may enter into contracts in legal transactions within its legal capacity" Code of Obligations (OG of the SFRY", No. 29/78, 39/85, 45/89 and decision USJ and 57/89, OG of the SFRY No. 31/93 and OG of Serbia and Montenegro, No. 1/03 - Constitutional Charter)

Also Art.274, Par.1 Law on Obligations, OG of Republic of Croatia No.35 / 05, 41/08, 125/11, 78/15

²⁰ Vrhovšek, M., A legal person as the perpetrator of the crime pursuant to the liability of legal persons for criminal offenses, *Journal of Crimanalistics and Law*, p. 19.

²¹ Vrhovšek, M., *aforementioned work*, p. 19.; Art. 55. Civil Obligations Act of Republic of Serbia "When the general act of the legal entity specifies and enters into the registry that its agent may conclude a contract only with the consent of a body, consent can be given previously, simultaneously or subsequently, if anything else is not entered in the register" also Art.275, *Par.1*. Civil Obligations Act of Republic of Croatia "When a statute, association or the rules of the legal person specify and enter into the registry that its agent may enter into a contract only with the consent of some of its bodies, approval can be given previously, simultaneously or subsequently, if nothing else has been entered into the registry, OG of Republic of Croatia No.35 / 05, 41/08, 125/11, 78/15

²² Vrhovšek, M., *aforementioned work*, p. 19.

²³ Ibid, p. 19.

²⁴ Ibid, p. 20.

Dilemma, but also the opposed and theoretical point of view on responsibility or irresponsibility of a legal person for criminal acts EU addresses by the adoption of Recommendation No. R (88)²⁵, which provides that legal persons are responsible for criminal offenses, while Article 7²⁶ provides for penalties for criminal acts. With the adoption of proposed recommendations EU proclaims the principle that directors and senior management bodies act on behalf of the company, legally speaking they are the company, represent the "alter ego" of the company, with the result that their guilt is attributed to the company, making it liable to prosecution. Based on the doctrine of identification, or the theory of alter ego, we start from the premise that individuals (managers, directors) that make up the bodies of a company and constitute the brain of a legal person are not representatives of a legal person, because their actions are not regarded as acting in the name and on behalf of a legal entity, but are seen as actions of a legal entity.²⁷ One of the first legal documents that has sublimated the theory of identification is the French Penal Code, which provides that legal entities, except the state, criminally liable in accordance with the differences set forth by Articles 121-4 and 121-7.²⁸

3. LAW ON THE LIABILITY OF LEGAL PERSONS FOR CRIMINAL OFFENCES IN REPUBLIC OF CROATIA

Law on the liability of legal persons for criminal offenses is divided into four titles. First title consists of the basic provisions governing the subject and purpose of the Act and establishes the subsidiary application of the Criminal Code²⁹, Criminal Procedure Code³⁰ and the Law on

²⁵ RECOMMENDATION No. R (88) 18, OF THE COMMITTEE OF MINISTERS TO MEMBER STATES, CONCERNING LIABILITY OF ENTERPRISES HAVING LEGAL PERSONALITY FOR OFFENCES COMMITTED IN THE EXERCISE OF THEIR ACTIVITIES (Adopted by the Committee of Ministers on 20 October 1988 at the 420th meeting of the Ministers' Deputies).

²⁶ Art. 7. "Consideration should be given to the introduction of sanctions and measures particularly suited to apply to enterprises. These may include the following:

- warning, reprimand, recognisance;
- a decision declaratory of responsibility, but no sanction;
- fine or other pecuniary sanction; - confiscation of property which was used in the commission of the offence or represents the gains derived from the illegal activity;
- prohibition of certain activities, in particular exclusion from doing business with public authorities; - exclusion from fiscal advantages and subsidies; - prohibition upon advertising goods or services;
- annulment of licences; - removal of managers;
- appointment of a provisional caretaker management by the judicial authority; - closure of the enterprise;
- winding-up of the enterprise;
- compensation and/or restitution to the victim; - restoration of the former state;
- publication of the decision imposing a sanction or measure.

These sanctions and measures may be taken alone or in combination, with or without suspensive effect, as main or as subsidiary orders". - RECOMMENDATION No. R (88) 18, available at:

<https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=09000016804f3d0c>

²⁷ Vrhovšek, M., aforementioned work, p. 20.

²⁸ Art. 121-2. However, local public authorities and their associations incur criminal liability only for offences committed in the course of their activities which may be exercised through public service delegation conventions. The criminal liability of legal persons does not exclude that of any natural persons who are perpetrators or accomplices to the same act, subject to the provisions of the fourth paragraph of article 121-3" – French Penal Code, available at: <http://www.legislationline.org/documents/section/criminal-codes/country/30>, viewed on 03/08/2016

²⁹ Criminal Code of the Republic of Croatia, OG, No. 125/11, 144/12, 56/15, 61/15

³⁰ Criminal Procedure Act of the Republic of Croatia, OG No. 152/08, 76/09, 80/11, 121/11, 91/12, 143/12, 56/13, 145/13, 152/14

the Office for the Suppression of Corruption and Organized Crime.³¹ Law on liability of legal persons for criminal offenses in relation to the said laws is *lex specialis* given that it addressed only the criminal law issues that are specific to the legal person. The second title lists the assumptions of culpability on the principle that the responsibility of legal person is based on the guilt of the person responsible,³² but that the legal person will also be punished for the offense of the responsible person even if the existence of legal or factual obstacles to the establishment of responsibility of the responsible person is determined.³³ The responsible person in the legal person is a person who manages the business affairs of the legal person or is entrusted with carrying out businesses of a legal person.³⁴ The third title provides for criminal penalties, fines and the abolition of legal persons, and security measures. The main monetary penalty that may be imposed is in the amount of 5.000,00 to 8,000,000.00 HRK if a criminal offense is punishable by a fine or imprisonment with a maximum measure of one year in prison,³⁵ in the amount of 15,000.00 to 10,000.000.00 HRK if a criminal offense is punishable by imprisonment for a maximum of five years,³⁶ amounting to 30,000.00 to 12,000,000.00 HRK if a criminal offense is punishable by imprisonment for a maximum of ten years in prison,³⁷ in the amount of 50,000.00 to 15,000,000.00 HRK if a criminal offense is punishable by imprisonment for a maximum of fifteen years in prison or more severe punishment.³⁸ If a legal entity was established for the purpose of committing criminal offenses or has used its activities mainly to commit crimes, the legal entity may be imposed the sentence of abolition and a fine by the court.³⁹ The law provides for the optional exemption of legal persons from penalty⁴⁰ provided that the legal person reported the offense by a responsible person before being discovered or before knowing that the deed has been discovered. The law provides the court with the possibility of pronouncing a suspended sentence so that the sentence will not be executed if the legal person during the time determined by the court, which may not be less than one nor more than three years, does not commit another criminal offense, taking into account that the suspended sentence may be imposed for criminal offenses for which the court has convicted a legal person to a fine of less than 50,000.00 HRK.⁴¹ The court may impose a sentence of one or more safety measures for a legal person. These measures include the prohibition of the performance of certain activities or businesses, a ban on the acquisition of licenses, authorizations, concessions or subsidies, ban on conduction business with the users of state and local budgets, as well as forfeiture of property gained, confiscation and publication of the judgment.⁴² The economic benefit that the entity has made with a criminal offense, shall be confiscated by the judgment establishing the perpetration of the crime.⁴³

³¹ Law on the Office for Combating Corruption and Organized Crime, OG of Republic of Croatia No 76/09, 116/10, 145/10, 57/11, 136/12, 148/13

³² Čl.5.st.1. Law on liability of legal persons for criminal offenses, OG of Republic of Croatia No.151/03, 110/07, 45/11, 143/12

³³ Art.5, Par.2 Ibid.

³⁴ The same definition is given by the CC of the Republic of Croatia in Art.87, Par.6. "The liable person is a person who manages the business affairs of the legal person or has been explicitly or really entrusted with tasks in the field of activity of the legal person or government body or body of local and regional (regional) governments."

³⁵ Art.10, Par.1 LOLLPCO of Republic of Croatia

³⁶ Par.2 Ibid.

³⁷ Par.3 Ibid.

³⁸ Par.4 Ibid.

³⁹ Art.12, Par.1 and 3 Ibid.

⁴⁰ Art.12.a. Ibid.

⁴¹ Art.13 Ibid.

⁴² Art.15- 21. Ibid.

⁴³ Economic benefit is any increase or prevention of the decrease of property of a legal person which occurred by a criminal offense, Art.20, Par.2. Ibid.

If the impossibility of seizure of property is determined, the court shall oblige the legal person to pay equivalent sum of money, and if the material gain is at another person on any legal basis, it will be taken away from that other person if that other person knew or could and should have known that the gains were proceeds of crime.⁴⁴

The fourth part contains the provisions relating to criminal proceedings conducted against a legal person. A single procedure will be carried out in respect of the criminal acts of the legal person and responsible persons and a single verdict will be passed.⁴⁵

4. LIABLE ENTITIES ACCORDING TO THE LAW ON THE LIABILITY OF LEGAL PERSONS FOR CRIMINAL OFFENCES IN REPUBLIC OF SERBIA AND REPUBLIC OF CROATIA

4.1. Legal person

The importance of LOLPCO of Republic of Serbia is that it provides that the liable entity can be a legal person (resident or a foreign legal entity) that is in accordance with applicable law considered a legal entity and responsible natural person who is legally or factually entrusted with certain business affairs in the legal entity as well as the person authorized, i.e. that may be deemed to be authorized to act on behalf of a legal entity.⁴⁶ According to LOLPCO of Republic of Croatia legal persons are considered as liable entities (including foreign entities that are by Croatian law considered legal persons)⁴⁷ as well as responsible persons (natural persons conducting business or legal persons entrusted with the businesses of a legal person). Based on the listed provisions there are two entities of criminal responsibility, namely: a) legal person (entity) and b) a natural person. In the following presentation, it is necessary to pay special attention to the interpretation of who and when can occur in the role of a legal person, and who might take the role of a natural person. When considering issues of criminal liability, it is especially necessary to further consider the liability of the legal person and the liability of the natural person.

The vagueness of the law in determining who should be considered a legal entity represents a specificum i.e. it does not specify precisely who can appear as a legal person.⁴⁸ However, this approach by the legislator can be considered a positive one because it allows for an extensive method of interpretation of that provision, and for the reasons of necessary familiarity with the positive legal provisions governing the status of a legal entity.

However, although we are talking about the status of the legal person it should be noted that in this case under the legal person we may consider only the legal person that was established for performing a business in accordance with positive legal regulations, and this is indicated by provisions which stipulate that "... the legal person is liable for a criminal offense that it performed in the context of its business operations ..."⁴⁹ "... legal person shall be punished for a criminal offense by the responsible person if it violates any of the duties of the legal person..."⁵⁰

and in compliance with which provides that "...the legal person in bankruptcy shall be liable for a criminal offense committed before the start or during the bankruptcy proceedings."⁵¹ In accordance with the above interpretation of the two laws we come to the conclusion that these

⁴⁴ Art.20, Par.4. and Par. 5 Ibid.

⁴⁵ Art.23 Ibid.

⁴⁶ Art. 5. LOLPCO of Republic of Serbia

⁴⁷ Art. 1., Par.1 LOLPCO of Republic of Croatia

⁴⁸ Art. 5 Par. 1. Law on liability of legal persons for criminal offenses of Republic of Serbia

⁴⁹ Art. 6 Ibid.

⁵⁰ Art. 3. LOLPCO of Republic of Croatia

⁵¹ Art. 9. LOLPCO of Republic of Serbia and Art.7 Par.3. LOLPCO of Republic of Croatia

are only legal persons that were established to exercise business activities. However, even though the law does not determine autonomously who has the status of a legal person, i.e. which organization that may be, it is necessary to fulfill the cumulative conditions, namely: a) that it is legally regulated; b) it is legally permissible and c) that the legal system recognizes its ability to acquire the rights and assume obligations.⁵² It is this last condition that is defined as a legal person's ability and the measure of differentiation of the legal person from an organization that has no legal status.⁵³ Only those entities who acquire the status of a legal person may be liable in court, while those who do not have such a status can not be held liable as is the case with the partnership or secret society.⁵⁴ However, although the above interpretation is extensive it should be noted that this is not fully applicable when determining the legal person in accordance with the provisions and intent of the law. This position is justified by the fact that in accordance with the law it is explicitly provided that legal persons are responsible for those crimes, which are started in the context of their business, and during the performance of activities for which they were established. LOLPCO of Republic of Serbia and LOLPCO of Republic of Croatia stipulate that in the case when bankruptcy has been initiated or in process against a legal person that legal person shall be held liable, while in accordance with the Law on Companies of the Republic of Serbia⁵⁵ and the Companies Act of Republic of Croatia⁵⁶ explicitly state against which legal persons i.e. against which businesses can bankruptcy be initiated and held. The significance of the provision according to which a legal person in bankruptcy shall be liable for a criminal offense committed before the start or during the bankruptcy proceedings is in the fact that that bankruptcy that may be induced by intention, and which may serve as a basis to justify that a legal person - company does not have enough assets, can not serve or be used as a basis for potential exclusion or exemption from criminal liability. From the results obtained it can be concluded that the law primarily applies to companies that have been established to carry out lucrative activities, and that at some point during the performance of business activities criminal offense may be committed even though there was no initial intention with the founders to set up such a business organization.

Of importance to the law, the market, and we can freely say to the legal person is the provision which requires that the provisions of the law, in addition to national legal persons, apply to foreign legal persons as well.⁵⁷ A foreign legal person shall be liable for a criminal offense only if it is "...according the positive law of the Republic considered a legal person."⁵⁸ All those cumulative conditions which must be fulfilled by a domestic person to gain the status of a legal person shall also apply to a foreign legal person.

When determining the applicable law in respect of the application of laws we always starts with the nationality of a legal person. Nationality of legal person is determined by the seat of the management. Legal systems of the Republic of Serbia and Croatia, especially when it comes to business companies, have adopted the concept of the real seat of the company i.e. location of the management head office.⁵⁹ Management head office is the place that is used to run the company, but it can be registered in one country only if there is a main management head office

⁵² Stanković, O., Vodinelić, V.V.: *Introduction to Civil Law*, Nomos, 2004, Boograd, p. 71, 72, 91.

⁵³ Ilić, G.: Marginal notes to the Law on corporate liability for criminal offenses, CRIMEN (I) 2/2010, p. 247

⁵⁴ Stanković, O., Vodinelić, V. V., *aforementioned work*, also Government of Republic of Croatia: Final proposal of the Law on liability of legal persons for criminal offenses, Zagreb, December 2002, p.17.

⁵⁵ Law on Enterprises, OG of Republic of Serbia, No. 36/2011, 99/2011, 83/2014 – second law and 5/2015

⁵⁶ Companies Act, OG of Republic of Croatia No. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15

⁵⁷ Art. 4. LOLPCO of Republic of Serbia and Art.1 Par.2 LOLPCO of Republic of Croatia ⁵⁸ Art. 5.

Par. 1 LOLPCO of Republic of Serbia and Art.1 Par.2 LOLPCO of Republic of Croatia

⁵⁹ Art. 37. Companies Act of Republic of Croatia, OG No 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111 / 12, 68/13, 110/15

there.⁶⁰ In accordance with those provisions that relate to the foreign company the question is what happens in circumstances where a company in its home country has no legal status of a legal person. The answer to this question should always be sought in the Art. 5 Paragraph 1 of LOLPCO of Republic of Serbia (Art.1 Par.2 LOLPCO of Republic of Croatia); no matter that the foreign legal person does not have a status of a legal person in its home country⁶¹ if it has one in accordance with the regulations of the Republic of Serbia and Republic of Croatia it shall be held liable for committing an offense. Using extensive interpretation is justified by the need to incriminate the criminal activities of legal persons even in cases when they do not have a status of a legal person under foreign law.⁶² For the application of legal provisions it is irrelevant whether a legal person has a branch in the territory of the Republic of Serbia, because this is criminal activity.

4.2. Natural person

The main characteristic of a legal person - company is that its assets consist of material and personnel substrate. While the law puts the emphasis on the liability of a legal person, as a person who possesses legal capacity and therefore can be held liable for a crime, individuals who poses reason, and which make the personal substrate of a legal person - company are important for its business. It is in this personal substrate as part of the assets of a legal person - company that includes persons whose decisions influence policy making. These are persons (directors, management) which are in the category of persons authorized by law or internal regulations.

Following the legal tradition provided by the provisions of the Economic Offences Act which point out that a liable person within a legal person can be held liable for the economic offense,⁶³ the law provides that a natural person is also held liable for the criminal acts that are attributable to the legal person.⁶⁴ In determining which natural persons may be held liable it should be stated that a liable person is considered "... a natural person who is legally or factually entrusted with certain jobs within a legal person, as well as the person authorized, or for which it is deemed to be authorized to act on behalf of a legal person".⁶⁵ Similar to this definition is the definition contained in the Act on Economic Offences of Republic of Serbia which provides that the liable person is "... a person who is entrusted with specific tasks in the field of economic and financial operations of a legal person ...".⁶⁶ LOLPCO of Republic of Croatia united the above definitions to state that the liable person is ... "a natural person conducting business of a legal person or is entrusted with jobs from area of activity of a legal person."⁶⁷ However, although with the interpretation of both definitions of the liable person we come to the conclusion that this is a person who has been entrusted with a "specific scope of affairs" within the legal person, the definition contained in LOLPCO RS and LOLPCO of Republic of Croatia RH is more comprehensive. Liable can be considered any natural person within the legal person who is factually or legally assigned to perform certain tasks. It should be noted that here we have a *question facto* being evaluated in each case, with the need to take into account the internal regulations of the legal person, and especially the fact that their responsible persons are

⁶⁰ Vasiljević, M.: Company law, Beograd, 2010, p. 105

⁶¹ Best example is a partnership society which in legal systems of Germany and England does not have a legal personality, while according to our positive law that business organization falls into the category of a legal person and as such possesses legal personality from the moment of registration. Vrhovšek, M., aforementioned work,

⁶² Ilić, G.: Marginal notes to the Law on corporate liability for criminal offenses, CRIMEN (I) 2/2010, p. 246–256, p.248.

⁶³ Art. 6. Par. 1. Law on Economic Offences of Republic of Serbia

⁶⁴ Art. 5. LOLPCO of Republic of Serbia and Art.4 and 5 of LOLPCO of Republic of Croatia ⁶⁵ Art. 5. Par. 2. Ibid.

⁶⁶ Art. 8. Par. 1. . Law on Economic Offences of Republic of

Serbia ⁶⁷ Art. 4. LOLPCO of Republic of Croatia

authorized to act on behalf of the legal person⁶⁸ that entrusted them with certain tasks.⁶⁹ Regulating the responsibilities of persons performing certain tasks on the legal basis legislator formalizes this kind of liability. However, a special form of liability which made a significant step forward in the area of responsibility of the natural person is: a) where a person within the legal person (employee) is without any legal basis entrusted to perform tasks for which it is not competent, or b) when a person who has no employment status is entrusted to perform certain tasks and it is not a case of a contractual relationship.⁷⁰ Finally it should be noted that by standardizing a specified mode of liability of natural persons by the legislature grounds for liability of legal persons for criminal offenses has been significantly expanded.⁷¹

5. ANALYSIS OF CRIMINALLY CHARGED, INDICTED AND CONVICTED LEGAL PERSONS IN REPUBLIC OF CROATIA

In this paper we have performed and presented the analysis of criminally charged, indicted and convicted legal persons in the five-year period, from 2011 to 2015. Further to the above, we have shown criminal offenses of legal persons for specific types of crimes and the very structure of the reported crime.

The table below No.2 shows the total number of criminally charged, indicted and convicted legal persons in that period. As for the number of criminally charged legal persons there is a notable fall from year to year. In fact, in 2011 there were 1508 charged legal persons, and in 2012 the number of charged legal persons has dropped by almost 30% and amounted to 1054. In 2013 it was even lower, with only 778, while in 2014 it reached the lowest number of only 717. In 2015 there was a small increase in legal persons charged for criminal acts of 812 on annual basis. The number of indicted legal persons in the period from 2011 to 2015 was relatively small compared to the actual number of charged legal persons. The largest number of indicted legal persons (406) was in 2013, and the lowest number (173) relates to the year 2015. The number of convicted legal persons in the five-year period varied from a minimum number (53) in 2015, up to a maximum number (193) in 2012. We can immediately notice that there is an appreciable discrepancy in relation to charged and convicted legal persons, for example, in 2011 for the total number of charges (1508) there were only 119 convicted legal persons or 7.89% of all criminally charged legal persons. Similar situation applies to 2015, with the total number of charged legal persons (812), and only 53 or 6.53% convicted.

Table No. 2. LEGAL ENTITIES PERPETRATORS OF CRIMINAL OFFENCES – REPORTED, ACCUSED AND RECOGNISED AS RESPONSIBLE⁷²

2011.	2012.	2013.	2014.	2015.	
1 508	1 054	778	717	812	Reported
266	383	406	310	173	Accused
119	193	143	120	53	Recognised as responsible

⁶⁸For example, procurator, legal representative, see Vasiljević, M., *aforementioned work*, str. 113-120.

⁶⁹Ilić, G., *aforementioned work*, p. 249.

⁷⁰Stojanović, Z.: The Criminal Code Commentary, Beograd, 2006, p. 311.

⁷¹Djurdjevic, Z.: Commentary on the liability of legal persons for criminal offenses, OG, Zagreb, p. 45.

⁷²Croatian Bureau of Statistics, Republic of Croatia, Communication 27.04.2016., NUMBER: 10.1.4, LEGAL ENTITIES PERPETRATORS OF CRIMINAL OFFENCES, BY TYPE OF DECISION, 2015

Table No 3. COURTS' DECISIONS AND CRIMINAL PENALTIES OR OTHER MEASURES, BY TYPE OF CRIMINAL OFFENCES, 2015⁷³

Criminal offences against							Official duty	Other criminal offences	Indices 2015. 2014.	
Total	Labour relations and social insurance	Environment	Public safety	Property	Economy	Intellectual property				
173	8	19	7	10	114	1	5	9	55,8	Total
53	5	11	5	1	25	-	1	5	44,2	Recognised as responsible
120	3	8	2	9	89	1	4	4	63,2	Not recognised as responsible
10	-	-	-	2	8	-	-	-	62,5	Rebuff
83	1	5	-	5	67	-	2	3	70,3	Terminated criminal proceeding
14	2	2	1	1	5	-	2	1	43,7	Judgement of acquittal
13	-	1	1	1	9	1	-	-	54,2	Judgement rejecting charges
53	5	11	5	1	25	-	1	5	44,2	Criminal penalties and other measures – total
53	5	11	5	1	25	-	1	5	44,2	Fine
9	3	-	-	1	5	-	-	-	20,0	5 000 – 10 000
22	2	4	4	-	8	-	1	3	52,4	10 001 – 20 000
15	-	2	1	-	11	-	-	1	57,7	20 001 – 50 000
2	-	1	-	-	1	-	-	-	33,3	50 001 – 100 000
5	-	4	-	-	-	-	-	1	500,0	Above 100 000
3	-	2	-	-	1	-	-	-	42,9	Confiscation of pecuniary benefit acquired by a criminal offence

Table No.3 shows types of criminal offenses for which legal persons have been found responsible in 2015 as well as the types of criminal sanctions that are imposed on them. The total number of the accused legal persons in 2015 was 173, out of which only 53 legal persons were found responsible. Of the 53 convictions, criminal sanction of fine has been imposed in all of them, and in three cases there was also a forfeit of proceeds of crime. Most were convicted to a fine ranging from 10,001 to 20,000 HRK (22 legal persons), and a fine from 20,001 to 50,000kn (15 natural persons). Legal persons were convicted largely due to crimes committed against the employment and social security, environment, public safety, property, economy, intellectual property, official duty, and some other criminal offenses. In the first place are crimes relating to offenses against the economy (25), while in the second are crimes against the environment (11).

Let us compare the situation in relation to the charged, indicted and convicted legal persons for criminal offenses relating to the period immediately after the adoption of the LOLLPCO Croatia, for the period from 2005 to 2009. Overview can be seen in Table No.4.

Table No. 4 Criminally charged, indicted and convicted legal persons for criminal offenses from 2005 to 2009⁷⁴

2005			2006			2007			2008			2009		
CH	IN	CO	CH	IN	CO	CH	IN	CO	CH	IN	CO	CH	IN	CO
149	11	8	310	23	17	597	64	39	666	130	80	844	133	84

⁷³ Ibid.

⁷⁴ Novosel D., Rogić-Hadžalić, D.: Criminal liability of legal persons for criminal offenses 2005 - 2009, Central Bureau of Statistics, Zagreb, 2010, p.10.

When LOLPCO of Republic of Croatia was first passed and in the early years of its implementation, in 2005, there was a relatively small number of legal persons charged for criminal offenses (149). However, the number of charges has increased from year to year, in 2006 (310), in 2007 (597), and in 2009 there were 844 criminally charged legal persons. 2011 with 1508 charged legal persons is the year with the highest number of criminal charges, and 2005 with only 149 charges is the year with the lowest number of charged legal persons. The same situation is with regard to convicted persons. Least convictions were recorded in 2005 (8), in order for that number to rise in the next few years and in 2009 there were in total 84 legal persons convicted.

6. CONCLUSION

In the process of joining the EU when we strive for more comprehensive unification of legal space, countries that belonged to the legal system of former Yugoslavia are required to adjust legal acts that have already been enacted and legal acts that are yet to be passed with the legal norms of the EU. The paper puts a special emphasis on the legal standardization of corporate liability for crimes from the perspective of the legal system of the Republic of Serbia and Croatia, because they use to both belong to a single legal system. When principle *societas delinquere non potest* was valid, therefore, before the introduction of criminal liability of legal persons, legal entities in the Republic of Serbia and Croatia were punished for economic offenses and misdemeanors.

Although the law on criminal liability of legal persons is a success of legislature, it should be noted that the legislation does not constitute voluntary legal regulations of the legislature of the Republic of Serbia and Croatia, but it is a result of international commitments. Legal persons are criminally liable according to the model of derived, subjective and cumulative liability, provided that the legal person will be punished for a criminal offense of a liable person and in the event that the existence of legal or factual obstacles to establishing the liability of the liable person is determined. The law on criminal liability of legal persons is *lex specialis* because of the possible objections on account of strict liability in criminal law.

The law represents a significant step forward in fuller and more complete legal regulations of corporate liability for the behavior of the market, however, there is one crucial questions of whether such a law in the public interest. The answer to this question can move in two directions: a) that there is a sincere desire to see its application to preventively influence the behavior of legal and responsible persons and b) that the legal act is only in public interest in the field of fulfilling international commitments, and without sincere wishes for its implementation.

Criminal liability of legal persons should be a necessary tool in the fight and crime prevention of each state because only the criminal law can achieve retribution, prevention and rehabilitation.

ACKNOWLEDGEMENT: *This research has been fully supported by the Croatian Science Foundation, under the project number 1949. „Multidisciplinary Research Cluster on Crime in Transition - Trafficking in Human Beings, Corruption and Economic Crime“*

LITERATURE:

1. Civil Obligations Act of Republic of Serbia, OG of the SFRY, No. 29/78, 39/85, 45/89 and decision USJ and 57/89, OG of the SFRY” no. 31/93 and OG of Serbia and Montenegro, No. 1/03 - Constitutional Charter
2. Civil Obligations Act of Republic of Croatia, OG No.35/05, 41/08, 125/11, 78/15

3. Council of Europe: Liability of enterprises for offences; Recommendation No. r (88) 18 of the committee of ministers to member states concerning liability of enterprises having legal personality for offences committed in the exercise of their activities
4. Companies Act of Republic of Croatia, OG No 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111 / 12, 68/13, 110/15
5. Convention on Cybercrime; Law on Ratification of the Convention on Cybercrime, OG OG International Agreements No. 9/02
6. Criminal Code of the Republic of Croatia, OG No. 125/11, 144/12, 56/15, 61/15
7. Criminal Law Convention of the Council of Europe Convention on Corruption, the Law on Ratification of the Criminal Law Convention on Corruption, OG International Agreements, No. 11/00
8. Criminal Procedure Act of the Republic of Croatia, OG No. 152/08, 76/09, 80/11, 121/11, 91/12, 143/12, 56/13, 145/13, 152/14
9. Croatian Bureau of Statistics, Republic of Croatia, Communication 27.04.2016., NUMBER: 10.1.4, LEGAL ENTITIES PERPETRATORS OF CRIMINAL OFFENCES, BY TYPE OF DECISION, 2015
10. Derenčinović D., Novosel D.: ACT ON THE CRIMINAL RESPONSIBILITY OF LEGAL ENTITIES –TEMPORARY CHILDHOOD DISEASES OR THE SQUARING OF THE CIRCLE?, Croatian Annual of Criminal Law and Practice (Zagreb), vol. 19, No 2/2012, p. 585-613.
11. Djurdjevic, Z.: Commentary of Act on Liability of Legal Persons for Criminal Offences, OG, Zagreb, 2005
12. French Penal Code, available at:
<http://www.legislationline.org/documents/section/criminal-codes/country/30>
13. Government of Republic of Croatia: Final draft of the Law on liability of legal persons for criminal offenses, Zagreb, December 2002
14. Ilić, G.: Marginal notes to the Law on corporate liability for criminal offenses, CRIMEN (I) 2/2010
15. Law on the liability of legal persons for criminal offenses, OG of Republic of Serbia", No. 97/2008
16. Law on liability of legal persons for criminal offenses, OG of Republic of Croatia No.151/03, 110/07, 45/11, 143/12
17. Law on Obligations, OG of Republic of Croatia No.35 / 05, 41/08, 125/11, 78/15
18. Law on Enterprises, OG of Republic of Serbia No. 36/2011, 99/2011, 83/2014 – second law and 5/15
19. Companies Act, OG of Republic of Croatia No. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15
20. Law on Misdemeanors, OG of Republic of Serbia, No. 65/13 and 13/16
21. Law on Economic Offences, OG of the SFRY, No. 4/77, 36/77 - corr., 14/85, 10/86 (consolidated text), 74/87, 57/89 and 3/90 and OG No. 27/92, 16/93, 31/93, 41/93, 50/93, 24/94, 28/96 and 64/2001 and OG of RS, No. 101/2005 – second law
22. Law on economic offenses OG of SFRY, No. 4/77, 14/85, 74/87, 57/89 and 3/90
23. Law on the Office for Combating Corruption and Organized Crime, OG of Republic of Croatia 76/09, 116/10, 145/10, 57/11, 136/12, 148/13
24. Law on takeover of the Law on economic offenses, OG of Republic of Croatia No 53/91
25. Law on Offences envisaged the abolition of economic misdemeanors and their transformation into offenses, OG of Republic of Croatia, No 88/02

26. Novosel D., Rogić-Hadžalić, D.: Criminal liability of legal persons for criminal offenses 2005 - 2009, Central Bureau of Statistics, Zagreb, 2010
27. Source: Republic Institute for Statistics of Republic of Serbia
28. Stanković, O., Vodinelić, V.V.: Introduction to Civil Law, Nomos, Beograd, 2004
29. Stojanović, Z., The Criminal Code Commentary, Beograd, 2006
30. Vasiljević, M.: Company law, Beograd, 2010
31. Vrhovšek, M., A legal person as the perpetrator of the crime pursuant to the liability of legal persons for criminal offenses, Journal of Criminology and Law

THE DYNAMICS BETWEEN RELIGIOUS FREEDOM AND EMPLOYMENT CONTRACT: A JURIDICAL CHRONICLE

Susana Sousa Machado
ESTGF.IPP / CIICESI, Portugal
scm@estgf.ipp.pt

ABSTRACT

The subject of the relationship between employment contract and religious freedom is a phenomenon which encompasses a growing conflictuality. There is already a strong awareness that the employee, when celebrating an employment contract, must not be deprived of the fundamental rights granted to all citizens. This state of affairs leads to ascertaining the relevance of protecting the employee's religious freedom. These reasons were paramount to determining the usefulness of building valiative criteria which contribute to the conformation of religious freedom on the employment contract, a task we will develop on the special framework of labour relationships. This article intends to reflect upon the articulation of the fundamental right to religious freedom within the labour relationship and all the heterogeneous network of reflexes that occur therein. The text is based upon a generic approach to the subject, yet seeking to find connecting points and especially to enrich the dogmatic questioning of the dynamics between religious freedom and employment contract.

Keywords: religious freedom, fundamental rights, workplace.

1. INTRODUCTION

One of the most controversial subjects to be found in the domain of Labour Law is that concerning the inference of the employee's religious freedom on the labour relationship (Fahlbeck, 2004, p. 28). Although being a relatively new theme, it begins to have an increasingly prominent impact on employment contracts. In fact, modern societies experience a certain degree of fragmentation and diversification of the religious phenomenon (Valdés Dal-Ré, 2006, pp. 575-576) once the cultural and religious monolithic standards of before, gave way to an accentuated religious pluralism.

In fact, there is a growing number of cases carried by religious freedom to the labour law order that are not limited to the prohibition of discriminatory behaviours but that accentuate a conflict of duties among, on the one hand, duties arising from the religious sphere and, on the other hand, duties relating to the execution of the employment contract.

In light of the problematic thus outlined, we intend to analyze the several dimensions of the subordinate employee's religious freedom and point out legally relevant criteria in face of the conflicts between religious freedom and labour duties. As far as we are concerned, in order to achieve the desired outcome, an integrated analysis of the subordinate employee's religious freedom and the employer's tolerance towards the specificities of the religious beliefs of the aforementioned employee will be necessary. It is our interest, above all, to ascertain whether the employer is bound by a duty to adapt its business organization when confronted with issues of (in)compatibility between religious freedom and the fulfilment of the employment contract. Although the main issue just referred to, is one of great dogmatic complexity, we will diligently seek to cast the first stone for the building of a system which allows for the setting of the conditions and articulation criteria between religious freedom and subordinate work.

2. ANALYSIS OF POTENTIAL SOURCES OF CONFLICT

External manifestation of religious beliefs must be a reality as no believer can be forced to keep his or her religious freedom private, even in the scope of working life. The solution to the conflict at issue would be much easier if the legal instruments limited themselves to referring

that the employer couldn't interfere with the employee's exercise of their right to religious freedom, yet, on the other hand, such as exercise should be kept as part of the individual's private affairs. Pointing this scenario as unreal, Savatier ends up concluding that "it is the entire life of the believer which is affected by his/her religious faith" (Savatier, 2001, p. 458). However, for the employee's religious freedom to make sense, he must be able to express his/her beliefs, convictions and acts of faith publicly in his/her daily provision of work. For a more informed reflexion, it is important to analyse some specific cases concerning different domains of manifestation of religious beliefs with repercussions on the labour relationship that have already been decided by the competent courts.

2.1. The organization of working time

The assertion of religious freedom can also be seen in the organization of working time, particularly in cases where the religion professed by the employee requires that a certain day is intended to rest or to practice a specific ritual. It should be noted, in this regard that the UN Declaration of 25 November 1981 on the elimination of all forms of discrimination and intolerance based on religion and beliefs applies to the freedom to observe days-off and to celebrate holidays and ceremonies in accordance with the precepts of one's religion or belief (article 6).

The European Court of Human Rights has already addressed this issue on the Konttinen case concerning the dispute between the employer and an employee who had converted to the Seventh-Day Adventist Church and who claimed not to work from Friday sundown until Saturday sundown (Sabbath) ending up being made redundant due to absences (Case Tuomo Konttinen versus Finland 3 December 1996.). In the aforementioned case, the Court ruled that what was at stake was a dismissal for absences and not due to the religious beliefs of the employee as the later, in case of incompatibility between religion and work, would be free to resign. This is clearly a "simplistic and unsatisfactory response" based on elementary reasoning, given the scale of the problem (Gomes, 2007, p. 310). It's interesting to note that, also in

France, the dismissal based on absences of a Muslim employee on a worship day prescribed by her religious faith (Aid-al-Kabir) was considered to be justified (Case reported by GOMES, 2007, p.310).

In this area, the decisions of the North American and Canadian case law are very distinct from those we have just laid out.

Hence, in the United States of America the Supreme Court considered that an employee who should alter his/hers religious beliefs during the course of the contract can, justifiably, refuse to work under the same conditions in which he used to work.

Summing it up, the courts impose upon the employer the duty of seeking to attend, within reason, to the religious practices of his/her employees, as long as that does not involve substantial sacrifice.

In Spain, in a case in which a believer of the Seventh-Day Adventist Church wished to enjoy his weekly day-off on a Saturday instead of Sunday as the other employees, the Constitutional Court considered that the employer could accede to such a demand although he was under no obligation to do so (Judgment of the Spanish Constitutional Court, CC n. 19/85, described by Abrantes, 2005., p.144-145). In this case, the Court argued that the Constitution forbids the employers from a "coercivity contrary" to the fundamental rights of the employees while at the same time it does not oblige them to submit the structure of the productive organization to the exercise of such rights.

In Portugal, the Constitutional Court has already recognized the right of the believers of the Seventh-Day Adventist Church not to work on Saturdays, having ascertained that shift work is a form of flexible work and thus, employees may ask for suspension from work. This may occur under certain circumstances, namely the possibility of compensating the work in another period.

Apart from the hindrance to work on certain week days, we can also verify situations altogether similar with respect to the issue of praying at work. As a matter of principle, the employee is free to pray whenever he/she wishes to but there is no clear duty on the employer's part to facilitate that exercise. Even with regard to places for prayer within the company, all will depend on the employer's good will and, obviously, on the company's dimension. Thereby, the employer may sanction the employees who insist on praying with prejudice to the fulfilment of the contract, the fulfilment of the company's activity or even its image. Moreover Brisseau stresses that the prohibition on prayer in the company may not be taken an absolute ban but should only be permitted in appropriate cases and for objective reasons considering, however, that if praying takes place during working time or is contrary to safety requirements, may be prohibited (Brisseau, 2008, p. 975).

2.2. Religious symbols

Another issue that may rise, concerns the display of religious symbols, which is often subject to misunderstanding on the part of the employer, co-workers and customers. It should be taken into account that the use of external symbols is also a manifestation of religious beliefs and the major difficulty is to know to what extent it would be lawful for the employer to restrict their use.

As Savatier states, the Islamic veil, except for safety reasons to the employee or to a third party, has no negative influence on the execution of work, which leads the employers to take refuge, in order to impose restrictions to its use and not to compromise the company's image "behind the hostility of the staff regarding veiled employees" but that "hostility would be suspicious and related to racism and not enough to exonerate the employer from his/her obligation of non-discrimination" (Savatier, 2004, p. 356).

In France, there has been a decision to integrate into the dismissal with just cause, the fact that an employee, selling female fashion items was wearing the clothing appropriate to the Islamic faith, which covers the body from head to toe, leading the court to consider that such clothing did not meet the demands of fashion and the customers' expectations (Judgment of 9 September 1997 of the Cour d' Appel de Saint -Denis de la Réunion , D 1998, 546). In this sense, Brisseau understood that, although employees may dress as they please, the company's image may also justify restrictions on the freedom of clothing (Brisseau, 2009, p. 973).

Another case occurred in Germany, where a saleswoman at the perfume section of a department store, after returning from maternity leave, informed her employer that, given the development of her religious beliefs, she intended to wear the Islamic veil. In this case, the first instances ruled in favour of the employer mainly because, parallel to the employee's religious freedom, the employer could also invoke competing fundamental rights, given the fact that, when faced with the costumer's reactions, he/she could suffer damage and prejudice to his/her right of property and also, for that matter, there was no other jobs available. Despite such arguments, the Federal Labour Court considered that the employee had all the conditions to fulfil her job and that the employer should take into account the freedom both of consciousness and of belief and carry out the contract in good faith. Thus, the Court also considered that, the Islamic veil is not a mere piece of clothing but rather the symbol of a religious faith and that the employee was, thereby, exercising her religious freedom. The mere fear of a negative reaction of the customers' part shouldn't justify a restriction to the exercise of a religious freedom constitutionally guaranteed.

The European Court of Human Rights has also ruled on the use of religious symbols. Indeed, the 2001 *Dahlab vs. Switzerland* case, regarding the claim of an elementary school teacher who wanted to wear the Islamic head scarf, the ECHR considered that the use of the headscarf was not compatible with gender equality and, on the other hand, it would be a very strong signal to

use front of impressionable children (Case Lucia Dahlab vs. Switzerland, 15 February 2001). The decision includes the following and rather interesting passage: “It seems difficult to reconcile the use of the headscarf with the message of tolerance, respect for others and, above all, equality and non-discrimination that all teachers in a democratic society should convey to their students.”

Actually, for many believers, the use of the veil or of other garments or symbols is not so much an option or choice but rather “as something which is part of one’s individuality” (Case Lucia Dahlab vs. Switzerland, 15 February 2001). The use of religious symbols is not always the outcome of a rational decision but, most of the times, the result from an obligation towards the divine (Cumper and Lewis, 2008, pp. 299-230).

More recently in the Eweida case of the ECHR, an employee for the airline company British Airways, was prohibited to wear a crucifix around her neck by legal requirement of the company’s rules of procedure. It was considered that too much weight was bestowed on the company’s interest to build a corporate image. The Court also stressed the fact that the company allowed for the use of other religious symbols without any effect on the company’s image.

Summing it up, it was considered that the prohibition imposed by the employer and validated by the British Courts violated article 9 of the Convention.

2.3. Religion and food at work

It often happens that some religions impose dietary restrictions that may be more or less demanding, and that can range from fasting at certain times to the prohibition of eating certain foods. As a principle, the time for meals is not regarded as working time, thus the main issues may arise from situations of activities organized by the company, such as congresses or meetings. As Sciberras highlights, in such cases, the question is to ascertain whether the employer imposes attendance to such meetings even though he/she knows that the concerned employee will not eat, or if he/she should not take into account the employee’s religious beliefs when scheduling such events, outside, for instance, the Ramadan period so that Muslim employees can participate on equal terms with the remaining co-workers (Sciberras, 2010, p.

75). There is also the question of whether the company’s canteen should provide a specific menu according to the different religious beliefs of the employees.

We believe that, from the sources of conflict to which we have pointed out, this would be the one less felt but whose solution requires, first of all, that employers seek to inquire and to acknowledge the employees’ religious beliefs in order to take them into account when carrying out the organization work.

3. GOOD FAITH AS A WEIGHING FACTOR

As it has been seen, one cannot require that the employee’s religious beliefs remain private for these may have an expression on their daily living, which, obviously, includes work since the employee does not suspend his or her beliefs for a few hours. However, despite the truthfulness of such a statement, specific criteria allowing for religious freedom not to collide with the execution of the contract should be arranged, in what might be called the intervention of good faith

The safest path should be enlightened by good faith, one which requires the employer to produce a reasonable effort in order to adapt the functioning of the company to its employee’s religious needs always looking on the particular case and avoiding to make excessive demands to the employer. But the recognition that religious freedom must go hand in hand with the requirements of the contract, requires that the aforementioned contract must be fulfilled according to the good faith imposed on both the employee’s side as the employer’s side.

Also Gaudu, confirming that good faith should be a standard of behaviour, understands that it is not precise that the employee must bring all his/her religious requirements to the attention of the employer at the time of the recruitment contract he nevertheless believes that good faith implies that the employer sincerely considers the employee's requirement (Gaudu, 2010, p. 69). In the context of access to employment, protection of religious freedom requires that the candidate will not be asked about his/her religious beliefs, although the same should be required during the execution of the employment contract. Indeed the employee's religious beliefs have no impact whatsoever on his/her capacity to execute work, except from exceptional cases of organizations whose purpose is the observance of religious acts, for in such cases, religious beliefs may come as a requirement for the exercise of the relevant profession.

On the other hand, invocation of economic damage for the employer cannot, by itself, be taken as a legitimate argument for restricting religious freedom. Let's, for instance, consider that we wouldn't have a shadow of doubt in stating that the idea of an employee being made redundant on the grounds of pregnancy is, in itself obnoxious and that, in that very same case, the employer could also invoke economic interests. On the other it would seem that the employer cannot take refuge on costumers' pressure, passing it on to their discriminatory attitude, rather than on to himself. We could consider, for instance, that a cleaning company could not refuse to contract men arguing that the costumers prefer that sort of job done by female employees. In specific cases, in the field of labour relationships, the employer's freedom to contract cannot overlap everything else, as the employee's religious freedom needs to be taken into account, and, in this specific context, the safeguarding of his/her job in view of xenophobic attitudes from costumers. Furthermore, the mere fear of costumer's reactions based on their attitudes is not a reason worth being considered for redundancy purposes.

The issue under analysis turns out to be a question of rights which requires resorting to the principle of proportionality and to the least possible restriction to the interests in conflict, based on good faith considerations and yet, always bearing in mind the specific case.

4. RELIGIOUS FREEDOM OF THE SUBORDINATE EMPLOYEE: FROM TOLERANCE TO ADAPTATION

Having analyzed the potential trouble spots, it is paramount to reflect upon possible criteria that may guide to a solution in the cases of conflict of rights between the employee's religious freedom and the employer's freedom for private economic initiative.

We could think of a solution with criteria based on contractual freedom, in which the positive dimension of religious freedom would be hindered at the moment of conclusion of the contract, insofar as we would be faced with the employee's consent. However, this purely contractualist position deserves criticism. The conclusion of an employment contract presupposes, naturally, that the fundamental rights of the employee will be limited as a result of weighting the legal assets. From this conception, what really needs to be outlined is the fact that the employee, when signing the employment contract, does not waive his/her fundamental rights. It thus appears to us that, the conflict between the employee's religious freedom and the employer's freedom for private economic initiative cannot be debated on a purely contractual plan.

It is paramount to take into account the dialectic between recognizing the employee's religious freedom and the employer's duty to shape the business organization in such a way that working duties are outlined according to certain religious beliefs. Although we are not able to clearly determine a rule which would solve all conflicts, some criteria for assessing with some degree of accuracy in which cases is the employers bound to an obligation of tolerating or even adapting, within reason, to the employee's religious requirements must called into question.

First of all, to address the employer's bond to a duty of tolerance and of acceptance, one must consider that the measures to be adopted must have an insignificant cost to the employer. As has been stated by the doctrine, the American case law has been addressing the issue through

the employer's duty to an adaptation that presupposes a minimum cost, so that the entrepreneur is not required to bear economic costs.

Another criterion to be considered and one which follows from the previous, concerns the very company, inasmuch as we consider that its *dimension* and *economic situation* should be taken into account. This, due to the fact that the cost of the adaptation measures may be a relative value depending on the economic and financial health of a business.

At large, the act of the employer deterrent of the employee's exercise of his/her religious freedom must not surpass reasonable requirements should be needed in order to achieve the goals pursued and must , also, be proportionate in relation to the sacrifice imposed on the rights protected (Valdés Dal-Ré, 2003, p. 99).

We would go as far as stating that the employer has the duty of adapting, within reasonable conditions, the running of the company to the fulfilment of its employee's religious freedom.

A rationale of confronting the employee with the choice between work and religion empties of all meaning the religious freedom constitutionally enshrined.

All this is worth in the present, so that in the (near) future, we may be able to demand that the employer, depending on the ascertainment of the already mentioned criteria, strives to adapt the running of the company to the religious needs of its employees. All of which, obviously, within an approach of reasonability, in view of the circumstances of the specific case and avoiding (excessive) costs to the employer.

LITERATURE:

1. Abrantes, J. J. (2005). *Contrato de Trabalho e Direitos Fundamentais*, Coimbra Editora, Coimbra.
2. Brisseau, Claire (2008). La religion du salarié, *Droit Social*, n.º 9/10, 969-980.
3. Cumper, P. and Lewis, T. (2008). Islamic Dress, Personal Autonomy and the European Convention on Human Rights, *Revista de la Facultad de Derecho de la Universidad de Granada, Creencias religiosas y Derecho*, n.º 11, 293-303.
4. Fahlbeck, R. (2004). Ora et Labora – On Freedom of Religion at the Work Place: a Stakeholder cum Balancing Factors Model, *The International Journal of Comparative Labour Law and Industrial Relations*, vol. 20, 28-64.
5. Gaudu, F. (2010). La religion dans l'entreprise, *Droit Social*, n.º 1, 65-71.
6. Gomes, J. (2007). *Direito do Trabalho, Relações Individuais de Trabalho*, Vol. I, Coimbra Editora, Coimbra.
7. Savatier, J. (2001). Liberté religieuse et relations de travail , *Mélanges Verdier*, Dalloz, 455.
8. Sciberras, J. (2010). Travail et religion: une cohabitation sous tension, *Droit Social*, n.º 1, 72-75.
9. Valdés Dal-Ré, F. (2006). Libertad religiosa y contrato de trabajo, *Las transformaciones del Derecho del Trabajo en el marco de la Constitución Española*. Estudios en homenaje al profesor M. Rodríguez-Piñero y Bravo Ferrer, La Ley Madrid, 565-613.

DIGITAL SINGLE MARKET AND EU DATA PROTECTION REFORM WITH REGARD TO THE PROCESSING OF PERSONAL DATA AS THE CHALLENGE OF THE MODERN WORLD

Marija Boban

University of Split Faculty of Law, Croatia

Email: marija.boban@pravst.hr

ABSTRACT

Differences in the level of protection of personal rights, in particular the right to the protection of personal data, with regard to the processing of personal data in the Member States, may prevent the free flow of personal data throughout the Union. On 15 December 2015, the European Parliament, the Council and the Commission reached the agreement on the new data protection rules, establishing a modern and harmonised data protection framework across the EU. The European Parliament's Civil Liberties committee and the Permanent Representatives Committee (Coreper) of the Council then approved the agreements and the agreements were also welcomed by the European Council of 17-18 December as a major step forward in the implementation of the Digital Single Market Strategy. On 8 April 2016 the Council adopted the Regulation and the Directive and on 14 April 2016 the Regulation and the Directive were adopted by the European Parliament. On 27th April 2016 European Parliament has brought the new regulation (EU) 2016/679 of the European parliament and of the Council on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) and Directive (EU) 2016/680 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA. In this paper, the author will present the new EU data regulation reform, with regard to the development of informatin technologies and digital single market, processing and protection of personal data and on the free movement of such data on digital single market as well the legal challenges of modern world to the pursuit of economic activities in the field of ICT support to business acitivites, with regulation overview in the Republic of Croatia and in the EU as well, potentials of effect on distortion of competition and impeding the authorities in the discharge of their responsibilities under Union law.

Keywords: *data processing, data protection, digital single market, EU, information technologies, legal framework, personal data, regulation.*

1. INTRODUCTION

Rapid technological developments and globalisation processes have brought new challenges for the protection of personal data in surroundings of the modern world. Information and coummunication technologies are allowing both, private companies and public authorities, to make use of personal data on an unprecedented scale in order to pursue their activities which has direct implication and the scale of the collection and sharing of personal data has increased significantly. While business processes are dedicated to profit on the other hand those developments require a strong and more coherent data protection framework in the European Union, backed by strong enforcement, given the importance of creating the trust that will allow the digital economy to develop across the internal market. Former Directive 95/46/EC of the European Parliament and of the Council seeked to harmonise the protection of fundamental rights and freedoms of natural persons in respect of processing activities and to ensure the free

flow of personal data between Member States. Although the objectives and principles of Directive remain sound it has not prevented fragmentation in the implementation of data protection across the Union, legal uncertainty or a widespread public perception that there are significant risks to the protection of natural persons, in particular with regard to online activity. That's why the European Union, in order to achieve the final goal: Digital single market needed to go in the process of General Data Regulation Reform which will be presented in this paper.

2. DEVELOPMENT OF NEW INFORMATION AGE AND DIGITAL SINGLE MARKET

Today, we are living in the Information Age¹, new period in human history characterized by the shift from traditional industry that the Industrial Revolution brought through industrialization, to an economy based on information computerization. The onset of the Information Age is associated with the Digital Revolution, just as the Industrial Revolution marked the onset of the Industrial Age. (Castells, 1999, p. 120) During the information age, the phenomenon is that the digital industry creates a knowledge-based society surrounded by a high-tech global economy that spans over its influence on how the manufacturing throughout and the service sector operate in an efficient and convenient way. The term “*knowledge-based economy*” results from a fuller recognition of the role of knowledge and technology in economic growth. Knowledge, as embodied in human beings (as “human capital”) and in technology, has always been central to economic development. But only over the last decade has its relative importance been recognised, just as that importance is growing. (Westeren, 2012, p. 16) These trends are leading to revisions in economic theories and models, as analysis follows reality. Economists continue to search for the foundations of economic growth. Traditional “production functions” focus on labour, capital, materials and energy; knowledge and technology are external influences on production. Now analytical approaches are being developed so that knowledge can be included more directly in production functions. Investments in knowledge can increase the productive capacity of the other factors of production as well as transform them into new products and processes. And since these knowledge investments are characterised by increasing (rather than decreasing) returns, they are the key to long-term economic growth. It is not a new idea that knowledge plays an important role in the economy. Adam Smith referred to new layers of specialists who are men of speculation and who make important contributions to the production of economically useful knowledge. Friedrich List emphasised the infrastructure and institutions which contribute to the development of productive forces through the creation and distribution of knowledge. The Schumpeterian idea of innovation as a major force of economic dynamics has been followed up by modern Schumpeterian scholars such as Galbraith, Goodwin and Hirschman. And economists such as Romer and Grossman are now developing new growth theories to explain the forces which drive long-term economic growth. (Beck, 1992) According to the neo-classical production function, returns diminish as more capital is added to the economy, an effect which may be offset, however, by the flow of new technology. Although technological progress is considered an engine of growth, there is no definition or explanation of technological processes. In new growth theory, knowledge can raise the returns on investment, which can in turn contribute to the accumulation of knowledge. It does this by stimulating more efficient methods of production organisation as well as new and improved products and services. There is thus the possibility of sustained increases in investment which can lead to continuous rises in a country's growth rate. Knowledge can also spill over from one firm or industry to another, with new ideas used repeatedly at little extra cost. Such spillovers can ease the constraints placed on growth by scarcity of capital. Technological change raises the relative marginal productivity of capital through education and training of the labour force,

¹ Phrases often used as synonyms are the Computer Age, Digital Age and New Media Age

investments in research and development and the creation of new managerial structures and work organisation. Analytical work on long-term economic growth shows that in the 20th century the factor of production growing most rapidly has been human capital, but there are no signs that this has reduced the rate of return to investment in education and training (Abramowitz, 1989). Investments in knowledge and capabilities are characterised by increasing (rather than decreasing) returns. These findings argue for modification of neo-classical equilibrium models – which were designed to deal with the production, exchange and use of commodities – in order to analyse the production, exchange and use of knowledge. Incorporating knowledge into standard economic production functions is not an easy task, as this factor defies some fundamental economic principles, such as that of scarcity. Knowledge and information tend to be abundant; what is scarce is the capacity to use them in meaningful ways. Nor is knowledge easily transformed into the object of standard economic transactions. To buy knowledge and information is difficult because by definition information about the characteristics of what is sold is asymmetrically distributed between the seller and the buyer. Some kinds of knowledge can be easily reproduced and distributed at low cost to a broad set of users, which tends to undermine private ownership. Other kinds of knowledge cannot be transferred from one organisation to another or between individuals without establishing intricate linkages in terms of network and apprenticeship relationships or investing substantial resources in the codification and transformation into information. (Drahoš and Braithwaite, 2002) In the new era, in a commercialized society, the new form of so called information industry is able to allow individuals to explore their personalized needs, therefore simplifying the procedure of making decisions for transactions and significantly lowering costs for both the producers and buyers. This is accepted overwhelmingly by participants throughout the entire economic activities for efficacy purposes, and new economic incentives would then be indigenously encouraged, such as the knowledge economy. (Hilbert, 2015) The knowledge-based economy places great importance on the diffusion and use of information and knowledge as well as its creation. The determinants of success of enterprises, and of national economies as a whole, is ever more reliant upon their effectiveness in gathering and utilising knowledge. Strategic know-how and competence are being developed interactively and shared within sub-groups and networks, where know-who is significant. The economy becomes a hierarchy of networks, driven by the acceleration in the rate of change and the rate of learning. What is created is a network society, where the opportunity and capability to get access to and join knowledge- and learning-intensive relations determines the socio-economic position of individuals and firms (David and Foray, 1995). The network characteristic of the knowledge-based economy has emerged with changes to the linear model of innovation (Figure 1). The traditional theory held that innovation is a process of discovery which proceeds via a fixed and linear sequence of phases. In this view, innovation begins with new scientific research, progresses sequentially through stages of product development, production and marketing, and terminates with the successful sale of new products, processes and services. It is now recognised that ideas for innovation can stem from many sources, including new manufacturing capabilities and recognition of market needs. Innovation can assume many forms, including incremental improvements to existing products, applications of technology to new markets and uses of new technology to serve an existing market.

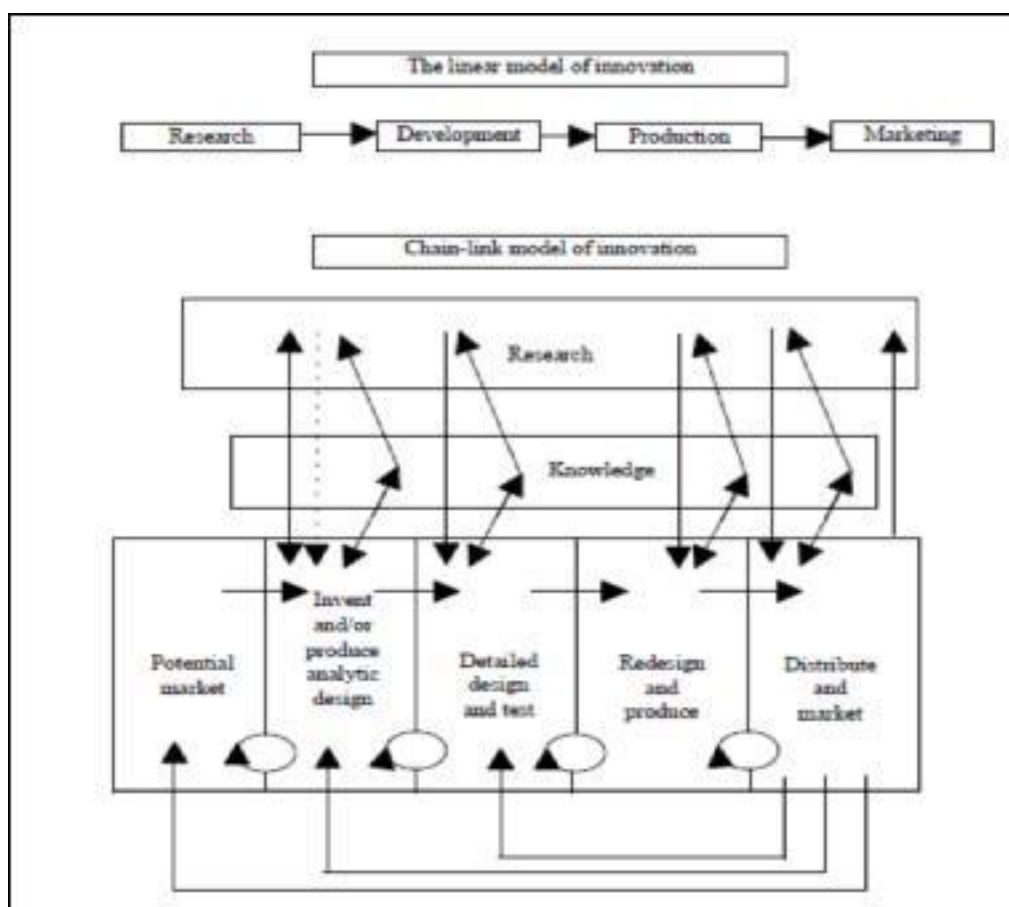


Figure 1: Models of innovation in knowledge based information economy (Source: Klein, S.J., Rosenberg, N. (1986), *An Overview of Innovation in R. Landau and N. Rosenberg (eds.), The Positive Sum Strategy: Harnessing Technology for Economic Growth*, National Academy Press, Washington DC.)

Also, on the other hand, the internet and digital technologies are transforming the world and European Union members have stated that existing barriers online mean citizens miss out on goods and services, internet companies and start-ups have their horizons limited, and businesses and governments cannot fully benefit from digital tools. The future of EU, as noted by European Parliament, is in potential of making the EU's single market fitting for the digital age – tearing down regulatory walls and moving from 27 national markets to a single one. In their analysis this transition will contribute €415 billion per year to EU economy and create hundreds of thousands of new jobs.²

² Data analysis available at European Commission, Official pages, retrieved 11. 08. 2016 https://ec.europa.eu/priorities/digital-single-market_en (11. 08. 2016.)

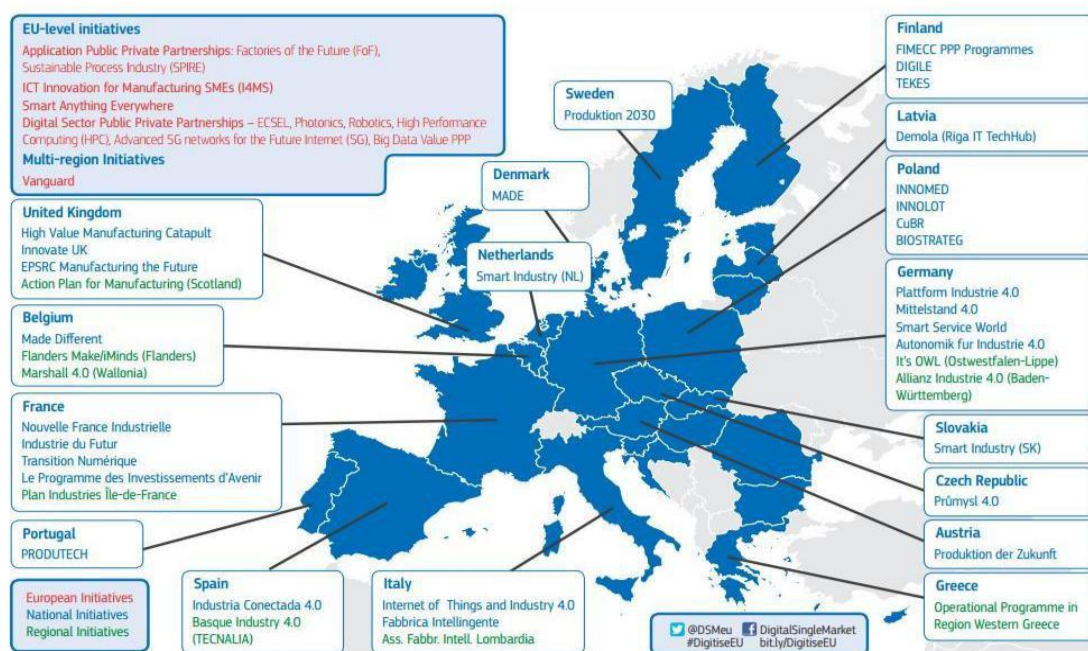


Figure 2: Overview on European Initiatives of Digital Single Market and Digitising Industry (Source: European Commission, retrieved 11. 08. 2016 from <https://ec.europa.eu/digital-single-market/en/digitising-european-industry>)

3. FREE FLOW OF INFORMATION AND DATA PROTECTION

New trends in the development of the information economy and development of information technologies have a significant impact on the free flow of information and the right to communication. They are primarily based on an intensive application of information and communication technologies in business to form a radical change in the perception of business resources - from physical (tangible) to digital (electronic) or intangible resources. Consequently this has not changed and specifically applies only to the technological characteristics but on all the activities, processes, structures, models, and thus changes the way of creating new values. (Spremić, 2004., p. 93). The transition from the traditional to the new economy in any case is not seen as a revolution, a sudden or unexpected turn of events, but as a series of small but irreversible developmental steps that rapidly alternating one another. (Panian, 2002., p. 55) For these settings, contemporary information economy emerges sovereignty of modern technology, internet technologies and communications while developing new technologies sovereignty. New technology was developed in the 20th century, in the 21st century experienced is its global updates and completeness. civilization rests on openness and ability to accept what is a crucial factor for the prosperity of communication sovereignty. (Čizmić and Boban, 2013., p. 290) The right to privacy in legal terminology is most often mentioned by the Anglo-American version of "Right to privacy". In French law however most times designated as "the right to respect for private life - *droit au respect de la vie*", and in Germany it is called "*Recht auf Privatheit*" or "*Recht auf Privatsphäre*". Instead of the notion of privacy as synonymous in the Croatian language is used and the concept of "distinctiveness: whereas according to their content, which is determined by factors outside the person, in connection with them, component the personality. (Brezak, 1998, p 12) Right to privacy, by legal definition, presents a basic human right, as internationally, as well as the constitutional right of public-legal significance and personal right of civil-legal significance as one of the indispensable elements of human existence that protects humans from excessive encroachment of state government, the public and other individuals in the individual's decisive mental, physical and information privacy. Also, it is important to compare and understanding personality through property relations,

which in turn possible breach of personal data is seen as a violation of the person (causing mental anguish, etc.) and not a property in the classical sense, nor on material values. (Krneta, 1970, pp 83) Thus, the right to privacy can be considered from several aspects: as a human right international legal nature, as a fundamental right guaranteed by the Constitution, and as an individual right protected by the instruments of civil rights. However, by itself, the right to privacy has absolute significance and operates "erga omnes" - to everyone - has a vertical relationship to the state authorities, and the horizontal relation to third parties. (Dika, 2006, p 267) However, by itself, is only important to act toward everyone, but not unlimited. Also, setting boundaries - either horizontal to other individuals or third parties, either vertically to government authorities, the foundation of the study of this paper. (Hendricks, 1990, p 12)

When and to what extent an individual can "interfere" in the performance of the privacy rights of another individual? There is only one right answer to this question. It is - illegality. Illegality, as a legal term, is defined as the limit that an individual may not exceed in achieving the opposite interest to preserve the inviolability of the right to privacy and the right to privacy. (Boban, 2012, p 576) Only a violation of privacy rights in the interest of the individual to maintain their privacy that prevail over the interests of that individual in exercising their rights, interfere with the right of privacy of another individual. Protecting data from abuse, ultimately protects the data subject, or person. So, the only distinction is grounded in the fact that it is not a violation of the data in the classical sense, but the violation of a person. Unfortunately, in recent history, more and more examples of violations of the right to privacy in the practice of European courts, whether it be a violation of the right to communication, or spatial information and privacy breaches and threats of personal data of citizens. With regards to the allegation that we can only establish that the person who increasingly becomes an object and all are less able to preserve its interests, rights, freedom, and especially intimate life. (Britz, 1999, p 351)

One of the assumptions of the development of modern democratic society is the right to create conditions for self-determination of citizens who are aware of their rights with the obligation of authorities to be informed about them. On the other hand, the modern state is obliged to ensure the protection of citizens' personality and therefore their dignity while preventing various forms of misuse of their personal data collected by government bodies. With a commitment accomplishment of these principles, the Republic of Croatia has created a normative framework which allows citizens access to information about the work of public authorities and ensures the privacy of citizens by prescribing ways of using and/or processing personal data. So, the easiest way to define the right to privacy is definition which determines the right to privacy as the basic human right and as a fundamental right of every individual, leading to a crisis of identity and personality. The foundation of thesis is that communication rights are fundamental human rights as it is strongly put in the *Constitution of the Republic of Croatia* ("Official Gazette" no. 56/90, 135/97, 8/98-revised text, 113/2000, 124/2000 - consolidated text, 28/2001, 41/2001-consolidated text, 85 / 2010-consolidated text - hereinafter *Constitution*). The Constitution of the Republic of Croatia Art. 36 explicitly state that "*The freedom and privacy of correspondence and all other forms of communication is guaranteed and inviolable*" (Official Gazette No. 85/10, revised). It guarantees the right to information (Constitution Art. 38, para 4), the right to participate in the media (Constitution Art. 38, paragraph 2, and the right to privacy (Constitution Art. 35). According to the given legal definition, the concept of privacy encompasses a number of spheres of human life, and the information about them: intimate sphere, private sphere, private-public sphere and public sphere of life. However, for the purposes of considering the protection of personal data, as a "fundamental element" of person in a defined legal requirements, national legislation of the Republic of Croatia popularly used term until the end of privacy that binds the value of personal data for intangible essence of each individual - each person. It is this relationship between the various features that define a person and that person, and their possible impact on

personal life, a need that, and such a person's right to protection compromising malicious use of such facts, is named „right to privacy“. It presents namely basic human right, both internationally and constitutional right of public-legal significance and in broader aspect personal right of civil-legal significance as one of the indispensable elements of human existence which protects a person from resorting to excessive government power, the public and other individuals in the individual's decisive mental, physical and informational privacy. (Boban, 2015, p 123)

Based on the Constitution, the legal framework of privacy and data protection in Republic of Croatia is regulated also by the following legislative: Law on Protection of Personal Data, Official Gazette of Republic of Croatia 103/03, 118/06, 41/08, 130/11, 106/12-revised text); Law on Right to Access Information, Official Gazette no. 172/03,85/15; Law on Information Security, Official Gazette of Republic of Croatia 79/07 and Law on Personal Identification Number, Official Gazette of Republic of Croatia, No. 60/08.(Boban, 2014, p 1689) In this area, as one of the most questions that the information society faces in today's digital economy is confidentiality of information, the second is availability and the third is integrity of the information. Together these three security principles form the basics of information security model which is namely intended for protection of access to information.(BÖHLEN, 2005., p 122)

4. GENERAL DATA PROTECTION REFORM

In contemporary information society, information is made pursuant to the process of public information, an integral part of the democratic and political process. Information became an important element of freedom and the right to disseminate information to a large extent depends on the legitimacy and management capabilities of data collections. It is obvious that the process of disseminating information, its printing, publication or broadcast in the media is subject to the erroneous interpretation. Logically, one of the constitutional and distinctive means of limiting the freedom of public information for the protection of personal rights is the right of correction of information.(Kelleher, 2016) The Republic of Croatia, as the entire member states of the European Union, was the signatory of the European Convention on Human Rights and the Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data, the European Commission was concerned that diverging data protection legislation would emerge and impede the free flow of data within the EU zone. Therefore the European Commission long ago decided to harmonize data protection regulation and proposed the Directive on the protection of personal data, which member states had to transpose into law by the end of 1998. In full name, Directive 95/46/EC on the protection of individuals with regard to the processing of personal data (Official Journal L 281 , 23/11/1995 P. 0031 – 0050) and on the free movement of such data contains a number of key principles which must be complied with. Anyone processing personal data needed to comply with the eight enforceable principles of good practice.

After over four years of discussion, the new EU data protection framework has finally been adopted. It takes the form of a Regulation – the General Data Protection Regulation (GDPR). On 15 December 2015, the European Parliament, the Council and the Commission reached agreement on the new data protection rules, establishing a modern and harmonised data protection framework across the EU. The European Parliament's Civil Liberties committee and the Permanent Representatives Committee (Coreper) of the Council then approved the agreements with very large majorities. The agreements were also welcomed by the European Council of 17-18 December as a major step forward in the implementation of the Digital Single Market Strategy. On 8 April 2016 the Council adopted the Regulation and the Directive. And on 14 April 2016 the Regulation and the Directive were adopted by the European Parliament. On 4 May 2016, the official texts of the Regulation and the Directive have been published in

the EU Official Journal in all the official languages. While the Regulation will enter into force on 24 May 2016, it shall apply from 25 May 2018. The Directive enters into force on 5 May 2016 and EU Member States have to transpose it into their national law by 6 May 2018. GDPR includes:

1. Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (GDPR, 2016)
2. Directive (EU) 2016/680 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA

The GDPR regulation applies if the data controller or processor (organization) or the data subject (person) is based in the EU. Furthermore (and unlike the current Directive) the Regulation also applies to organizations based outside the European Union if they process personal data of EU residents. The regulation does not apply to the processing of personal data for national security activities or law enforcement ("competent authorities for the purposes of prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties"). According to the European Commission "personal data is any information relating to an individual, whether it relates to his or her private, professional or public life. It can be anything from a name, a photo, an email address, bank details, posts on social networking websites, medical information, or a computer's IP address." (GDPR, 2016)

The main foundation of GDPR is that the regulation applies if the data controller or processor (organization) or the data subject (person) is based in the EU. Furthermore (and unlike the current Directive) the Regulation also applies to organizations based outside the European Union if they process personal data of EU residents. The regulation does not apply to the processing of personal data for national security activities or law enforcement ("competent authorities for the purposes of prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties"). According to the European Commission "personal data is any information relating to an individual, whether it relates to his or her private, professional or public life. It can be anything from a name, a photo, an email address, bank details, posts on social networking websites, medical information, or a computer's IP address." (Blackmer, 2016)

The proposal for the European Data Protection Regulation contains the following key changes: A single set of rules will apply to all EU member states. Each member state will establish an independent Supervisory Authority (SA) to hear and investigate complaints, sanction administrative offences, etc. SAs in each member state will cooperate with other SAs, providing mutual assistance and organising joint operations. Where a business has multiple establishments in the EU, it will have a single SA as its "lead authority", based on the location of its "main establishment" (i.e., the place where the main processing activities take place). The lead authority will act as a "one-stop shop" to supervise all the processing activities of that business throughout the EU[10][11] (Articles 46 - 55 of the GDPR).

A European Data Protection Board (EDPB) will coordinate the SAs. EDPB will replace Article 29 Working Party. There are also exceptions for data processed in an employment context and data processed for the purposes of the national security, that still might be subject to individual country regulations (Articles 2(2)(a) and 82 of the GDPR).

The notice requirements remain and are expanded. They must include the retention time for personal data and contact information for data controller and data protection officer has to be

provided. Automated individual decision-making, including profiling (Article 22) is made contestable. Citizens now have the right to question and fight decisions that affect them that have been made on a purely algorithmic basis. Privacy by Design and by Default (Article 25) require that data protection is designed into the development of business processes for products and services.

Data Protection Impact Assessments (Article 35) have to be conducted when specific risks occur to the rights and freedoms of data subjects. Risk assessment and mitigation is required and a prior approval of the DPA for high risks. Data Protection Officers (Articles 37–39) are to ensure compliance within organizations. They have to be appointed for all public authorities and for companies processing more than 5000 data subjects within 12 months.

Consent -Valid consent must be explicit for data collected and purposes data used (Article 7; defined in Article 4). Consent for children under 16[12] must be given by child's parent or custodian, and verifiable (Article 8). Data controllers must be able to prove "consent" (opt-in) and consent may be withdrawn.[13]

Data Protection Officer - where the processing is carried out by a public authority, except for courts or independent judicial authorities when acting in their judicial capacity, or where, in the private sector, processing is carried out by a controller whose core activities consist of processing operations that require regular and systematic monitoring of the data subjects, a person with expert knowledge of data protection law and practices should assist the controller or processor to monitor internal compliance with this Regulation. The DPO is similar but not the same as a Compliance Officer as they are also expected to be proficient at managing IT processes, data security (including dealing with cyber-attacks) and other critical business continuity issues around the holding and processing of personal and sensitive data. The skill set required stretches beyond understanding legal compliance with data protection laws and regulations. Monitoring of DPOs will be the responsibility of the Regulator rather than the Board of Directors of the organisation that employs the DPO. The appointment of a DPO within a large organisation will be a challenge for the Board as well as for the individual concerned. There are a myriad of governance and human factor issues that organisations and companies will need to address given the scope and nature of the appointment. In addition, the post holder will need to create their own support team and will also be responsible for their own continuing professional development as they need to be independent of the organisation that employs them, effectively as a "mini-regulator".

Data breaches- under the GDPR, the independent Data Protection Officer (DPO) will be under a legal obligation to notify the Supervisory Authority without undue delay and this is also still subject to negotiations at present. The reporting of a data breach is not subject to any de minimis standard and it is likely that the GDPR will provide that such breaches must be reported to the Supervisory Authority as soon as they become aware of the data breach (Article 31). Individuals have to be notified if adverse impact is determined (Article 32).

Sanctions – GDPR imposes the following sanctions can be imposed: a warning in writing in cases of first and non-intentional non-compliance regular periodic data protection audits; a fine up to 10,000,000 EUR or up to 2% of the annual worldwide turnover of the preceding financial year in case of an enterprise, whichever is greater (Article 83, Paragraph 4); a fine up to 20,000,000 EUR, or in the case of an undertaking, up to 4% of the total worldwide annual turnover of the preceding financial year, whichever is higher (Article 83, Paragraph 5 & 6)

Right to erasure - A so-called right to be forgotten was replaced by a more limited right to erasure in the version of the GDPR adopted by the European Parliament in March 2014.[16][17] Article 17 provides that the data subject has the right to request erasure of personal data related to him on any one of a number of grounds including non-compliance with article 6.1 (lawfulness) that includes a case (f) where the legitimate interests of the controller is overridden

by the interests or fundamental rights and freedoms of the data subject which require protection of personal data.

Data portability - A person shall be able to transfer their personal data from one electronic processing system to and into another, without being prevented from doing so by the data controller. In addition, the data must be provided by the controller in a structured and commonly used electronic format. The right to data portability is provided by Article 18 of the GDPR. [8] Legal experts see in the final version of this measure a "new right" created that "reaches beyond the scope of data portability between two controllers as stipulated in Article 18.

5. CONSLUSION

The GDPR is replacing the current Directive and will be directly applicable in all Member States without the need for implementing national legislation. It will not apply until 25 May 2018. However, as it contains some onerous obligations, many of which will take time to prepare for, it will have an immediate impact. Ever since the European Commission first proposed its text back in 2012, this legislation has attracted a huge amount of attention. It even appears to have been influencing decisions by the Court of Justice of the EU. Organisations across the EU and beyond have been frustrated by the increasing lack of harmonisation across the Member States, despite data flowing increasingly without boundaries. There was a growing desire to get the GDPR agreed quickly, even if that meant that some of the detail is left for later. The EU institutions have certainly stepped up to the plate. Adoption of the GDPR marks a milestone in data protection laws and step up closer to the establishing digital single market in the EU.

LITERATURE:

1. Abramowitz, M. (1989), *Thinking about Growth*, Cambridge University Press, Cambridge
2. Beck, N. (1992), *Shifting Gears: Thriving in the New Economy*, Harper Collins Publishers, Toronto
3. Blackmer, W.S. (2016), "GDPR: Getting Ready for the New EU General Data Protection Regulation". Information Law Group, InfoLawGroup LLP, Retrieved 22. 08. 2016.
4. Boban, M. (2012), Right to privacy and freedom of information in the modern information society. *Proceedings of the Faculty of Law, Split*. Vol 49 (2012), No 3 (105); pp 576-577
5. Boban, M. (2015), *Covergence of technological innovation, global media, culture and economics in information society*, *Global Media and Socially Responsible Business*, Collection of Scientific Papers of International Scientific Conference Media and Economy, pp 114 - 129
6. Boban, M., (2014), *Information Security And The Right To Privacy in Digital Economy– The Case Of Republic Of Croatia* rights of access to information and protecton of personal data, *MIPRO 2014/DE-GLGPS*, pp 1687 – 1692
7. Böhlen, M. H. (2005), *E-government: towards electronic democracy : international conference*, TCGOV 2005 Bolzano, Italy, March 2-4, 2005 proceedings, Springer
8. Britz, J.(1999), *Access to information: The ethical challenges of the information era- The ethics of electronic information in the twenty first century*, ed. Lester Pourciau, West Lafayette, Purdue University Press
9. Castells, M. (1999). *The Information Age, Volumes 1-3: Economy, Society and Culture*. Cambridge (Mass.); Oxford: Wiley-Blackwell
10. Čizmić, J., Boban, M. (2013) *The impact of the development of the Internet as a global infrastructure to information security and network data transmission*, Internet, government and politics - *Proceedings of international scientific and professional*

- conferences, Kemerovo, pp 286-305
11. Dika, M., (2006.) Protection of personal rights in litigation and enforcement proceedings, in Klaric P. (ed.) Responsibility for non-pecuniary damages for the infringement of personal rights, OG, Zagreb
 12. Drahos, P., Braithwaite, P. J., Information Feudalism: Who Owns the Knowledge Economy?, Earthscan, 2002
 13. General Data Protection Regulation- GDPR, (2016), OJ L 119, 4.5.2016, p. 1–88 (2016), Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC, retrived 10. 08. 2016. from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2016.119.01.0001.01.ENG&toc=OJ:L:2016:119:TOC
 14. Hendricks, E. (1990), Your Right to Privacy, ACLU, Carbondale
 15. Hilbert, M. (2015). Digital Technology and Social Change [Open Online Course at the University of California] (freely available). Retrieved from <https://canvas.instructure.com/courses/949415>
 16. Kelleher, D. (2016), EU Privacy and Data Protection Law, Tottel Publishing
 17. Klein, S.J., Rosenberg, N. (1986), An Overview of Innovation in R. Landau and N. Rosenberg (eds.), The Positiv Sum Strategy: Harnessing Technology for Economic Growth, National Academy Press, Washington DC
 18. Krneta, S.(1970), Civil law to protect the privacy of European law, Proceedings of Law Faculty in Sarajevo, pp 81-97
 19. Panian, Ž. (2002), Challenges of e-business, OG, Zagreb
 20. Rooney, D., Hearn, G., Ninan, A. (2005), Handbook on the Knowledge Economy, Edward Elgar Publishing
 21. Spremić, M. (2004.), "Business models in the new economy," Modern Businesses, No. 4/April 2004, Zagreb
 22. Western, K. I., (2012) Foundations of the Knowledge Economy: Innovation, Learning and Clusters, Edward Elgar Publishing

LEGAL ASPECTS AND PROBLEMS OF ENVIRONMENTAL PROTECTION IN LATE 19th AND EARLY 20th CENTURY IN TOWN OSIJEK

Visnja Lachner

Faculty of Law Osijek

Josip Juraj Strossmayer University of Osijek, Croatia

vlachner@pravos.hr

ABSTRACT

Today one of the biggest challenges is protecting the environment through model based on waste and water utility management, a municipal water supply, waste water supply, drainage, wastewater treatment and disposal of municipal waste. Environment protection is a complex area in which local and regional self-government units are continuously gaining increased competences, obligations, and responsibilities. Based on relevant literature and archive sources, the author warns of problems with environmental protection, and its early warning signs dating back to early medieval times. Indeed, the problem receives its modern terms in Modern Era, namely, during the second half of 19th and early 20th century. Growth of economy, commerce and crafts, as well as building of roads and slow industrialization faced the town of Osijek with problems of environmental protection in various ways. Since these industries started to endanger environment, in 1884 Croatian parliament brought a Law on crafts, which, naturally, had to be put in effect in Osijek too. Articles 25-36 give ruling on environment and ecology issues, as well as possible ways to deal with problems. The paragraphs listed 45 crafts and trades, that provided hazard to the environment: slaughterhouse, tanning, lime and whitewash, brickyard, candle and foundry, mineral oil refinery, soap produce, brewery, oil mill, sugar mill, hard liquor, silk plant, etc. Beside, environmental protection and clean streets were needed, as in the late 19th century Osijek had a Town embellishment society which tried to form and build up citizens' awareness of ecology issues and the need for environmental protection.

Keywords: *ecology, environment protection, industrialization, legal regulation, local self-government.*

1. INTRODUCTION

In the modern state Local units, according to some, are "the natural basis for the exercise of democracy" because they are closer to the people and the fulfillment of their interests, and according to the others they are only one more power, and "power is dangerous for the freedom of the individual" (Pusić, 2002, p. 8). They should meet public needs and interests of citizens, thus local units are obliged to create conditions for meeting those interests and needs. In fact, from the very beginning of the organization of the human community, first in smaller towns and cities, and later in all major urban areas, there has been a need to engage in certain activities aimed at preserving the smooth functioning of the settlement as a form of organized human community (Sarvan, 2008, pp. 1055-1086). One of the major obligations of local government is performing and organizing the performance of affairs of municipal economy. In the earliest era residents of urban settlements faced the question of ensuring the supply of drinking water for the population, drainage of waste water, solid waste, maintenance of public squares and roads, as well as other activities necessary for the survival of the community. Pavić said that the city is a settlement with dense population, developed social division of labor, a compact built-up area, and appropriate public services (Pavić, 2001, pp. 1-10). Utility services are performed as a public service, and operators who perform them are often public authorities. The idea of public service comes from the 19th century, from the practice of the French State

Council, and a definition which defines public services as "services whose even the shortest suspension leads to social disorder," perhaps best describes the necessity of municipal activities as a public service (Ivanišević, 1968, p.42). Public services have undergone a development path, in which the country was gradually taking on a more important role in their performance. Therefore, in the legal literature it is stated that the concept of a public service should primarily legally cover and interpret the business of the state and other self-governing public bodies as opposed to private activities, in opposition to private services. By its nature they can be divided into two basic groups. The first one are economic public services that perform activities that are by their very nature commercial.¹ The second group includes non-public services, those that do not have a commercial character (Klarić, Nikolić, 2011, p. 91). Considering the above mentioned, utility services can be generally defined as economic activities that provide public services of interest to individuals and legal entities at the local community in which they live and work every day and which directly address the everyday needs of citizens in the settlements (Pavić, 2001, p. 120). In the legal literature "everyday needs" in the history of state are: food supply, quality control of grain, public works, maintenance of public buildings, construction line, control of measures and weights, cleanliness of streets and squares, aqueducts, river regulation, sewage, post office, the fire service, road maintenance and traffic order, public baths and so on. However, there is neither universal definition, nor universal list of utility services.

2. THE FORMS OF ORGANIZATION OF MUNICIPAL SERVICES

Utilities can be organized to perform as a concessioned public service, as mixed enterprises, and in the form of utility services that are under the direct control of the city administration (Pavić, 2006, pp. 281-285).

2.1. Concessioned public services

Krbek defines the so-called concessioned public service as a public service "which is performed by a private person in his own name (whether physical or legal person) by special authorization of the competent public authorities" (Krbek, 1932, p. 60). Thus, the concessionaire is a private person and the grantor is a public authority. For practical reasons (rational and cost) such service shall be given in the hands of private entrepreneurs which he performs under the control of a public authority so to coordinate private management of services and the public interest. A public authority establishes the essential conditions under which a concessioned public service is performed, providing that the concession holder must continuously and in a prescribed manner carry out his service and provide services to users on equal terms, charging for his services. Concessioned public services are primarily services in public transport - railways, steamers, buses, trams, river traffic, then communication services - mail, telegraph, telephone, radio. It also includes utilization of water resources, power stations, gasworks, private hospitals with public rights, private accredited schools, pharmacies, mines, banks with special powers.

However, the state often takes concessioned activity entirely in their hands, and usually when it is obvious that it gives considerable profit. Such a case of transferring concession companies in the hands of the grantor, i.e. public administration were railway companies, particularly utility companies (tram, gasworks, waterworks, power plants) which are then taken over by the city municipality (Pavić, 2006, p. 283). All these examples Krbek calls etatization of public service (Krbek, 1932, p. 66).

2.2. Joint venture companies

Specific combination of cooperation of public administration and private persons in the exercise of public service is represented by a joint venture in which the "public administration and

¹ The utilities usually includes public transport (railways, shipping lines, airlines, etc.), Postal services, energy supply, telecommunications, waste management, water supply.

private companies together took over the supplying of the needed capital, as well as the joint management of the entire company" as "a kind of a companionship." (Krbek, 1932, p. 311). Such companies are usually formed in the field of economy (regulation of river, rail traffic), but are often used in the utility domain when urban municipalities want to encourage the activity of each utility company, forcing it to more effective economy. They are also founded in those cases where the municipality does not have sufficient means necessary for execution of communal services and, therefore, provide an equity through private entrepreneurs. They are considered one of the forms of commercialization of utility companies.

2.3. Utilities under the direct control of the city administration

Because of their importance, some utility services are more related to the city unit thus it establishes utility service and has significant powers in respect to the appointment of governing bodies, the adoption of certain acts in connection with the service, in terms of financing the service and control over it. In this case specific conditions are determined for their operation, which do not apply to other activities,.

3. SOME UTILITY SERVICES IN

OSIJEK 3.1. Municipal water supply

The problem of health and drinking water seriously began to be felt in the city of Osijek in the late 19th century, as various chemical industry waste and other pollutants, that were pumped daily into rivers and surface water, made a natural water unusable for drinking unless specifically purified. Also well surface water was often infected due to poorly derived sewage. In fact, until the end of the 19th century citizens of Osijek directly used water from the Drava river and water from surface wells, and all this prompted the citizens of Osijek and their agents to seriously start thinking how to provide the town with a sufficient quantity of healthy and cheap water. Especially because the military command proposed the city administration to approach the solving of the water supply of the city², as a military fortress water supply could not meet the required civil purposes, and was no longer suitable for public use. Since then, i.e. by the end of the eighties of the 19th century the question of water supply system of the city of Osijek would stay on the agenda of the meetings of the City Council, daily newspapers and citizens. Thus, already in 1886 it was proposed to invite a Czech company in Osijek to give their expert opinion on the supply of Osijek drinking, healthy, sufficient and low-cost water; thus the city representation ordered 300 forints for the following year for formulating a general basis for the plumbing. It was the first official conclusion of the city administration to take a systematic approach to solving the water supply of Osijek, followed by many projects and plans developed and offered by experts across Europe in subsequent years. Some of them proposed the construction of water supply from the river Drava, and the others from the mountain springs near Orahovica or deep (artesian) wells (Sršan, 1985, pp. 160-161). Indeed, many expert opinions and expertise were presented, many detailed examinations were carried out in order to determine which way of the water supply was the most acceptable.³

In late October 1895 the Government of the Land approved, in principle, drafts, cost estimates and the conclusion of the city government to carry out the plumbing in the city of Osijek and through the mediation of the county authorities on March 12, 1896 the contract should have been signed by the authorized person, which would solve the water issue in Osijek. At the

² HR-DAOS, The city authorities in Osijek, No. 14141, 1884

³ By 1889 14 tenders and proposals came for the construction of water supply in Osijek. In the beginning the Drava water supply seemed the most appropriate one because of sufficient quantities of water, but also because of the cheapness. One of the first advocates of water supply of Osijek from Drava river, already in 1887, was ing. Artur Oelwein from Vienna, who gave his opinion in the statement in German language entitled Gutachten (Opinion), See in: HR-DAOS, GPO, Case files, no. 1601-1607

session of the City Council in April 3, 1896, which was presided over by the county mayor, Count dr. Theodor Pejačević, it was discussed about the agreement for the construction of urban water supply systems, with particular emphasis on Article 35 of the agreement and about the "Regulation". According to the agreement, current and future taxpayers were supposed to provide the capital for the construction which was estimated to about a million and a half forints. When the agenda accessed the debate on the participation of the city in participating the costs, the city cession was almost ended. Likewise, there were also hassels about the water supply installment from the street pipes into the houses. However, in the end all was unanimously adopted and submitted to the Government of the Land for approval.⁴ At the beginning of the 20th century the city of Osijek received several new offerings for the construction of municipal water supply. Namely, while the joint stock company for water, lighting and heating in Vienna and Budapest in early 1897 requested the postponement of the start of construction of urban water supply and the extension of the completion of the works, at the same time the Berlin company David Growe submitted a bid for the construction of water supply through concessions. Also, the city government was also addressed by civil engineers Prinz and Gleitsmann from Draždjanci offering a bid for construction of the aqueduct. The city authorities were supposed to decide whether to adopt the reasons for extending the deadline⁵ for construction of water supply or to adopt one of the new offers.

The Special Committee of Osijek dealership established a contract between the company David Growe and the municipality of Osijek on the construction of a municipal water supply from mountain springs according to which the city guaranteed an annual income to the company Growe from water supply in the amount of 40,000 forints by water users. The city itself paid 19,500 a year for the use of water for public use, while the company Growe took over the guarantee for the bounty of mountain springs for municipal water supply. Under the agreement, the company would enjoy the privilege for 50 years, and for the purchase within this period a total amount of 1,680,000 forints was established according to the annual top contribution, and after the period of 50 years the plumbing would pass into the ownership of the city in a good condition. The company Growe guaranteed the quality and quantity of water, and the obligation of residents was to install the plumbing from the main streets into their houses. The poor ones, factories and public baths were exempted from this obligation. For each tenant there was a minimum amount of water that they had to pay. The company was also guaranteed an annual income of 80,000 crowns, while, under the agreement, the township should have received an income from 25% of revenue in the amount of more than 240,000 crowns, and 50% from more than 260,000 crowns. After the agreement was printed and prepared for discussion at the city council at the end of 1899, it came to some new agreements according to which the water supply would pass free of charge into the ownership of Osijek after 45 years.⁶

However, as the city had a bad experience with the concession of horse-pulled tram and the gas plant, it did not want to have the water supply run by the concessionaire, so in early 1900 the city representation voted against the construction of water supply being carried out by the company Growe. In addition, representatives claimed that the water supply was too expensive and that there was no difference between pure Drava water and clear mountain water. At that time in Osijek half a cubic meter of water from Drava cost a crown, i.e. 10 L of water cost 2 filirs, while according to the company Growe the same amount would cost 22 filirs. The idea of mountain water supply had not been abandoned until the beginning of World War I, when the works on the execution of mountain water supply were started and ended.⁷ As already

⁴ On the initiative and need for the construction of the city water supply system was written on daily basis by daily news: "Die Drau" and "Slavonische Presse".

⁵ Journal of the Virovitica county, 1896, No. 1, p. 8; No. 5, p. 36; No. 8, p. 62; 1897, No. 2., p. 16; No. 3, p. 26

⁶ Journal of the Virovitica county, 1898, No. 4, p. 31; 1899, No. 24, p. 197.

⁷ Journal of the Virovitica county, 1900, No. 8, p. 69

indicated above, a third possibility of Osijek water supply was from deep wells, so at the session of the city council in November 23, 1909 it was almost unanimously concluded to build water supply in Osijek from deep wells. The session was presided over by the Mayor Konstantin Graff in the presence of the county mayor Baron Rajačić and almost all the members of the Board of Waterworks. They elected the select committee as an aid of the city government for the development of the basics of water supply ordinance, the modalities for the collection of water charges, and for the establishment of the foundation for the financial implementation of the planned venture. In late December 1910, there was another meeting of the city council where they unanimously adopted conclusions on the implementation of the Drava water supply.⁸ The accepted study was sent to be resolved by the Government of the Land.⁹ At its session in April 1911, the City Hall decided to finance the costs for city sewage, city water supply system and building of a new city hall. Negotiations were carried out with financial institutions, upon which a loan was designated in the amount of 6.5 million crowns. In August 1911 The Government of the Land approved the conclusion of the city council regarding the shrinkage of the open account loan of 1,500,000 crowns at the Osijek branch of the Croatian First Savings Bank and Osijek savings in order to cover the costs of the first execution of sewerage and water supply.¹⁰ However, just in time for the start of works, the realization was interrupted by the start of World War I. After the collapse of the Austro-Hungarian Empire in 1918 the attempts to construct urban hygiene water supply continued, but at a lower intensity than before. Therefore, the existing water supply network of the fire water supply was extended (Sršan, 1985, pp. 176-184). Namely, in the city of Osijek water supply an important role was played by the fire water supply. On June 26, 1893 the city authorities gave permission for the fire water supply that was already being built.¹¹ The permission expressly stated that this water could only be used for fire-fighting purposes and for industrial purposes, but not for drinking and household. The city held the right that once a new city water supply was built all such waterworks had to be plugged on it. In 1905, the Fire department decided to build a water supply system for the more important streets to the most important points of the city with the corresponding hydrants in the Upper Town. Although the first normal water supply¹² was introduced, which set the basis for expansion of the existing water supply system, it was impossible to stop thinking about building a true hygienic water supply system, which would supply the town with water from deep or mountain sources. But as the city of Osijek was in debts because of the construction of power plants and municipal electric tram in 1926, the issue of the construction of water supply was postponed for ten years.

3.2. City drainage

With the expansion of the city and increasing population it came to the need for construction of the main water drainage channels that would receive excess water during the rainy and winter days, and dirt from the town houses. The idea was to protect citizens from possible infection and to classify Osijek in a group of modern cities of the Monarchy, and it was for that reason that already in the middle of the 19th century the construction of the main Upper Town water drainage channel was started and completed by the first mid of March 1867.¹³ The importance of drainage or sewage waste water treatment and purification is very important for each urban

⁸ HR-DAOS-6, GPO, Minutes of the city council, Books No. 1062

⁹ Journal of the Virovitica county, 1909, No. 23, p. 219.; 1910, No. 24, p. 241

¹⁰ Journal of the Virovitica county, 1911, No. 7, p. 73; No. 16, p. 161

¹¹ Memorial book of the volunteer Fire Department Osijek, Upper Town, Osijek, 1926, p. 190

¹² From the Rok Square through Strossmayerova street to Šamačka, then through Pejačevićeva street to the Main square (today Ante Starčević) and Županijska street to the theatre with a total length of 4 km.

¹³ The Upper Town main water line passed through Kapucinska street, leading road of the Upper Town, and turned into the Drava river through today's street Vjekoslava Hengla to the area of the than Upper Town steamship station along the Drava river. HR-DAOS-6, GPO, 1867, Box 1029, file 2149.; Box 1030, file 2480; Box 1032, file 3379

area with regard to health, aesthetic and economic conditions. Drainage is an indicator of the cultural level and the situation in the city, and it is even more important than any other utility structure. Due to this, water supply Committee at its meeting held in November 1909, discussed the entire city sewer. In the second half of the 19th century, after the first general sanitation had been conducted in Tvrđa in 1779 (Bösendorfer, 1948, p. 52), the sewage was built in other parts of the city. It happened gradually, as necessary, without a complete project and the unique canal network. Because of this, and other reasons (the main sewer was Drava river from which the majority of the population drank water, which caused the appearance of infectious diseases - typhoid, etc.) it was necessary to build a new, unique and modern drainage network (Šandor, 1937). Thus, at the above mentioned session it was concluded that the sewerage network had to be laid throughout the city based on the design, even in recently designed streets. At their meeting the Plumbing Board in principle concluded that the city needs to implement the construction of sewage main collection channel, and the planned cost of construction amounted to 637,600 crowns. The committee proposed the city authorities gradual development of urban sewage, provided that in the first phase, in the next 6 months collection channel was built, and other activities in the coming years.¹⁴ So right from the start of construction of the canal network in 1912 some mistakes were made, but already in 1914 because of World War I, further works on the construction of drainage network had to be suspended. At the same time, with the attempts of Osijek to solve the problem of building hygienic water supply and single channel network, the city's government at its session on February 20, 1911 issued the fundamentals of the statute of the city of Osijek for the construction of home channels and drainage of the soil. This statute was supposed to come into force after being approved by the City Assembly and the Royal Government of the Land, and those who were to act contrary to the provisions of this Constitution would be penalized according to the existing regulations, and unfinished activities would be finalized by the township at the expense of the private entrepreneur, and the cost would be enforced through the court. The sewer which was located within the boundaries of the house and land had to be implemented by the owner of the house in the preclusive period of three months and under the threat of financial penalties. The owner was also required, before the start, to inform the city government about these actions and to submit a layout plan, thus the construction could not begin until the owner received a written permission from the city government according to the institutions of the construction order. The city district could also take over the cleaning of private sewer, if so requested, but under the condition that private entrepreneur bears the costs. But in any case it performed the cleaning of the part of the sewage canal that was below the street, but again the costs were at the expense of a private entrepreneur. If the owner wanted to obtain a permit for the sewer, he had to surrender a written statement to the city district that he would carry on the cleaning (as a private entrepreneur) or it would be carried out by the township at his expense. Also, this declaration was required from those owners who had had a complete sewage implemented. The city district was required to establish a permanent price for cleaning. These costs had the character of public appropriations, so they could also be enforced through the court. As the introduction of water supply in all the houses on the basis of this Constitution was a precondition for connection to the sewer, so the water supply could have been introduced to all households only pursuant to a separate water supply Statute. For all the objects and details of the city's sewage system there were standard parts prescribed, so everyone could get a glimpse of the models of these objects which were placed in the city's construction office. Each house or land that was connected to the city sewer, had to bear the cost of construction of sewage and in such a way that the duty of payment began from the date of sewage-house connections to public street connection. Sewer charges were arranged as follows: City levy increased 11% per year for the purpose of building a major sewage, and

¹⁴ Journal of the Virovitica county, 1909, No. 23, p. 218

in addition each homeowner paid 8,000 filirs per constructed or planned land, and the owners of gardens and fields paid 200 filirs per m² for use of urban sewage. For factories and public buildings there had to be a lump sum determined by the amount of running water instead of fees per levies (Art. 1-20).¹⁵ After the collapse of the Austro-Hungarian Empire, the works on the construction of the canal network continued, but in another mode of financing: nomore from the investment loan but on the basis of regular annual budget of the city of Osijek. However, as the city did not have a lot of money at its disposal, and there were constructions of other utility facilities (power plants, electric trams), construction of drainage network dragged on for a long time.

3.3. Waste management

The provisions of the Statute on the export of garbage from the houses in the city of Osijek in 1913 regulated the measures for dealing with household waste in those parts of the city where there was an organized system of waste management for all residents and it was determined that the fee for handling household waste (transport) had to be paid by all owners of real estates (houses). Treatment of household waste in the city of Osijek was performed only by the city authorities through designated authorites or through lease agreements. In 1895 a contract was signed between the city of Osijek and volunteer Fire Department Gornji Grad in Osijek on garbage collection (street cleaning). In this case, the tenant was required to obtain a specific number of vehiclees for performing the transport of household waste, thus to collect the fee. City authorities were responsible for deciding on the location of disposal (landfill) which had to be located outside the city. Instead of taxes for the export of garbage homeowners were required to pay the yield for that purpose, i.e. the wage determined in the amount of 1% of the rent.¹⁶ Namely the former Statute from 1893 regulated the payment of a fee for garbage collection in a way that the streets of the city were divided into three categories (classes). Thus it was determined that the owners of the houses in the first class streets pay 80 filirs, in the second one 60 filirs and in the third one 40 filirs.¹⁷

4. CONCLUSION

In the current view of municipal activities that had been organized in the city of Osijek, we noticed that most of the services that were technically complex and required a lot of money, the city administration performed through various companies, joint stock companies. So, there is a model of organization by joint stock company which is typically based on long-standing concession and contract rules. This is therefore a concessionaire service. However, as the Osijek city government had a bad experience with giving concessions concerning the horse tram and gas company, it came to the transition of the concession companies into the hands of city municipality and under its direct control. The city formed a management and supervisory board and set more legal solutions that regulated the issue of traffic in the city. That is why the construction of the water suply system was in the competence of the city municipalities. In addition to city municipalities, the state also often takes concessioned service into their own hands, which was the case with the construction of the telephone network in Osijek. Besides the fact that the concession documents could have been assigned to a joint stock company or a legal entity, it could have also been assigned to a physical person. This is evident in the city of Osijek in the case of chimney sweeping and waste management. And in terms of bus transport

¹⁵ In addition to the aforesaid, the basis of the statutes also regulates the following issues: the construction and the materials needed for sewerage, drainage of the roof, water supply for domestic and kitchen use, flushing toilets, traps, ventilation, rinsing and the like. Read more in: HR-DAOS-6, GPO, city statutes, box No. 5906 (The basis of the statute of the city of Osijek for construction of home channel and drainage).

¹⁶ HR-DAOS-6, GPO, City statues, box No. 5906

¹⁷ Ibid.

and its normative regulation, we can say that it is of a private-legal nature, and that carriers are obliged to comply with the instructions regarding driving. Also, from the aforesaid it comes out that the utility system in the city of Osijek was financed by revenue from the city budget, from the price of utility services, utility fees and concession fees.

Besides, in support of the development of civic awareness in terms of environmental protection, as well as adequate neatness and cleanliness of city streets, speaks the fact that at the end of the century there was founded an Association for the beautification of the city of Osijek. At that time, with the help of the Society for the Beautification of the city of Osijek, which was founded in 1891 by architects, prominent citizens, artists and industrialists, there was a city document made under the name a Building Order. Its content precisely determined the way of decorating the space between and in front of the newly constructed buildings, as well as necessary gardening works, and the way of construction of certain fences.

LITERATURE:

1. Bösendorfer, J. (1948). Pravoslavni elemenat kao sekundarni faktor u oblikovanju građanskog staleža u Osijeku. In J. Bösendorfer (ed.), *Osječki zbornik No. II, III.* (p. 48-101). Osijek: Muzej Slavonije
2. Ivanišević, S. (1968). Prilog diskusiji o pojmu javne službe. In J. Kolaković (ed.), *Zbornik radova Visoke upravne škole.* Zagreb: Sveučilište u Zagrebu Visoka upravna škola.
3. Journal of the Virovitica county (1897). *Vjesnik Županije Virovitičke*, No. 2, p. 16; No. 3, p. 26
4. Journal of the Virovitica county (1900). *Vjesnik Županije Virovitičke*, No. 8, p. 69
5. Journal of the Virovitica county (1909). *Vjesnik Županije Virovitičke*, No. 23, p. 218, p. 219
6. Journal of the Virovitica county (1896). *Vjesnik Županije Virovitičke*, No. 1, p. 8; No. 5, p. 36; No. 8, p. 62
7. Journal of the Virovitica county (1898). *Vjesnik Županije Virovitičke*, No. 4, p. 31
8. Journal of the Virovitica county (1899). *Vjesnik Županije Virovitičke*, No. 24, p. 197
9. Journal of the Virovitica county (1910). *Vjesnik Županije Virovitičke*, No. 24, p. 241
10. Journal of the Virovitica county (1911). *Vjesnik Županije Virovitičke*, No. 7, p. 73; No. 16, p. 161
11. Klaric, M., Nikolić, M. (2011). Ustrojstvo javnih službi u Europskom pravnom poretku. In A. Bačić (ed.), *Zbornik radova Pravnog fakulteta u Splitu* (p. 89-102.). Split: Pravni fakultet u Splitu.
12. Krbek, I. (1932). *Upravno pravo- Organizacija javne uprave.* Zagreb: Tisak i naklada jugoslavenske štampe.
13. Memorial book of the volunteer Fire Department Osijek (1926). Osijek: Gornji grad.
14. Pavić, Ž. (2001). *Od antičkog do globalnog grada.* Zagreb: Društveno Veleučilište: Pravni fakultet.
15. Pavić, Ž. (2006). Upravni problemi grada. In I. Koprić (ed.), *Javna uprava – nastavni materijali* (p. 281-298). Zagreb : Društveno veleučilište: Pravni fakultet.
16. Pusić, E. (2002). Globalno i lokalno: lokalne jedinice u procesu globalizacije. In D. Medvedović (ed.), *Hrvatska javna uprava* (p. 3-19). Zagreb: Institut za javnu upravu.
17. Sarvan, D. (2008). Obavljanje komunalnih djelatnosti kao javne službe. In I. Koprić (ed.), *Hrvatska i komparativna javna uprava* (p. 1055-1086). Zagreb: Institut za javnu upravu.
18. Sršan, S. (1985). Vodoopskrba Osijeka - nekada i danas. In D. Dekaris, J. Martinčić (ed.), *Anali Zavoda Jugoslavenske akademije* (p. 155-203). Osijek: Zavod za znanstveni rad JAZU
19. Šandor, F. (1937). *Opskrba vodom u Hrvatskoj i Slavoniji.* Osijek.

LEGAL REGULATION OF TAX INCENTIVES FOR INVESTMENTS IN SERBIA

Marko Dimitrijevic

*Faculty of Law, University of Niš, Serbia
markod1985@prafak.ni.ac.rs*

ABSTRACT

The subject of analysis in this paper is the role of corporate tax incentives in attracting foreign investments. The only form of taxation, which, in our opinion, can contribute to an optimal attracting foreign capital (that includes the investment in knowledge, production technology and innovation), is the corporate tax. Certainly, it is not devoid of weaknesses in its structure (especially in developing countries), but it only imposes the need for its reform in order constituting the optimal tax structure. The problems that its implementation carries in domestic law (complexity and lack of transparency) and international law (the problem of unfair tax competition and legal illegitimate tax evasion) are complex, but not irresolvable. The thesis of the so-called the "inappropriateness" of tax incentives in modern tax law must be seriously reconsider, because in the conditions of financial crises tax incentives can be an effective tool for the long-term economic policies of developing countries (such as Serbia). The structure of the tax incentive was determined in the function of stimulating economic growth, development of small enterprises and employment. In order for tax incentives to be effective, it is essential that their incorporation into legal norms provide that they act as automatic stabilizers, as this reduces investment uncertainty, administrative costs and favouring less profitable investments. In the area of corporate taxation in Serbia, tax incentives are usually seen as intention of the legislator to encourage capital investment in certain area. The abolition of tax credit in Serbian tax law will affect the overall level of investment in the country and prevents the undermining already undertaken investment projects. In addition, it remains unclear how these changes will affect the location of the tax base and changes firms' legal status (mergers, divisions and joint ventures agreements).

Keywords: *economic development, investments, tax competition, tax incentives, Serbia.*

1. INTRODUCTION

In the financial literature, there are divided opinions on the impact of tax policy on economic development. While one group of scholars believes that the reduction of public expenditure justifies the low production rates and high costs of taxation, another group points out that the government (by its decision on the amount of public spending) has an important role in the economic development of a country, because it provides public goods, encourage investment and establishes a socially desirable direction of our economic development. This paper will try to analyze the main settings of conflicting currents and to highlight the important role of the corporation tax in the program of development of economic policy and in the process of capital accumulation, with particular focus on the role of corporate tax incentives in attracting foreign investments in Serbia.

2. A BRIEF REVIEW OF MODEL OF ECONOMIC GROWTH

To determine the effects of tax policy on economic development in the theory it used the three basic models (Myles, 2000, pp. 141-168). According to the first model, it is considered to analyze effects, which must determine the average cost of execution of public expenditures or tax rates. Proponents of this approach believe that there is a negative relationship between keeping the concepts of fiscal policy and increasing budget revenues (Gier, Tullock, 1989, pp. 259-276). Given that research results include the impact of the period of 60 to the late 80-ies of

the last century, the question is whether they can be applied in the present circumstances. This primarily refers to the traditional setting of classics that taxation and public spending can have an impact on the economic growth rate, viewed over a longer period, but can only talk about their current impact on the amount of output. In the second methodological approach, (i.e. the model of the "new economic development") is considered to be that fiscal policy has a permanent effect on raising the general level of social welfare. Thus, for example, Robert Barro in his research, emphasize the fact that the distorting effects of taxes on economic growth are much more important than the traditionalists considered it. In particular, he point to the important role of the tax system to attract efficient investment (Barro, 1992, pp. 407-444).

However, it should be noted that the aforementioned model of balanced economic development based on the fact that the share of public expenditure in the domestic national product (NDP) is constant in time, which is a condition that is now difficult to accept. The third model seeks to correct the defects of other models and allows changes in the share of public expenditure in the cost of NDP, but also the significance of the structure of taxation. This approach is particularly favoured by Ramm, who found a positive link between the measures and instruments of fiscal policy, on the one hand and to achieve, the desired economic growth on the other hand (Rati, 1996, 195-203). We must emphasize that we are talking about the models which establish the link between economic growth and overall tax burden. In the more recent study, Agell reviewing the methodology of previous researchers and found weak ties between the rise of public expenditure and GDP (Agell, Ohlsson, Thoursie, 2006, pp. 211-218.). Partially speaking, none of these models in our view does not explain the universal connection between the effects of tax policy and economic development, but offers contradictory conclusions, which is why it is necessary to look for a model that would offer a concise explanation. In fact, each of the models corresponds to a particular historical period in the development of legal and economic scientific thought, and as such cannot have absolute importance and act *pro futura* (lat.), but must be re-adjust to dynamic legal and economic relations.

2.1. The Relationship between Tax Policy and Economic Growth

By synthesizing these theoretical models and the inclusion of some new components, we can try to determine the impact of taxes on the process of capital accumulation. Regarding the influence of different forms of taxation on economic growth, the study did not provide a uniform understanding. Some economists, such as Koester and Cormendi considered that the average tax rate (dependent on the average fixed tax rate) has negative and independent effects on the rate of economic growth (Koester, Cormendi, 1990). Certainly, none of mentioned models for analysis had no impact of the tax system on investment decisions, as a very important factor in generating GDP. Supporters of the so-called "balanced economic growth" insisted on the fact that decisions on tax policy, determine the level of investment in a country. However, it is the question of the existence of valid evidence to confirm mutual influence of tax rates and the volume of investment. Certainly, the administrative structure of the tax system and the breadth of the tax base determined by the total amount of collected tax revenues. Practice has shown that countries that relied on high tax rates as opposed to narrowly defined tax bases (characteristic of underdeveloped countries) are not tax revenue significantly affected the GDP, as opposed to countries with relatively high tax burden, but a uniform base (due to the cancellation of the perverse effects the behaviour of taxpayers, who do not have a way to "territorial migrating" in a lower-tax unit to reduce their tax liability). Also, the analysis must make a distinction between the level of the tax burden and effective tax rates of corporate tax, as the most important factor of determining investment decisions. Previous studies have shown that the level of the overall tax burden in one country although high (e.g. in Sweden) do not adversely affect the reduction of investment, as the rate of domestic corporate tax is relatively low (Engen, 1992, pp.15-30). In our opinion, the influence of corporate tax (with all its

mandatory constituent elements and particularly optional) on GDP in terms of globalization and liberalization of financial flows are increasingly gaining in importance and requires serious analysis of existing legal and economic regulation and the revision of certain postulates inherited from the classical theory economic growth. Primarily because of the great importance of tax incentives (exemptions and reliefs) which cannot be considered separately from other elements of the tax, we believe that the analysis of corporate taxes to GDP in both developed and less developed countries of the world must take into account the legal provisions on tax investment credits, accelerated depreciation, tax holidays, stimulating research and development and other motivated by attracting both domestic and foreign capital. In terms of free movement of capital, these provisions have become the tool of tax competition as a loyal and disloyal, that policymakers justify the necessity for rapid economic development, despite all the negative repercussions of such a policy, we mean the problem of environmental pollution and disturbance of natural resources for the sake of technical-technological progress as a kind of GDP catalyze (Goodspeed, Vasquez, Zhang, 2006). When we talk about the impact of taxes on the objectives of the investment policy, we must start from the individual analysis of all its elements. This means that it must take into account not only the rules regarding the determination of the taxpayer, the tax items, tax base and tax rates, but also tax incentives (exemptions and reliefs), which in the period of financial crisis and global economic trends of optional elements of the tax, becoming more and more characteristics of the obligatory. If we believe that an investment decision determined the cost of realization of investment, on the one hand and the rate of investment efficiency (as determined by the time of return on investment), on the other hand, it seems that the influence of corporate tax is negative if it prolongs the period of investment return (Johansson, Heady, Jens, Brys, Vartia, 2008, p.31.). The openness of the domestic economy also has the effects of attracting foreign investments, as well as the extent of development of the economy of a country, because these effects are not identical in both developed and less developing countries, nor their legal and economic consequences of the same intensity. In our opinion, the thesis of the so-called "negative impact" taxes on attracting investments cannot be unreservedly accepted. In this sense, we think that should be noted in the OECD study (which involved 14 member countries through 21 branches of industry) showed significant correlations: first- to increase the cost of investment reduces their number, but it is characteristic of countries with highly profitable industries (in our opinion, this thesis cannot be applied in less developed countries); second- that the costs of capital investments have different repercussions, depending on the size of the company. It is believed that the "younger" companies less profitable than the "older" but branded companies (think it was a relative presumption!) or to benefit more from the tax incentives or reduced tax rate (which is, in our view, more acceptable explanation); third-rate of amortization is also conditioned by the tax rate (Fundamental Reform of Corporate Income Tax, OECD, 2007). Of course, in a country without an effective judiciary, transparent tax laws, poor infrastructure burdened by corruption and political instability, tax incentives have significant role. Obviously that "developing" countries would not wear that epithet if they have built infrastructure, highly skilled workforce, zero inflation and progressive taxation as a function of vertical equity, which contributes to the fact that the taxpayer is taxed in accordance with its economic strength (in the sense that those with economically stronger can bear greater part of the tax burden to their shoulders). We have to be realistic in their assessment of their economic system and the need for economic development, and therefore the importance of tax stimulation of investment. In addition to investments in the production, it is very significant investments in the development of production factors primarily invest in human capital, knowledge and research. Therefore the tax relief on research and development receive a special significance in practice. As innovation, in our opinion, is the main pillar of economic development and prosperity, these incentives can influence the creation of production, product and organizational innovation, which each in its

own way raises the standard of living and impact on economic growth. Its influence is reflected in the fact that so create better products and provide better services (product innovation); improve production technology (procedures) or modes of delivery of goods and services (production innovation); or enable new ways of managing, organizing and operating companies (Palazzi, 2011). Policymakers must work on a program that promotes the dissemination of knowledge (just tax incentives), because scientific and technological achievements just need to enable the raising of living standards, protection of natural resources and health, and generally speaking, the public order. Contemporary theories of economic growth consider that in the economic system there is a special technology sector, which all other sectors supplies with the new technologies and users pay for this sector the right to use the same. As this sector has information that does not have their opportunity cost it is able to achieve monopoly profits (the more matches the image in objective social reality of the little, remote neoclassical model). One of the most effective ways of spreading the technology in the world is just foreign direct investments of multinational companies because these investments produce positive externalities (as opposed to the neoclassical model of economic growth that insists on saving, now insists on education). It is these positive external effects in the form of investment in human capital contribute to a higher rate of economic growth (Engen, Skinner, 1996, pp. 617-642). The only form of taxation, which, in our opinion, can contribute to an optimal attracting foreign capital, (which includes the investment in knowledge, production technology and innovation) is a tax on corporate profits. Certainly it is not devoid of weaknesses in its structure (especially in developing countries) but it only imposes the need for its reform in order constituting the optimal tax structure. The problems that its implementation carries in domestic law (complexity, lack of transparency, and the crowd-dispersed incentives that are duplicated with other tax incentives instruments) and international law (the problem of unfair tax competition and legal illegitimate tax evasion) are complex, but not unsolvable. We also believe that adequate tax reform and the adoption of certain conventions (agreements) mentioned defects can be reduced in a socially acceptable level, with the aim of exploiting the full potential of this tax (in our opinion, unjustly neglected), which in conjunction with other taxes contribute the desired economic growth. Regardless of evolution of scientific thinking about the connection of the instrument and tax policy measures and objectives of the investment policy, we consider that there is no reason to take conflicting positions on whether to achieve these goals as the optimal solution occurs tax instruments or infrastructure public expenditure, because both show the advantages and disadvantages in the application. In our opinion, the so-called "negative" relationship between the structure of corporate taxes and GDP requires a new analysis. The thesis according to which tax incentives of tax products distortion effects cannot be accepted, because their *ratio legis* precisely the same distortions with regard to attracting foreign capital in the territory of a particular country. In the absence of incentives to that would not have happened, even if the specific capital investments at a certain point does not exist, we cannot say that the stimulus is inefficient (due to lack of investment is often asymmetry of information between potential investors and local companies). An alternative way of looking at the effectiveness of corporate tax incentives could be the following: "the tax capital distorts the behaviour of investors, and tax incentives reduce economic distortions (because they represent a better alternative than negative (zero) tax rates (Margalioth, 2010, pp.23-24). The understanding that the tax incentives are dangerous and socially harmful, in the sense that their costs exceed the benefits, do not fit the image that exists today in the economic sphere of social life. If we are not efficient it would mean that at least have a "false value in the tax law" and these alone cannot even be harmful. If the investor is not attracted, nor his behaviour cannot be "distorted" and tax revenues then are not lost. The above remark could be accepted only if the taxpayer is somehow able to take advantage of the facilities, and that doing so does not invest, or if the investor invested capital without tax incentives, and yet gained any benefit from it

(Bittker, 1979). Certainly, that this argument could be applied to all forms of state intervention in the economy, and includes both tax and non-tax regulations. It is a legal and technical issue of development and implementation of legislation and problems of legal gaps, or betrays sense (objective) legal norms (and their use to achieve personal interests, contrary to the general that the legislator had in mind when adjusting the rules).

2.2. Tax Treatment of Investments

However, globalization requires a review of all the factors mentioned together, because so many of the early determinants ceased to exist (by the creation of free trade zones and customs unions, instruments of foreign policy lost on its importance). The thesis about the importance of tax incentives to attract foreign capital supports a large number of scholars in the world, while in the domestic literature on the said comparison can be found insufficient scientific papers (Hasset, Hubbard, 1997, p.114). When we talk about complaints classics that tax incentives cannot be compensated for investing in unattractive areas, it would be logical to discuss about it only if we believe that the incentives are ineffective (previously we presented counter-arguments). We believe that the tax on corporate profit as an instrument of investment policy greatest impact on the achievement of its tasks and functions have exactly the legal norms of tax incentives (in the form of provisions on tax exemptions, investment tax credits, exemptions for research and development and accelerated depreciation). Also, we believe that the thesis of the so-called. The "inappropriateness" of tax incentives in modern tax law must seriously reconsider, because in the conditions of globalization, financial crises (which often end the moratorium or bankruptcy of the state) and growing public debt, tax incentives can be an effective tool for the economic policies of developed countries, in particular developing countries (such as Serbia) to generate the desired economic growth. The structure of the aforementioned incentive was determined so that it is in the function of achieving long-term goals of economic policy, and stimulates economic growth, development of small enterprises, concession investments and employment of workers and improves the environmental situation. We believe that quality reform (and the eventual abolition of) provision for stimulating investment must be preceded by a precise and detailed statistics to determine the expenditure in the domestic legislation. Legal uncertainty caused by imprecise standardization of tax incentives for investment and the lack of coordinated communication between the executive and the legislature, calls into question their usefulness (Lazović Pita, Pita, 2011, pp.105-116). At this point we must note that tax incentives can often become an instrument of unfair tax competition by the countries in order to attract investment (Morisset, 2003). Even there is no universal definition; tax competition can be viewed as a form of competition between states (jurisdictions) in attracting capital (investors) by tax instrument, especially tax incentives (Goodspeed, 1998, pp. 579-582). The positive effects of this process are control power, innovation and incentives, while the negative effects are embodied in unfair tax competition. As a result, suffers from the spill-over effects, which is reflected in undermining the integrity and fairness of the tax structure and transfer the tax burden to the less mobile tax bases (Raičević, Nenadić, 2003, p.207). We also believe that the process of tax competition can only be described as bad or as good trend in international tax relations, regardless of the legal, economic and political circumstances in which the competition takes place. In addition, we believe that the positive effects of this process more important than the poor, because they allow the inflow of foreign capital to developing countries in the form of foreign direct investments (i.e. investments in manufacturing technology, knowledge and innovation). The negative consequences of tax competition (in the form of illegitimate exercise of legitimate tax evasion) may limit the adoption of certain agreements and adequate tax reform, where countries impose an obligation to exchange tax information in order to achieve optimal levels of economic development.

3. TAX STIMULATION OF INVESTMENTS IN SERBIA

Tax incentives to attract foreign capital have traditionally been determined by the Law on Tax on Legal Entities. Ratio legis of this legislation is that it contributes to the achievement of the basic objectives of development of economic policy in terms of stimulating economic growth. The implementation of these tax incentives directly realize the basic tasks of the investment policy which is reflected in the increase of investment, their adequate structuring and enhancing efficiency. In order for tax incentives to be effective, we believe that it is essential that their incorporation into legal norms provide that they act as automatic stabilizers, as this reduces investment uncertainty, administrative costs and favouring less profitable investments. Legal provisions governing the tax incentives in this area traditionally see the intention of the legislator to encourage capital investment in certain areas and to encourage employment. During regulating the tax, treatment of investment is necessary to proceed cautiously for reasons to avoid the collapse of the base and the investment of short-term investments that do not contribute to economic development. Amendments to the Law on corporate profit tax rate in Serbia were increased from 10 to 15 per cent. In relation to the tax rates in the region it is still the lowest, which at first glance should mean greater inflow of foreign capital into the country, as viewed in a broader sense, the low tax rate can be a significant stimulus for investment in a particular area. Regardless of the engaging structure of the domestic corporate tax, by itself it is not enough to attract foreign capital because a significant influence on the investment of foreign capital and a factor of political (in) stability in the country.

The decision on the investment of foreign capital in a particular country determines the degree of efficiency of the legal system, considered in terms of protecting their rights and interests at the national territory (Clark, Cabeiro, Bohmer, 2007, p.18). In this sense, certainly it must take into account the transparency, security and certainty in tax law, because today there is a real and logical need to protect the rights of taxpayers and the codification of the tax laws, as they would at any time be able to foresee the consequences of their decisions. However, when we talk about transparency in tax regulations, we must take into account that tax laws are very complex, and that the requirement for the definiteness and clarity of legislation (*lex certa*), in the field of tax law relativized. For most people tax regulations are not sufficiently clear, and to meet legal and tax rates it is necessary to engage experts (tax advisors). Generally, the best way to overcome the disadvantages of tax incentives that would draw attention of foreign investment is to lower the corporate tax rate, while broadening the tax base, which would benefit both existing and new capital, which would avoid harmful tax planning. However, the creators of tax policy must take into account that these incentives could be misused for purposes that legislature had in mind. The system of tax incentives for investment of foreign capital in domestic law is often amended (Randjelović, 2010, pp. 82-90). Thus, the new amendments to the tax law on corporate profit repealed the previously established provisions on tax investment credit, tax credits, accelerated depreciation and concessional investments.

The explanation for the new direction of government policy should be sought in (in) efficiency of previous stimulus, their administrative costs, abuses and actual use conditions, which is why the legislator took the view that it should derogate from all those solutions that are in practice poorly enforced. By the amendments to the Law on Tax on Legal Entities, it was found that the exemption from payment of tax liabilities for a period of ten years, a taxpayer who personally or through another person invests in fixed assets, the registered activity of more than one billion dinars, under the condition to employ at least 100 persons on indefinite period. In these legal regulations, we can notice the obvious intention of the legislator to encourage capital investment in certain areas and to encourage employment.

The new amendments to the Law was abolished incentives in the form of so-called small exemptions for a period of five years, for a taxpayer who carries on business in an underdeveloped area, provided that the taxpayer personally or through another in fixed assets

invest more than 8,000,000 dinars with employment of at least five persons for an indefinite period, which in this area have their permanent residence. However, the laws of the area of particular state interest is not defined, which made it difficult factual application of the exemptions, while the new law changes this stimulus completely annulled, which, in our opinion, lead to the achievement of the objectives of regional policy, which is reflected in the reduction differences in terms of the level of development of the economy within the country. In public can be heard the criticism that the actual scope of these incentives very limited taking into consideration the experience in the past when it came to their abuse and selective use, which calls into question its validity. Experts point out that this tax exemption does not help the newly formed company, because in the first years of business they can generate significant profits (in our opinion, this is a relatively rebuttable presumption), which calls into question the justification for the legislator's intention for such a tax expenditure. One of the reasons for the elimination of these exemptions can be the attitudes of taxpayers towards the benefits, which it brought. Therefore, it seems that the taxpayers in Serbia too freely realized this relief, believing that once they get longer have any formal commitments during its validity, which can be very detrimental to the interests of the state. In order to prevent abuse of the law it is determined that the payer will lose the right to exemption if further reduce the number of employees below 100 or if prior to the expiration of the period of liberation cease to operate or ceases to use or alienate the fixed assets in which investment is done and in the new fixed assets he does not invest at least equal to the amount the market price of the alienated assets. Namely, the duty to provide information to the tax administration on realized profits certainly must exist. Administrative expenses for the realization of these benefits in the form of return of already paid taxes are not high, but the taxpayers still have themselves to apply for a refund (*ex privato*), because the refund is not granted automatically (Eason, Zolt, 2002, p. 20). Also, in order to prevent possible abuse of the new Law provides that if a taxpayer terminates its business, ceases to use or divest assets (in new fixed assets not invested in the same tax period, the amount equal to the market price of stolen funds in the amount that ensures that the total amount of investment is not falls below a predetermined amount) may lose the right to tax exemption. Therefore follows that the taxpayer is required to the date of submission of the tax return for the following tax period, calculate and pay the tax that would have paid that he had not used this incentive. Also, in order to return the same values of money given the impetus of the law stipulates that the amount of the tax debt must valorise (from the date of filing the tax return for the tax period in which he exercised his right to tax exemption up to the date of filing the tax return for the following tax period) by the consumer price index according to the data of the republic authority responsible for the statistics issues. These protection mechanisms would reduce the possibility of abuse of tax incentives on investments, which in the past often occurred and at the same time protecting the interests of the state in this area, because we should not forget that by recognizing these government incentives waived part of their income which in the absence of their appropriateness (i.e. to attract investments in this case) implies an aliquot part of the loss of social welfare. At the same time these mechanisms contributes to the reduction of legal uncertainty, which is needed in this area. In order to protect the already acquired rights of all those taxpayers who have acquired the right to use the tax credit to the entry into force of the new law, their legal interests can be legitimately achieved, but the question of legal consequences of abolition of the tax investment credit on possible future investments in the country. It is interesting that the abolition of these tax reliefs made a precedent in domestic tax law. It could hear the numerous criticisms in the public, that by applying the new tax rulings came only twenty-two days from the adoption of fiscal strategy with projections for 2015 and 2016 year, which stipulated that the abolition of the tax investment credit should be prolonged (because of the importance that this relief had for foreign investors). Numerous representatives of foreign associations of employers pointed to the fact that the abolition of this tax incentive

can have serious consequences on the investment of foreign capital, as a rule, in long term investments; the investment decision is always based on the medium-term plan where there is no room in applying civil law clause *rebus sic stantibus* (lat).

4. CONCLUSION

The only form of taxation, which, in our opinion, can contribute to an optimal attracting of foreign capital, which includes the investment in knowledge, production technology and innovation, is a tax on corporate profits. Certainly, it is not devoid of weaknesses in its structure (especially in developing countries) but it only imposes the need for its reform in order constituting the optimal tax structure (meaningful and effective "epitome" of domestic capital). The problems that its implementation carries in domestic law (complexity, lack of transparency, and the crowd-dispersed incentives that are duplicated with other tax incentives instruments) and international law (the problem of unfair tax competition and legal illegitimate tax evasion) are complex, but not unsolvable. Adequate tax reform and the adoption of certain conventions (agreements), these problems can be reduced in a socially acceptable level, with the aim of exploiting the full potential of this tax (in our opinion, unjustly neglected), which in conjunction with other forms of taxes contributes to the desired economic growth. Legal uncertainty is caused imprecise standardization of tax expenditures and the lack of coordinated communication between the executive and legislative authorities. Therefore, with the introduction of tax incentives (in the system of corporate taxation of corporations), we have to make an accurate analysis of the costs and benefits, because all incentives have particular purpose, based on real needs and in line with the proclaimed national economic and social objectives. Although a growing number of authors take the view that tax incentives should replace the subsidies, we must take into account the fact that the ineffectiveness of tax incentives in part caused by the dynamics of tax regulations and frequent laws changes. The reason for the abolition of tax credits on that basis in domestic law can be partly explained by these shortcomings that the legislator sought to avoid the tax reform. Nevertheless, we must ask whether the abolition of these subsidies affect the overall level of investment in the country and prevent the undermining already undertaken investment projects. In addition, it remains unclear how these changes will affect the location of the tax base and changes firms' legal status

(mergers, divisions and joint ventures agreements). Time will show what will be the legal and economic consequences of the abolition of previously planned tax incentives to the implementation of the objectives of the investment policy and whether the complete abolition of the same be legally justified on the grounds that these incentives are still used in many more developed tax systems. Certainly, it is questionable the way by which these incentives abolish accelerated procedure without prior announcement. New studies show that measures of direct state supports in the form of subsidies cannot represent substitution to the tax investment credit under the conditions of budgetary imbalances.

ACKNOWLEDGEMENT: *The paper is a part of the research done within the project "Protection of Human and Minority Rights in the European Legal Area", D172046 financially supported by the Ministry of Education, Science and Technological Development of the Republic of Serbia.*

LITERATURE:

1. Agell, J., Ohlsson, H., Thouursie, P. (2006). Growth Effect of Government Expenditure and Taxation in Rich Countries: A Comment. *European Economic Review* 50(1), pp. 211-218.
2. Bittker, B. (1979). Equity, Efficiency and Income Tax Theory: Do Misallocations Drive Out Inequities?. *San Diego Law Review* No. 735.

3. Clark, S., Cabeiro, A., Bohmer, A. (2007). Tax Incentives for Investment-A Global Perspective: Experience in MENA and non MENA Countries, OECD.
4. Easson, A., Zolt, E. M.(2002). *Tax Incentives*. Amsterdam: IBRD.
5. Enghen E., Skinner J.(1996). Taxation and Economic Growth. *National Tax Journal* vol. 49 (4).pp. 617-642.
6. FDI Statistics. (2002). *Division on Investment, Technology and Enterprise Development*. UNCTAD.
7. Fundamental Reform of Corporate Income Tax. (2007b). OECD Tax Policy Studies No. 16.
8. Gareth, D. M. (2000). *Taxation and Economic Growth*. Fiscal Studies. Vol. 21(1). pp. 141-168.
9. Goodspeed, J.T. (1998). Tax Competition, Benefit Taxes and Fiscal Federalism. *National Tax Journal* Vol. 51(3). pp. 579-582.
10. Goodspeed T., Martinez-Vasquez J., Zhang L. (2006). *Attracting FDI: Are Government Policies More Important Than Taxation in Attracting FDI*. Andrew Young School of Policy Studies Research Paper No. 06-28.
11. Grier, K., Tullock, K. (1989). An Empirical Analysis of Cross-National Economic Growth, *Journal of monetary economic* Vol. 24. pp. 259-276.
12. Hassett K., Hubbard G. (1997). *Tax Policy and Investment*. in Fiscal Policy: Lessons from Economic Research 339, The Mit Press.
13. Johansson, A., Heady C., Jens A., Brys B., Vartia L. (2008). *Taxation and Economic Growth*. OECD Economic Department Working Papers no. 620.
14. Lazović-Pita L., Pita S.(2011). *Porezni izdaci u sustavu poreza na dobit: Primjer Bosne i Hercegovine*. In: Zbornik radova sa konferencije: Skrivena javna potrošnja: sadašnjost i budućnost poreznih izdataka. Institut za javne financije. Zagreb. pp.105-116.
15. Margalioth, Y. (2010). *Tax Competition, Foreign Direct Investments and Growth: Using the Tax System to Promote Developing Countries*. Chicago Law School Work-in-progress Workshop and IDC Law Faculty Seminar, pp. 23-24.
16. Morisset, J. (2003). *Tax Incentives: Using Tax Incentives to Attract Foreign Direct Investment*, Public Policy for Private Sector. February, 2003.
17. Palazzi, P. (2011). Taxation and Innovation, OECD Taxation Working Papers No. 9.
18. Raičević B., Nenadić J. (2003). Porez na dobit u zemljama zapadnog Balkana-uporednopravni prikaz rešenja. *Ekonomist* Vol. 39. p. 207.
19. Randelović, S. (2010). *Unapređenje performansi poreskog sistema Srbije kroz reformu poreza na dobit. Poreska politika u Srbiji*, Pogled unapred, USAID, Fond za razvoj ekonomske nauke. Beograd, mart 2010. pp. 82-90.
20. Rati, R. (1996). Government Size and Economic Growth: A New Framework and Some Evidence from Cross-Section and Time-Series Data. *American Economic Review* 76. pp.191-203. Robert, B. J. (1991). Economic Growth in a Cross-Section Countries. *Quarterly Journal of Economic* 104. pp.407-444.
21. Summers L.,Vergara R., Gruber J.(1992). *Taxation and the Structure of Labor Markets: The Case of Corporatism*. Mimeo.
22. Zakon o porezu na dobit pravnih lica, Službeni glasnik RS, br. 25/01, 80/02, 43/03, 80/04, 18/10, 101/11, 119/12, 47/13, 108/13, 68/14 i 142/14.

COUNCIL REGULATION (EC) NO 1206/2001 OF 28 MAY 2001 ON COOPERATION BETWEEN THE COURTS OF THE MEMBER STATES IN THE TAKING OF EVIDENCE IN CIVIL OR COMMERCIAL MATTERS AS A GUARANTEE OF THE RIGHT TO EFFECTIVE JUDICIAL PROTECTION

Paula Poretti

*Faculty of Law Osijek
J.J. Strossmayer University of Osijek,
S. Radića 13, Osijek, Croatia
pporetti@pravos.hr*

ABSTRACT

Council Regulation (EC) No 1206/2001 of 28 May 2001 on cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters (hereinafter: the Regulation 1206/2001) is a part of procedural legislation with the aim of ensuring that the transmission and execution is to be made directly and by the most rapid means possible between Member States' courts and contributing to the efficiency of judicial procedures in civil or commercial matters. At the same time, the Regulation 1206/2001, as well as other EU instruments containing measures relating to judicial cooperation in civil matters, should be observed and understood in the broader context than that set out by its aim. Thus, the paper presents a judgment of the German Constitutional court from 14 September 2015 concerning violation of the right to effective judicial protection due to the Municipal court's failure to use possibilities available through the application of the Regulation 1206/2001 in order to investigate and establish the facts of the case that have good prospects of success. Namely, the decision of the German Constitutional court raises a number of questions relating to the application of specific institutionalised facilities and measures of assistance of complementary character to the Regulation 1206/2001 which should be taken into account by a judge when deciding in a cross-border case. Also, it suggests that a reference for preliminary ruling to the CJEU should have been made by the German Municipal court. The paper questions to what extent the new regime of taking evidence presents not only an instrument with an aim to make easier taking evidence in another Member State but another sophisticated EU instrument with an objective to contribute to harmonization of standards of procedural guarantees in Member States.

Keywords: *Regulation 1206/2001, taking of evidence, judgment, German Constitutional court, procedural guarantees.*

1. INTRODUCTION

In order to improve cooperation between the courts on the taking of evidence in civil and commercial matters and enhance judicial cooperation which is crucial for the proper functioning of the internal market Council Regulation (EC) No 1206/2001 of 28 May 2001 on cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters (hereinafter: Regulation 1206/2001) was adopted in 2001. Although the activities in the field of transmission of requests for taking of evidence date back to the signing and the ratification of the Hague Convention of 18 March 1970 on the taking of evidence abroad in civil or commercial matters (hereinafter: the Hague Convention), unfortunately it applies only to 11 Member States so it cannot be considered that there is a binding instrument on the taking of evidence at the EU level (Recital (6) Regulation 1206/2001). Hence, the initiative for the creation of the new procedural legislation in cross-border cases has found support and it resulted

in the adoption of the Regulation 1206/2001.¹ The Member States should still be free to adopt agreements to further strengthen and facilitate cooperation in the taking of evidence. However, The Regulation 1206/2001 should prevail over the provisions contained in these agreements between Member States (Recital (17), Article 21 Regulation 1206/2001).

The system established under the Hague Convention has been used to a certain extent in order to model the solutions contained in the Regulation 1206/2001. This approach has certainly contributed to facilitating the integration of the newly established system in the Member States. At the same time, the Regulation 1206/2001 departs from solutions of the Hague Convention which have been deemed unsatisfactory² and provides mechanisms which speed the transmission of the requests for taking of evidence and ensure the efficiency of judicial procedures in civil and commercial matters (Recital (8) Regulation 1206/2001). Despite the efforts made, the application of Regulation 1206/2001 has revealed that there are still obstacles to ensuring simplified and accelerated taking of evidence in cross-border cases as a prerequisite for efficient judicial procedures as guaranteed under Article 6 European Convention and Article 47 Charter of Fundamental Rights of the European Union.

In the first part of the paper the basic features of the system established under Regulation 1206/2001 will be briefly presented. In the central part of the paper a judgment of the German Constitutional court from 14 September 2015 concerning violation of the right to effective judicial protection due to the Local court's at Frankfurt am Main (*Amtsgericht Frankfurt am Main*; hereinafter: the Local court) to use possibilities available through the application of the Regulation 1206/2001 in order to investigate and establish the facts of the case that have good prospects of success will be presented. Namely, the decision of the German Constitutional court raises a number of questions relating to the application of specific institutionalised facilities and measures of assistance of complementary character to the Regulation 1206/2001 which should be taken into account by a judge when deciding in a cross-border case. Also, it suggests that a reference for preliminary ruling to the CJEU should have been made by the German Local court. In the final part of the paper it will be deliberated whether and to what extent the new regime of taking evidence presents not only an instrument with an aim to make easier taking evidence in another Member State but another sophisticated EU instrument with an objective to contribute to harmonization of standards of procedural guarantees in Member States.

2. BASIC FEATURES OF THE SYSTEM OF THE TAKING OF EVIDENCE UNDER REGULATION 1206/2001

2.1. The scope of application

The substantial scope of application as provided under Article 1(1) Regulation 1206/2001 includes taking of evidence in civil and commercial matters³. There are two possibilities for making a request for taking of evidence in a cross-border case. Either the requesting court will request from the competent court of another Member State to take evidence (evidence taking using the international legal aid) or to take evidence directly in another Member State. The latter

¹ At its meeting in Tampere on 15 and 16 October 1999 the European Council initiated the creation of a new legislation on the taking of evidence.

² See *supra*.

³ According to the Practice guide for the application of the Regulation on taking of evidence it even applies to matters which are excluded from the scope of application of the Brussels I Regulation, such as in matters relating to the status or legal capacity of natural persons, rights in property arising out of a matrimonial relationship, wills and succession; bankruptcy, proceedings relating to the winding-up of insolvent companies or other legal persons, judicial arrangements, compositions and analogous proceedings. (Practice guide for the application of the Regulation on the taking of evidence, p. 10).

possibility reflects the operation of the principle of mutual trust between Member States since it assumes renouncement of the principle of territoriality. According to Article 1(2) Regulation 1206/2001 applies only to requests to obtain evidence which are intended for use in judicial proceedings, commenced or contemplated. Obviously, the provisions of the Regulation 1206/2001 are not intended for *fishing expeditions* in order for the parties to establish if there is evidence sufficient to initiate proceedings.

The fact that the definition of the term „Member State“ under Article 1(3) Regulation 1206/2001 includes all Member States except Denmark provides for the conclusion that Denmark is not bound by it or subject to its application.

2.2. The principles of the procedure

The focus of the system under Regulation 1206/2001 on the consistent realisation of the guarantee of efficient judicial procedure is obvious from the persistency in the use of the principles of urgency, efficiency, written form and the use of standard forms, the use of communication technologies, publicity and directness.

The speed in the performance of taking of evidence highlighted in the interpretative rules of the Regulation 1206/2001 should be equally provided in the transmission of requests (Recital 9 Regulation 1206/2001) as well as their execution (Recital 10 Regulation 1206/2001). Accordingly, standard forms are provided in the Annex of the Regulation 1206/2001 (Form A-J)⁴ which enables courts to exchange information in a timely and uniform manner. In this sense, the system of the acceptance of the request by the central body and its sending to the body responsible for its execution which was established under Article 2 of the Hague Convention is no longer in use (Betetto, 2006, p. 140). Further, all actions should be taken in accordance with the principle of urgency. Thus, the period for sending an acknowledgement of receipt to the requesting court is 7 days from the receipt of the request, the period for informing the requesting court that the request is incomplete is 30 days from the receipt of the request and the period for execution of the request is 90 days from the receipt of the request. However, given that there are no sanctions if these time limits are not respected, it is doubtful whether the provisions prescribing them can achieve the desired effect (Study, 2007, p. 26).

The efficiency of the procedure is not only achieved through the use of standards forms but also through the use of available communication technologies according to 10(4)⁵, the guarantee of the execution of the request by the requested court without imposing additional cost, except those stemming from the participation of experts or interpreters and the use of specific methods and the exemption of the authentication or any other formality of the documents according to 4(2) Regulation 1206/2001. Unlike Article 7 Hague convention which only provides for the possibility of the parties and their representatives to be present, Regulation 1206/2001 enables them to participate in the proceeding before the requested court under certain conditions. According to Article 11(1) Regulation 1206/2001 if it is provided for by the law of the Member State of the requesting court, the parties and their representatives, have the right to be present at the performance of the taking of evidence by the requested court. Also, if it is compatible with the law of the Member State the requesting court, representatives of the requesting court have the right to be present in the performance of the taking of evidence by the requested court under Article 12(1) Regulation 1206/2001.

⁴ However, the Study on the application of Regulation 1206/2001 revealed that the efficiency of standard forms depends on the training and specialisation of civil servants in the departments of the Member States which come into contact with the procedure (Study on the application of Council Regulation (EC) No 1206/2001 on the taking of evidence in civil or commercial matter, 2007, p. 7).

⁵ The application of communications technology depends on the level of available compatible infrastructure which at the moment varies between Member States. This significantly restricts the swiftness of the system set out in the Regulation 1206/2001. (Study on the application of Council Regulation (EC) No 1206/2001 on the taking of evidence in civil or commercial matter, 2007, p. 7).

2.3. Basis rules on taking of evidence

One of the novelties provided under Regulation 1206/2001 in comparison with the system under Hague convention is the direct taking of evidence by the requesting court.⁶ While under Article 2 Hague convention the central body is in charge of acceptance of the request by the central body and its sending to the competent body, the role of the central body in the taking of evidence under Article 3(3) Regulation 1206/2001 consists of supplying of information to competent courts, seeking solutions to any difficulties which may arise in respect of a request and forwarding, in exceptional cases, at the request of a requesting court, a request to the competent court.⁷ Additionally, if there is no other competent authority in the Member States for receiving requests for direct taking of evidence, the requesting court shall submit the request to the central body according to Article 17(1) Regulation 1206/2001. In order to facilitate the search for the competent court Member States are requested to provide a list of competent courts according to Article 2(2) Regulation 1206/2001 which is available in a manual in the European Judicial Atlas for Civil Matters.

As prescribed in Article 10(2) Regulation 1206/2001, the execution of the request for the taking of evidence by the requested court shall be done within 90 days at the latest in accordance with the law of its Member State. The law of the requested court is applicable to the procedure of taking of evidence. However, in order to establish if conditions for taking of evidence have been met the provisions of Regulation 1206/2001 apply (Betetto, 2006, p. 141). Under Article 10(3) Regulation 1206/2001, upon a request, the requested court may execute the taking of evidence according to a special procedure provided for by the law of the Member State of the requesting court. The requested court shall not comply with the requirement if the procedure is incompatible with the law of the Member State of the requested court or by reason of major practical difficulties. The possibility for the application of the foreign law at the requested court was provided in order to ensure the usefulness of the received evidence for the requesting court (Betetto, 2006, p. 141).

Generally, the possibility of direct taking of evidence by the requesting court presents both a novelty and a significant advantage in comparison to the taking of evidence by the requested court. Nevertheless, there are disadvantages in terms of the submission of the request to the central body which upon acceptance sends the request to the competent court and the exclusion of the possibility of the use of coercive measures.

3. RIGHT TO EFFECTIVE JUDICIAL PROTECTION UNDER REGULATION 1206/001-SOME PRACTICAL CONSIDERATIONS

Having in mind the results of the Study of the application of Regulation 1206/2001, it will be interesting to analyze a recent order of the German Federal Constitutional court. Namely, problems in the application of Regulation 1206/2001 have been attributed to the brief period of application due to which those participating in the procedure were not able to get more familiar and adapt to the new system of taking of evidence. Thus, the order of the German Federal Constitutional court from 14 September 2015 (German Federal Constitutional Court's Order, 1 BvR 1321/13, [GER-2015-3-021]) will be interpreted in the light of the longer period of the application of Regulation 1206/2001 and presumably, more experience of those participating

⁶ The limited knowledge of the direct transmission system under Regulation 1206/2001 and the lack of practice in making use of it lead to its only being employed on an irregular basis, and the central bodies are still often called upon to pass on the request to the competent courts (Study on the application of Council Regulation (EC) No 1206/2001 on the taking of evidence in civil or commercial matter, 2007, p. 7).

⁷ The Study showed that the central bodies were included in a large number of cases which was perceived as a significant degree of attachment on the part of the legal practitioners to the way things were done prior to the Regulation 1206/2001, and especially to the system of central bodies provided for in the Hague Convention of 18 March 1970 on the taking of evidence abroad in civil and commercial matters (Study on the application of Council Regulation (EC) No 1206/2001 on the taking of evidence in civil or commercial matter, 2007, p. 7).

in the procedure. A critical assessment will be made in order to discuss the potential barriers to the efficient judicial protection under Regulation 1206/2001. In the proceedings before the German Federal Constitutional court in an order from 14 September 2015 1 BvR 1321/13, [GER-2015-3-021] the court found that the applicant's right to effective judicial protection (Article 2(1) in conjunction with Article 20(3) of the German Basic Law) was violated. In such cases violation consists of the courts' interpretation of their procedural possibilities to investigate and establish the facts of a case in such a restrictive way that a review of the merits of the case is not possible.⁸ The applicant, a Romanian national (hereinafter: the applicant) according to the will of her husband, also a Romanian national after his death in 2008, was his only heir. However, another Romanian national, the nephew of the deceased (hereinafter: the plaintiff) had sued the applicant before the Local court for a share of the inheritance of her deceased husband based on the assertion that they had adopted him. The applicant contested that that plaintiff had been adopted by herself and her husband. Therefore, the plaintiff applied for recognition of the adoption supposedly having taken place in Romania and submitted documents in order to prove the fact.⁹ The applicant again contested that it had taken place.

In the proceedings, the Local Court did not request the Romanian adoption files for consultation by way of judicial cooperation. The applicant challenged that decision by a Local Court before the Federal Constitutional court. The applicant asserted that Article 3(1) and Article 103(1) of the Basic Law had been violated by the Local Court, as it had not requested the adoption files for consultation.

The Federal Constitutional Court reversed and remanded the challenged decision for a new decision to the Local Court, as the right to effective judicial protection had been violated by the Local Court. The decision is based on the following considerations. While a court, if this is provided by law, is obliged to establish all facts relevant for case, it does not have to follow any potential lead. It may close a case if further investigations would not add any pertinent, decisive facts. It does not always have to grant applications to take evidence that are made by the parties to the proceedings. This includes cases in which evidence would be inadmissible, cannot be obtained, or would be completely useless. However, in the case at issue, the Local Court, pursuant to the relevant German laws, had been obliged to investigate the relevant circumstances *ex officio*. At the EU level, judicial cooperation in the field of taking evidence is governed by Regulation 1206/2001 which the court did not use in order to determine whether there was an obstacle to recognising the adoption that allegedly had taken place. The general conditions for requesting the taking of evidence were present. However, the Local Court –inexplicably – was of the opinion that the applicability of the Regulation 1206/2001 depended on the proceedings abroad still pending. The Regulation 1206/2001 might enable a court to request case files from other Member States. However, the Local Court had dismissed the possibility of such a request without due consideration. In particular, it did not consider that opinions as to whether the Regulation 1206/2001 permits a German court to request (original) case files from other Member States still differ for various reasons (different from Article 1(1) of the Hague Convention). There is no explicit mention of “other judicial acts” in the Regulation 1206/2001 which is interpreted in different ways – resulting either in such acts being within or falling outside of the scope of the Regulation 1206/2001; there is no unanimity with regard to the question whether a request of

⁸ Federal Constitutional Court, 2 BvR 1533/94, 07.12.1999; 2 BvR 779/04, 19.10.2004; 2 BvR 429/11, 9.12.2014; 2 BvR 2063/11, 18.12.2014.

⁹ Decision on adoption by an Executive Committee from 1970 of the People's Council of the Town Timișoara, a certificate of the entry in the adoption registrar of Timișoara from 7 July 2010 and a certificate of the German Jugendamt from 29 July 1966.

case files constitutes “another judicial act”). Thus, it cannot be ruled out from the outset that it is possible. Even if such a request were impossible under the Regulation 1206/2001, Article 21(1) of the Regulation 1206/2001 would have allowed for an application of the Hague Convention and might have provided another possibility. Obviously, the court was inconsistent in its approach. As it considered the question of whether the couple had applied for the plaintiff’s adoption to be decisive, as it did not take into consideration any other means of establishing that fact and as there was no case-law of the Court of Justice of the European Union (hereinafter: CJEU) about the disputed question whether the Regulation 1206/2001 allowed for a request of the case law in another Member State, it would have been under a duty to refer the question to the CJEU pursuant to Article 267.3 of the Treaty of the Functioning of the European Union (hereinafter: TFEU). In addition, even if it had been impossible to request the case files under the Regulation 1206/2001, the Local Court should have tried to use other means available under the Regulation 1206/2001. Moreover, the court could have asked for assistance by way of general mutual judicial assistance, assistance not regulated and depending on the good will of the other state involved, but, from the facts of the case, an option that might have been possible. The court also failed to use the mechanisms established through the European Judicial Network in Civil and Commercial Matters mechanisms¹⁰ to facilitate judicial cooperation, which would have been a means to learn about the different options available.¹¹

Regulation 1206/2001 provides for a general legal framework while the Member States are free to apply their national legislation in the procedure for taking of evidence. Thus, the provisions of Regulation 1206/2001 are broadly defined and leave room for interpretation. Namely, the approach of the European legislator in the field is based on coordination rather than unification of the rules. Thus, the application of Regulation 1206/2001 requires autonomous interpretation of its provisions in accordance with the aim of each provision. Thereby, national understanding of certain terms should be disregarded.¹² The European legislator refrained from the encroachment in the national procedural law of Member States while at the same time, trying to ensure equally available mechanism for cross-border taking of evidence in Member States.

However, the order of the Federal Constitutional court reveals problems which can occur in the interpretation of Regulation 1206/2001. The Local court mistakenly concluded that Regulation 1206/2001 cannot apply to taking of evidence before the Rumanian authority since the procedure in question was completed. Further, the Local court uncritically concluded that Regulation 1206/2001 does not allow for acquiring documents from the competent authority in Romania regarding the alleged adoption. Obviously, the Local court disregarded the requirement of autonomous interpretation of Regulation 1206/2001 in accordance with its meaning, aim, development and systematic. Having in mind its aim in furthering the functioning of the internal market, the concept of taking evidence should not be interpreted too strictly, in order to include as many cases as possible to which Regulation 1206/2001 would be applicable. This was emphasized in an opinion of AG Kokott regarding the interpretation of Regulation 1206/2001 in an earlier case.¹³ Additionally, Local court disregarded the possibility to seek guidance by requesting preliminary ruling from the CJEU.

¹⁰ Council Decision 2001/470/EC of 28 May 2001 establishing a European Judicial Network in civil and commercial matters.

¹¹ Abstract of the German Federal Constitutional Court’s Order of 14 September 2015, 1 BvR 1321/13, [GER-2015-3-021]. Available at http://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2015/09/rk20150914_1bvr132113en.html

¹² The concept of taking evidence must equally, as the entire Regulation on Evidence, be interpreted autonomously. Certain points of support for its proper understanding are contained in the Statute of the ECJ and the Rules of Procedure of the ECJ. Betteto, 2006, p. 140.

¹³ This was confirmed by AG Kokott in case C-175/06, t. 43.

It seems that the order of the Federal Constitutional court warned that problems revealed during the research on application of Regulation 1206/2001 are still current. Thereby, mention should be made to the fact that the case occurred before the court of the Member State in which Regulation 1206/2001 is applied from 2004 and all necessary adaptation for its proper operation have been made. This raises questions regarding the application of Regulation 1206/2001 in Member States which are not so advanced. For example, in Croatia as a new Member State the Regulation 1206/2001 applies from 1 July 2013. Given the internal problems regarding efficiency in judicial procedures, inadequately equipped system for the use of communication technologies, the lack of training for judges and insufficient funding available for taking of additional measures for improvement in Croatian legal system, it cannot be argued that the application of Regulation 1206/2001 will be without obstacles or difficulties.

However, the omissions in the decision of the Local court should not be entirely attributed to the errors of the court in the interpretation of Regulation 1206/2001. Although it represents a valuable instrument which should contribute to the higher standard of judicial protection in Member States it also provides sophisticated mechanisms which are unfamiliar to the courts of Member States and in some cases even require fundamental change of the practice of courts.

First, the fact that in the taking of evidence Regulation 1206/2001 provides for a dual system which requires application of both its provisions and the national law of the Member States. While the provisions of Regulation 1206/2001 provide guidelines for the procedure of receiving and executing of requests, the national law should be applied to the operation of taking of evidence. Thereby, the requested court at the request should even apply the law of the Member State of the requesting court, if all conditions are met. The request for the direct exchange of requests and information between court of the Member States does not seem to take into account the language barriers or the additional efforts which should be made by judges in order to participate in the cross-border taking of evidence within the system established under Regulation 1206/2001.

Although the approach of the European legislator who strives for the broad interpretation of the concept of taking of evidence thus leaving the terms such as „taking of evidence“ undefined might seem adequate for achieving the aim, it might also provide for the hesitations of the courts in the application of Regulation 1206/2001. It must be kept in mind that the majority of legal systems of South Eastern Europe did not foster the creativity of judges in the interpretation of legal norms and principles. Traditionally, the rules for procedure in taking of evidence are straightforward, unambiguous and simple.

Also, since the scope of the application of Regulation 1206/2001 is not defined, the courts should rely on the autonomous interpretation of the notion of *civil and commercial* matters which differs from the notion in regard to the Brussels I/Brussels I *bis* Regulation (Practice guide, p. 5). The European legislator relies on the CJEU to provide guidance and a uniform interpretation of the terms under Regulation 1206/2001 in cases where it is needed. However, this implies that the uniform application of Regulation 1206/2001 is (at least) in part dependent on the preference of the national court to request preliminary rulings of the CJEU.

Finally, the use of communication technologies and standard forms has advantages, especially in terms of efficient and urgent execution of requests. At the same time, insufficiently equipped systems of Member States are damaging for the efficiency of the system established under Regulation 1206/2001. One of the examples revealed by the Study of the application of Regulation 1206/2001 is that the majority of Member States indicated the use of post for the exchange of information.

4. CONCLUDING REMARKS

Undoubtedly, Regulation 1206/2001 presents a valuable effort of the European legislator to contribute to the guarantee of efficient judicial procedure in Member States. As the order of the German Federal Constitutional court showed, in order for the instrument to produce the desired effect, its rules have to be unambiguous and simple to use. But it seems that the application of Regulation 1206/2001 still raises questions and concerns for the national judges. Additional steps in the direction of their elimination, along with the enhanced education of judges and further adjustment to the „European idea“ in the interpretation of Regulation of 1206/2001 are welcome as means for achieving its proper functioning in the Member States.

LITERATURE:

1. Betetto, Nina. (2006). Introduction and practical cases on Council Regulation (EC) No 1206/2001 on cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters, *The European Legal Forum (E)* 2006(4), p. 137 - 144
2. Practice guide for the application of the Regulation on the taking of evidence (2006). European Commission. Retrieved from http://ec.europa.eu/civiljustice/evidence_guide_en.pdf
3. Study on the application of Council Regulation (EC) No 1206/2001 on the taking of evidence in civil or commercial matter (2007). European Commission. Retrieved from http://ec.europa.eu/justice_home/doc_centre/civil/studies/doc_civil_studies_en.htm
4. Council Regulation (EC) No 1206/2001 of 28 May 2001 on cooperation between the courts of the Member States in the taking of evidence in civil or commercial matters, OJ 2001, 174/1, 27.6.2001
5. 20. Convention of 18 March 1970 on the taking of evidence abroad in civil or commercial matters. Retrieved from <http://www.hcch.net>
6. Abstract of the German Federal Constitutional Court's Order of 14 September 2015, 1 BvR 1321/13, [GER-2015-3-021]. Retrieved from http://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2015/09/rk20150914_1bvr132113en.html
7. Federal Constitutional Court, 2 BvR 1533/94, 07.12.1999; 2 BvR 779/04, 19.10.2004; 2 BvR 429/11, 9.12.2014; 2 BvR 2063/11, 18.12.2014
8. Opinion AG Kokott delivered on 18 July 2007 case C-175/06, ECLI: EU:C:2007:451

THE PUBLIC AND INTERESTED PUBLIC IN ENVIRONMENTAL PRACTICES

Merica Pletikosic

CEMEX, Croatia

merica.pletikosic@cemex.com

Majda Tafra Vlahovic

University of Applied Sciences Baltazar, Croatia

majda.tafra@gmail.com

ABSTRACT

The 21st century has seen great progress in all areas of scientific knowledge, in particular climate change and the right to participation and informing the public in making environmentally-friendly decisions. Today the right to a healthy environment is a fundamental human right. European rules provide for early public participation in environmental impact assessment procedures. The goal is early involvement, and continuous public participation in the process, creating the preconditions that allow the public to significantly affect the outcome of environmental impact assessments. This is regulated with various regulations, and their amendments. Following the adoption of the Aarhus Convention, in 2003 the EU adopted the Directive on Public Participation in the Process of Preparing Plans and Programmes Relating to the Environment. This paper presents the results of empirical research on information and opinion of interested public in the Republic of Croatia according to the differences between the interested public and the public in the procedures on the assessment of environmental impact studies. Qualitative research on the target sample was conducted using in-depth interviews and participatory observation. The grounded theory method was used in the analysis of empirical material, and the quantification of qualitatively processed encrypted material was performed using Statistica 11.00. Most respondents believe that there is a difference between the interested public and the public and explain that the interested public includes the local community and stakeholders directly and immediately interested in a specific project, while the public includes stakeholders who do not belong to the community, and do not have direct interest. Slightly less than half of the respondents think that there is no difference between the public and the interested public due to the fact that this is only legally regulated, insignificant in the environmental process, and only means meeting the legal form and alignment with the EU regulations.

Keywords: *the interested public and the public, the Aarhus Convention, environmental protection.*

1. INTRODUCTION

By European standards, the interested public is consulted in the conceptual phase of the project, as well as continuously throughout the procedure. European rules provide for early public participation in environmental impact assessment. The goal is early involvement, as well as continuous public participation in the process, creating the preconditions that allow the public to significantly affect the outcome of the environmental impact assessment (Cox, 2013). This is governed by various regulations, which have experienced several amendments from design to date. Following the adoption of the Aarhus Convention, in 2003 the EU adopted the Directive on Public Participation in the Process of Preparing Plans and Programs Relating to the Environment and changes to the Directive on Environmental Impact Assessment in order to harmonize them with the principles of the Aarhus Convention (Ofak, 2009). **The Aarhus Convention** (the basis of the international legal framework for improving environmental

democracy) – the UNECE Convention on Access to Information, Public Participation in Decision-making and Access to Justice in Environmental Matters was signed on 25 June 1998 in Aarhus, Denmark. *The Convention is particularly significant as it is the first international agreement signed in Europe in which the right to a healthy environment is designated as a fundamental human right.* The Convention is based on the so-called Three Pillars: access to environmental information, public participation in environmental decision making and access to justice in cases related to environmental law. The Aarhus Convention is based on the concept of **environmental democracy**. Environmental democracy postulates that solving environmental issues should include all those affected by a certain decision, not just the relevant government bodies and economic sector (Ofak, 2009). In this process, all participants must be given equal status in order to prevent the decision-makers from taking only one side's arguments into account. Availability of information is therefore a central part of environmental democracy as it encourages concerned members of the public to become active participants in the decision-making processes related to environmental issues. The terms "public" and "interested public" are defined by the Convention itself:¹ The term "PUBLIC" stands for one or more natural or legal persons and their associations, organisations and groups as defined by local law or practice. The public can be any person, regardless of their citizenship, residence or headquarters (for legal persons). Discrimination on the basis of citizenship, nationality, residence or location of headquarters (for legal persons) is forbidden. The term "INTERESTED PUBLIC" stands for segments of the public that are or could be affected by environmental decision-making, or that are interested in the issue; non-governmental organisations whose work is in the field of environmental protection and that meet all the criteria set by local law will be considered members of the interested public. This is important for the realisation of the terms set out in the Convention and is related to public participation in the decision-making process. The exact details of how the public is to be informed and consulted, as well as its role in access to legal institutions, are defined individually by every state. Public participation is a mechanism established with the aim to involve the public in the decision-making process (a procedure governed by legislation), as well as a way of achieving broader social goals. Public administration is tasked with identifying and implementing public interest. In time, we have come to the conclusion that state administrative bodies are not the sources of objective identifying and decision making in the best interest of the public, but are rather arbitrators between the various interests that exist, and practice has shown that economic and political interests are always stronger than the declarative and non-binding right to a healthy environment. That is why public participation is a challenge to the traditional management/decision-making model implemented by experts or public administration bodies. The broader social significance of public participation consists of the following goals (Beierle i Cayford, 2002): including public values in the final decision, improving the quality of the final decision, solving conflicts between differing interests, building trust in institutions, educating and informing the public. The success of public participation is defined as the extent to which the five social goals have been realised, i.e. the success of achieving these social goals is proportional to the quality of public participation. The European community regulated this field even before the Aarhus Convention. Moreover, the so-called EIA Directive and the IPPC Directive of the European Community have served as the basis for Appendix I of the Convention (Ofak, 2009). When it comes to public participation, the solution is to be found in more modern legislation. For the past 30 years, the importance of public participation in the procedures of environmental impact assessment has constantly been growing. Little is going to change in practice with no procedural, administrative and legal instruments for monitoring the processes of environmental impact assessment and decision making in the hands of citizens.

The main objectives of developing effective strategies for involving the public are better understanding, better communication, strengthening the ability/skills to apply the appropriate forms of participation/involvement with respect to the purpose of the process, and strengthening the relationship and cooperation between stakeholders, with the aim of better planning and realization of (local) sustainable development. Introducing new legal opportunities for public participation is not sufficient in itself – the public must first learn what it has available and how to use that in order for the process of social assessment to be carried out within or prior to the process of environmental impact assessment (Čaldarović, 2006). This paper presents the results of empirical research on information and opinion of interested public in the Republic of Croatia according to the differences between the interested public and the public in the procedures on the assessment of environmental impact studies.

Based on the defined goal, the following **general hypothesis (H_G)** was made:

There are significant differences between the defined sector and target groups in the level of awareness and opinions on the distinction between “the public” and “the interested public” in environmental impact assessment procedures.

2. METHODOLOGY

The qualitative study was carried out using a purposive sample and the methods of in-depth interview and participant observation. The method of grounded theory was used in the analysis of the empirical material. Three basic types of coding were applied: open or initial coding, axial coding, selective coding. The initial coding included the first rearranging and sorting of the data, noting similarities and forming response groups. Final analysis and categorisation of the key concepts created the conceptual matrix with the content of qualitative empirical material in the integrated theoretical framework (Holton, 2007; Charmaz, 1990). Inductive and deductive methods were used on the data, as well as the method of analysis and synthesis, comparison method, classification method, and the descriptive method (Silverman, 2006). The study was conducted in 2014. Respondent selection was done according to previously set criteria: a target sample of participants in the empirical study who are involved in the procedures relevant to the research either professionally or voluntarily (Pletikosić, 2012). The sample was defined with 100 entities, 46 males and 54 females. The average respondent age was 52.1 years. Respondents were divided into 10 subsamples (target groups) which were qualitatively defined with 10 entities:

1. *STUDY MAKERS* – persons authorised by the Ministry of Environmental and Nature Protection;
2. *DEVELOPERS* – investors;
3. *MINISTRY OF ENVIRONMENT/COMMITTEE* – representatives of the governing body conducting the process, and members of committees for study evaluation;
4. *CITIES* – representatives of the employees of the city administration for environmental protection responsible for conducting public debates, and spatial planning representatives;
5. *COUNTIES* – representatives of the employees of the county administration for environmental protection responsible for conducting public debates, and spatial planning representatives;
6. *ASSOCIATIONS* – representatives of non-governmental environmental associations;
7. *CIVIL INITIATIVES* – representatives of NGOs and civil society who are involved in the process, but are not environmentally oriented;
8. *ECONOMIC ASSOCIATIONS* – representatives of the Croatian Employers' Association, Croatian Chamber of Commerce, and other economic interest associations;

9. *POLITICAL PARTIES* – representatives of political structures which are included in the process;
10. *SCIENTISTS/JOURNALISTS* – representatives of academic institutions and journalists who are involved in the process.

Three new qualitatively defined control groups (clusters) were classified based on the above subsamples:

1. *PUBLIC SECTOR* – 40 respondents from target groups: MIN. OF ENVIRONMENT/COMMITTEE, CITY, COUNTY, SCIENTISTS/JOURNALISTS;
2. *CIVIL SECTOR* – 30 respondents from target groups: ASSOCIATIONS, CIVIC INITIATIVES, POLITICAL PARTIES;
3. *ECONOMIC SECTOR* – 30 respondents from target groups: *STUDY MAKERS, DEVELOPERS, ECONOMIC ASSOCIATIONS.*

Research material consisted of two dependent (grouping) variables according to the criteria of the target group, the criteria of the control group, and one independent variable. The respondents were asked to state their opinion on whether there were differences between the public and the interested public in environmental impact assessment procedures. The responses related to the two independent variables were coded with a measuring scale from 1 to 3. We calculated the following descriptive parameters: frequency and cumulative relative values of the responses in the whole sample, and in the predetermined focus and control groups. Processing was carried out using the Statistica Ver.11.00 software suite (Petz et al., 2012).

3. RESULTS AND INTERPRETATIONS

Quantitative processing of the variable entity matrix was based on the responses provided to the qualitatively defined question: “Do You believe that there is a difference between **the public** and **the interested public**?”

Respondents were asked to state their opinion on whether there was a difference between the concepts of the public and the interested public. The answers were defined on three levels: *The first group* was classified according to negative responses, and represents those entities who answered:

There is no difference between the public and the interested public in environmental impact assessment procedures; there is no need for regulations to differentiate between the two. There is no real difference, the distinction is only in legal terms and is ultimately irrelevant for environmental impact assessment procedures. I believe that the distinction is only made to meet the requirements of the legal form and adjust procedures to EU regulations.

Quantitatively, these negative responses were coded as zero (0), for the upcoming statistical data processing.

The second group says that it does not have enough information, does not know or is not sure how to respond, is undecided, and stands by the following positions:

The legal distinction between the two concepts is vaguely defined, the regulations are confusing. There should be a difference in definition between the public and the interested public, as the interested public is expected to possess more information and more detailed knowledge, but I am not certain what exactly is achieved by this, I do not know how to reply.

Quantitatively, these undecided responses were coded as one (1) for later statistical processing.

The third group of entities responded affirmatively, and argued its views as follows:

Yes, “the public” stands for all citizens, “the interested public” cannot stand for all citizens (or legal persons) because there could be a potential or real conflict of interest. “The interested public” refers to persons directly concerned about a particular project in their local community, while “the public” refers to persons who have no immediate interest in the project and are not members of the local community.

Quantitatively, these undecided responses were coded as two (2) for later statistical processing. Responses to the question were coded in the statistical process under the variable *difference_public and interested public*.

Table 1 shows the frequency of all instances of the variable *difference_public and interested public*.

Response s	Frequency	Cumulative relative frequency
0	41	41,00
1	11	52,00
2	48	100,00

Chart 1.

Absolute and cumulative relative frequencies of the variable difference_public and interested public, N=100.

Legend: 0 - no; 1- I don't know, I'm not sure; 2 - yes.

41 of the respondents believe that there is no difference between the public and the interested public. Their opinion is based on the premise that the distinction is merely legal and ultimately irrelevant in environmental impact assessment procedures, as well as that it exists only to meet the requirements of the legal form and adjust procedures to EU regulations. On the other hand, 48% of the total number of respondents believe that there indeed is a difference between the public and the interested public. They claim that "the interested public" refers to persons directly concerned about a particular project in their local community, while "the public" refers to persons who have no immediate interest in the project and are not members of the local community. 11% of the respondents could not provide a definite answer to this question and remained undecided.

Table 2 shows the frequency of the variable *difference_public and interested public* in the 10 predefined *target groups*.

Responses	SM	DE	ME	CI	CO	AS	CI	EA	PP	S/J	Total
0	2	0	6	3	3	7	8	0	5	7	41
1	0	1	0	3	2	3	2	0	0	0	11
2	8	9	4	4	5	0	0	10	5	3	48

Chart 2. *Frequencies for the variable difference_public and interested public according to target group, N = 100*

Legend: 0 - no; 1- I don't know, I'm not sure; 2 - yes.

SM - STUDY MAKERS– persons authorized by the Ministry of Environmental and Nature Protection;

DE – DEVELOPERS – investors;

ME – MINISTRY OF ENVIRONMENT/COMMITTEE – representatives of the governing body conducting the process, and members of committees for study evaluation;

CI – CITIES – representatives of the employees of the city administration for environmental protection responsible for conducting public debates and spatial planning representatives;

CO – COUNTIES – representatives of the employees of the county administration for environmental protection responsible for conducting public debates and spatial planning representatives;

AS – ASSOCIATIONS – representatives of non-governmental environmental associations;
CI – CIVIL INITIATIVES – representatives of NGOs and civil society who are involved in the process, but are not environmentally oriented;
EA – ECONOMIC ASSOCIATIONS – representatives of the Croatian Employers' Association, Croatian Chamber of Commerce, and other economic interest associations;
PP – POLITICAL PARTIES – representatives of political structures which are included in the process;
S/J – SCIENTISTS/JOURNALISTS – representatives of academic institutions and journalists who are involved in the process.

It is clear from Table 2 and the frequencies of the variable in the 10 predefined *target groups* that responses obtained in certain subsamples differ completely. Respondents from the target group ECONOMIC ASSOCIATIONS (representatives of the Croatian Employers' Association, Croatian Chamber of Commerce, and other economic interest associations which are not environmentalist) have all provided positive answers, i.e. 100% of them believe that there is a difference between the public and the interested public. Their opinion is shared by a majority of STUDY MAKERS and DEVELOPERS. These respondents believe that “the public” is a general term, while “the interested public” only refers to those directly concerned about a particular project, as well as that the process should be open to both groups.

On the other hand, the majority of respondents from the target groups CIVIL INITIATIVES, ASSOCIATIONS, as well as those from the target groups SCIENTISTS/JOURNALISTS and MINISTRY OF ENVIRONMENT/COMMITTEE, have provided a negative answer and believe that there is no difference between the public and the interested public, and that the distinction is merely legal and exists only to meet the requirements of the legal form and EU regulations.

Quantitative analysis of the frequencies of the variable *difference_public and interested public* with respect to *sector group* is shown in Table 3.

Responses	PUBLIC SECTOR	CIVIL SECTOR	ECONOMIC SECTOR	Total
0	19	20	2	59
1	5	5	1	5
2	16	5	27	36
Total	40	30	30	100

Table 3. Frequencies for the variable *difference_public and interested public* according to sector group, *N* = 100

Legend: **0** - no; **1**- I don't know, I'm not sure; **2** - yes.

Public sector - MIN. OF THE ENVIRONMENT/COMMITTEE, CITY, COUNTY, SCIENTISTS/JOURNALISTS;

Civil sector - ASSOCIATIONS, CIVIC INITIATIVES, POLITICAL PARTIES; **Economic sector** - STUDY MAKERS, DEVELOPERS, ECONOMIC ASSOCIATIONS.

40% of the respondents from the *public sector* believe that there is a difference between the public and the interested public, while 48% claim that there is no real difference and that the distinction is only legal in nature. Respondents from the *economic sector* account for 30 entities in the entire quantitative analysis, 27 (90%) of which have provided a positive answer and claim

that there is indeed a difference between the public and the interested public. This opinion is shared by only 5 respondents from the *civil sector* (17%).

Taking into account the results of the empirical study, the **general hypothesis (H_G)** which states that

“there are significant differences between the defined sector and target groups in the level of awareness and opinions on the distinction between ‘the public’ and ‘the interested public’ in environmental impact assessment procedures”

is confirmed and accepted in its entirety.

4. CONCLUSION

The goal of this study was to determine the level of awareness and opinions among members of the general and interested publics in Croatia on the difference between “the public” and “the interested public” in environmental impact assessment procedures. The empirical study was conducted on a target sample comprised of persons involved in environmental impact assessment procedures either voluntarily or professionally. The sample was defined with 100 entities, 46 males and 54 females. The average respondent age was 52.1 years. Respondents were divided into 10 subsamples (target groups) which were qualitatively defined with 10 entities and additionally classified into three new control sectors (clusters). Research material consisted of two dependent (grouping) variables according to the criteria of the target group, the criteria of the control group, and one independent variable. 40% of the respondents from the *public sector* believe that there is a difference between the public and the interested public, while 48% claim that there is no real difference and that the distinction is only legal in nature. Respondents from the *economic sector* account for 30 entities in the entire quantitative analysis, 27 (90%) of which have provided a positive answer and claim that there is indeed a difference between the public and the interested public. This opinion is shared by only 5 respondents from the *civil sector* (17%). 41 of the respondents believe that there is no difference between the public and the interested public. Their opinion is based on the premise that the distinction is merely legal and ultimately irrelevant in environmental impact assessment procedures, as well as that it exists only to meet the requirements of the legal form and adjust procedures to EU regulations. On the other hand, 48% of the total number of respondents believe that there indeed is a difference between the public and the interested public. They claim that “the interested public” refers to persons directly concerned about a particular project in their local community, while “the public” refers to persons who have no immediate interest in the project and are not members of the local community. 11% of the respondents could not provide a definite answer to this question and remained undecided. The majority of the respondents believes that there is a difference between the public and the interested public, and claims that “the interested public” refers to persons directly concerned about a particular project in their local community, while

“the public” refers to persons who have no immediate interest in the project and are not members of the local community. A little less than half of the respondents believes that there is no difference between the public and the interested public, and bases their opinion on the premise that the distinction is merely legal and ultimately irrelevant in environmental impact assessment procedures, as well as that it exists only to meet the requirements of the legal form and adjust procedures to EU regulations.

LITERATURE:

1. Beierle, T.C., Cayford J. (2002). *Democracy in Practice: Public Participation in Environmental Decisions*. Washington, DC: RFF Press.
2. Charmaz, K. (1990). Discovering Chronic Illness: Using Grounded Theory. *Soc.Sci.Med.* 30, 11(1990), pp. 1161-1172.

3. Cox, R. (2013). *Environmental communication and the public sphere*. (Third Edition). The University of North Carolina at Chapel Hill: Sage Publications.
4. Čaldarović, O. (2006). Conceptualization of nature as a public good value and ways of its assessment. *Sociological Review*, Vol XXXVII. No 1–2(2006), pp. 47–62.
5. Holton, J. A. (2007). The Coding Process and Its Challenges. In A. Bryant, K. Charmaz, *Grounded Theory: the Sage Handbook*. London: Thousand Oaks. New Delhi. Singapore: Sage Publications.
6. Ofak, L. (2009). Public participation in environmental decision-making. In M. Kaštelan Mrak, *Economics and Public Sector Management* (114-150 (115-117)). Rijeka: University of Rijeka, Faculty of Economics; as per: Directive 2003/35/EC of the European Parliament and of the Council providing for public participation in respect of the drawing up of certain plans and programmes relating to the environment and amending with regard to public participation and access to justice Council Directives 85/337/EEC and 96/61/EC. (EIA, 2011/92/EC); Aarhus Convention (NN – MU 1/07).
7. Ofak, L. (2009). Public participation in environmental decision-making. In M. Kaštelan Mrak, *Economics and Public Sector Management* (114-150 (125)). Rijeka: University of Rijeka, Faculty of Economics.
8. Petz, B., Kolesarić, V., Ivanec, D. Petz (2012). *Statistics: basic statistical methods for non mathematicians*. Jastrebarsko: Naklada Slap.
9. Pletikosić, M. (2012) *Public attitudes towards the use of alternative fuel in cement industry*. (Master thesis). Zadar: University of Zadar.
10. Silverman, D. (2006). *Interpreting Qualitative Data: Methods for Analyzing Talk, Text and Interaction*. (Third edition). London: Thousand Oaks. New Delhi: Sage Publications.

FRAUD IN ECONOMIC BUSINESS OPERATIONS IN CROATIA: PRACTICAL PROBLEMS AND LEGAL SOLUTIONS

Lucija Sokanovic

*Faculty of Law – University of Split, Croatia
lucija.sokanovic@pravst.hr*

ABSTRACT

Fraud in economic business operations is criminalised in Croatia in 1997. Since 2011 this offence was placed in chapter XXIV of Criminal Code, namely offences against economy. Almost 20 years after its introduction into Croatian criminal law, it represents one of the most common offences in the field of economic crimes. In the introduction of the paper development of the criminal offence of fraud in economic business operations is analysed. Recent legal regulation of the offence is criticised from the nomotechnical aspect and problems arising in practice. Evaluation of the final judgements of the Municipal Criminal Court in Zagreb and Municipal Court in Split is discussed next indicating diversity of the convictions and lenient imposed punishments; mostly suspended short term imprisonment. This practice suggests arbitrariness in application of the Act on the responsibility of legal persons for the criminal offences. The results are validated by the analysis of the data of the Croatian Bureau of Statistics concerning convictions of the adult persons who have committed criminal offence of fraud in economic business operations in the period from 2010-2014. Short term suspended imprisonment, restraint in imposing security measures and special obligations, overpopulation in the jails and insufficient number of qualified persons for rehabilitation and treatment of the offenders seriously cast doubt in efficiency of special and general prevention as purposes of the punishment. The paper shows that satisfactorily legal solutions confront numerous practical challenges. Only joint institutional action leaded by profoundly thought State criminal politics can guarantee success in fight against economic crime.

Keywords: *economic business operations, economic criminal law, fraud.*

1. INTRODUCTION

There is no generally accepted definition of economic crime that would include all aspects and elements of this specific form of crime (Eder-Rieder, 2011, p. 29, Zieschang in Achenbach, Ransiek, 2012, p. 394). Thought, it can be stated that the framework of the actual fight against economic crime in Republic of Croatia limited thereby to criminal offences against economy from the Criminal Code constitute criminal offences of illicit trade, fraud and abuse of trust in economic business operations, as well as embezzlement of taxes or custom and avoiding customs control. Until the adoption of new Criminal Code, the majority of economic criminal offences were abuse of office and official authority (Art. 337 Para 3 and 4), abuse of authority in economic business operations (Art. 292) and fraud in economic business operations (Art. 293). Namely, after independence, Croatia conducted twice great reforms of criminal substantive law: in 1997 with the first complete Croatian Criminal Code and in 2011 within the aim of harmonisation with international acts, especially with *acquis* and conventions of Council of Europe, to eliminate inherent discrepancies and contradictions, to improve the system of criminal sanctions and review descriptions of some offences (Novoselec, Bojanić, 2013, p. 51). Criminal Code from 1997 is published in Croatian Official Gazette 110/97, 27/98, 129/00, 51/01, 129/00, 51/01, 111/03, 105/04, 84/05, 71/06, 110/07, 152/08, 57/11 and the new Criminal Code from 2011 in Croatian Official Gazette 125/11, 144/12, 56/15, 61/15. Common abbreviations for these acts are CC/97 and CC/11. In fact, since mid 2000, academic and professional interests for modernisation of Croatian economic criminal law grew. With an aim of achieving effective prosecution of offences that belong to economic crime, in 2003 the *Act*

on responsibility of legal persons for the criminal offences was adopted (Official Gazette 151/03, 110/07, 45/11, 143/12). The conditions of adoption were described as the time in which the publicity was under strong negative impression of the process of conversion and privatisation of public companies where the corporations were positioned at the both sides of the criminal spectre: some as the impoverished and devaluated victims, and the others as criminal screen for devastation of almost whole national economy (Derenčinović, Novoselec, 2012, p. 586). The reforms were, as previously, strong influenced by German, Austrian and Swiss criminal law, but specificity of Croatian commercial criminal law compared to above mentioned, was transition – perceived in nineties as “predatory capitalism”, leaving the profound mark on economy, society as whole and legal system of the State. In that sense, commercial criminal offences were often symbolically manifested. Most of discussions included symbols or slogans rather than exact scientific insights and in one part of the literature moreover, the symbols were used. For example, abuse of office and official authority was labelled as “*Tyrannosaurus*” or relict of the past and abuse of authority in economic business operations as “*caoutchouc paragraph*” (Novoselec, 2009, p. 46; Novoselec, Roksandić Vidlička, 2010, p. 703; Bačić, Pavlović, 2004, p. 1009; Orlović, 2013, p. 5).

2. LEGAL PROVISIONS

This section presents origins of criminalisation of fraud of economic business operations in Croatia and actual legislative provisions detecting the basic nomotechnical and practical problems.

2.1. Origins of criminalisation of fraud of economic business operations in Croatia

Fraud of economic business operations was for the first time criminalised in the Criminal Code from 1997. Namely, by the provision of the Art. 293 Para 1 CC/97 perpetrator of this offence was one acting as a representative or mandatory of a legal entity, with an aim of acquiring illegal material benefit for that or other legal entity, using uncollectible payment orders, checks that he knows to have no coverage, or otherwise misleads another or keeps such person in mistaken belief, and thereby induces him/her to do or not to do something to the detriment of his/her own or someone else’s property. Qualified form of this offence was regulated in the Art.

293 Para 2, when the significant material benefit was gained or significant damage caused and the perpetrator acted with this specific aim. The Government did not justify in June 1997 the reasons for introduction of this offence, it stated only that the final form of incrimination was suggested by the representatives of the State Attorney’s Office (Novoselec, 2009, p. 89).

Only three years afterwards, within the Law on Amendments to the Criminal Code, paragraph 1 was changed, so the perpetrator of the offence was declared as responsible person in legal entity acting with an aim of acquiring illegal material benefit for that or other legal person using uncollectible instruments of insurance of payment or otherwise by false presentation or suppression of facts misleading another or keeping such person in mistaken belief and thereby inducing him to do or not to do something to the detriment of his own or someone else’s property (Sokanović, 2014, p. 111).

After 2000, this offence seemed to be forgotten and finally in 2011 it was placed in chapter XXIV of CC/11 – offences against economy. So, almost twenty years after transition from the self-governing economy with elements of or market economy to free market economy, Croatia got special list of the criminal offences against economy (Novoselec, 2009, p. 4).

2.2. Current legislation

Fraud of economic business operations is now regulated under provision of Art. 247 Para 1 CC/11. The Ministry of Justice stated in the Draft Criminal Code of June, 2011, that the offence has been extremely simplified by removing certain descriptions from the mean of committing the

crime and general clause (Turković *et al.*, 2013, p. 320). The perpetrator is defined as someone who in economic transactions with an aim of acquiring illegal material benefit for the legal entity that he represents or some other legal entity brings another by false presentation or suppression of facts in mistaken belief or keeps in mistaken belief and thereby induces him to do or not to do something to the detriment of his own or someone else's property.

Qualified form of the offence in Para 2 is purified and requires causing only the significant damage. The Criminal Department of the Croatian Supreme Court brought legal opinion No. Su-IV K-4 / 2012-57 from 27 December 2012 in relation to qualified form of fraud of economic business operations determining legal feature "substantial damage" that exists when the value of the damage exceeds 60,000.00 Kuna. The same amount is prescribed now in Art 87 Nr 29 of the CC11.

Two basic problems concerning this criminal offence especially in relation to the fundamental form of fraud as a crime against property can be detected: determination of the nature of the perpetrator and of the person for whom illegal material benefit is acquired. Namely, most of Croatian scientists took an attitude that fraud of economic business operations is *delictum proprium* because it can be committed only by person "who in economic transactions with an aim of acquiring illegal material benefit for the legal entity that he represents or some other legal entity...", so it requires some special attribute of the perpetrator that is basic or constitutional characteristic of the offence (Derenčinović in Horvatić, Šeparović, 1999, p. 392; Novoselec, 2007, p. 318). On the contrary, Maršavelski considered it *delicta propria sui generis* justifying it upon the fact that fraud of economic business operations is qualified form of fraud, the special attribute of the perpetrator is qualified characteristic of the crime and additional cumulative characteristic that has to be established is acquiring illegal material benefit for the legal person (Maršavelski 2005, p. 91). The additional aspect of this problem is indeterminate nature of the term "economic transactions" in theoretical as well as practical concept. That leads us to another problem – questioning the nature of the offence as *lex incerta* (for explanation of the term „economic transactions“, see Sokanović, 2014, pp. 123-124)

The second problem is less dogmatic and more pragmatic. Fraud in economic business operation is committed only when illegal material benefit is acquired for the legal person that the perpetrator represents or some other legal person. The fact is that most of the cases in recent Croatian practice lack stating where illegal material benefit ends up (Sokanović, 2014, p. 132, Bedi 2013, p. 422). It should be noted that the aim of acquiring illegal material benefit for the legal entity that perpetrator represents or some other legal entity is special subjective feature of the offence. Without establishing this very fact, no one can claim that fraud in economic business operations is committed, or more precise, any such conviction should be regarded unlawful. Pragmatic, but not predictable solution would be legislative return to the common offence of fraud moreover because both of the offences provide imprisonment in duration of six month to five years. For the qualified form of fraud in economic business operations, imprisonment of one to ten years is prescribed (Art. 247 Para 2) and for qualified form of fraud imprisonment of one to eight years (Art 236 Para 2).

Strong influence of German, Austrian and Swiss criminal law on Croatian is stated in introduction, but none of these systems, though having deeply developed jurisprudence and dogmatic of commercial criminal law, do not recognize fraud in economic business operations as a special criminal offence incriminated in the Criminal Code.

3. IMPRISONMENT PRACTICE

Imprisonment practice is analysed using two approaches or two levels of research. First included final judgements of the Municipal Criminal Court in Zagreb and Municipal Court in Split in five years period (26 final judgements issued in the period 2007-2011; 19 convictions, 3 acquittals, 4 rejections; Sokanović, 2014, pp. 115-123) and the second, analysis of the recent

official data of the Croatian Bureau of Statistics regarding fraud in economic business operations.

3.1. First steps

Analysis of the judgements suggested alarming results showing that convictions differ from each other and that even six different types of convictions can be abstracted:

- a) natural person as responsible person has been convicted and also obliged to compensate damage (46%);
- b) natural person has been convicted and the offended has been versed in litigation concerning damages (3%);
- c) natural person has been convicted and the legal person in which the natural person is responsible person is obliged to compensate damage (7%);
- d) both, natural and legal persons are convicted and the natural person is obliged to compensate damage (3%);
- e) both, natural and legal persons are convicted and the legal person is obliged to compensate damage (7%);
- f) both, natural and legal persons are convicted and the offended has been versed in litigation concerning damages (7%).

What does this diversity of the practice mean and is it even admissible? Does it mean that it is totally arbitrarily will some natural persons, as responsible persons be charged as well as convicted for fraud or fraud in economic business operations? Does it mean that only some judges apply *Act on the responsibility of legal persons for the criminal offences* and the others resist it (and why)? Namely, if the application for prosecution is submitted only against responsible person, attorney general can *ex offio* initiate criminal proceedings for the same offence against the legal person as well (Art. 27 Act on legal responsibility of legal persons for the criminal offences). It should be recalled here that initiation of criminal proceedings against legal persons is liable through the principle of appropriateness: attorney general can reject criminal charges or withdraw of the prosecution if the legal person has no property or the property is insignificant to that extent that it would not be enough to cover the costs of the proceedings or it is under bankruptcy proceedings (Art. 24). Whereas the reasons for judgements – convictions of natural persons for fraud in economic business operations have no explanations is the principle of appropriateness decisive for lack of criminal proceedings against legal persons, we can only speculate about the true reasons of convictions of only natural persons. That is why it would be productively to conduct a special research to determine the number of cases and reasons for withdrawal of prosecution of the legal persons for fraud in economic business operations, because only then one will be able to answer to introductory question of arbitrariness in application of *Act on the responsibility of legal persons for the criminal offences*.

In the analysis of the convictions prevail conditional judgements, very lenient. Out of 19 convictions, only 4 refer to the unconditional imprisonment, 5 conditional imprisonment of six month, 4 conditional imprisonment of 11 month, 4 conditional imprisonment of 10 month and 2 conditional imprisonment of one year. The legal person were imposed by fine of 10.000,00 Kuna in 60% of cases, 15.000,00 Kuna in 20% and 20.000,00 Kuna in last 20% of cases.

The perpetrators of the fraud in economic business operations in all analysed judgements were representing Ltd. as directors (only in one case it was stipulated that the accused was the person who actually leaded business of one Ltd.). The perpetrators were mostly men (proportion of

woman is 10,5%), in the ages between twenties and thirties (41%), thirties and forties (41%), forties and fifties (17%). Excess is established regrading two offenders at the age of 66 and 59 years. In 31% of cases perpetrators were previously convicted. Most of them are high school graduate (57%) and without specially profiled profession (electrical engineers, economists, car mechanics, drivers, agricultural technicians). Even 47% of the perpetrators declared themselves without any property. Bringing or keeping in error was done by using blank promissory notes (42%) and accounting check (15%) and as much as 31% of cases, the perpetrator did not use any specific means of securing. Per one court case waste 54.743,00 Kuna property damage on average. In Germany the damages resulting from economic criminal operation amount circa 300.000,00 Euro yearly per company. In Austria and Swiss it was circa 300.000,00 Euro of the SMEs per case (Heerden, Weller, Weidinger, 2013, p. 3). In 21% of cases the offence was committed in concurrence and it was generally a concurrency of basic and qualified form of fraud in economic business operations (in three cases) and in one case – concurrency of fraud in economic business operations and forgery of documents (Art. 311 KZ97) and breach of duty in case of loss, over-indebtedness or insolvency (Art. 626 Para. 1, item. 2 *The Companies Act*). Participation (complicity) or accomplice was not found in either case.

The courts have taken into account as extenuating circumstances the family situation (*father of the child*), sincere remorse, previously no criminal record and a willingness to compensation or reduction of the damage, the defendant's appropriate behavior in court, special circumstances under which the crime was committed and under which Ltd. operated, the lapse of time since the crime was committed, the fact that the defendant was a participant of the Homeland war. As aggravating circumstances, the courts evaluated the amount of damage, previous convictions and social risk of the offence.

3.2. Current Issues

The second part of research included data of the Croatian Bureau of Statistics regarding convicted adult persons by penalties for fraud in economic business operations (general and qualified form) in a period of last five years (Statistical Reports 1451/2011 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions; Statistical Reports 1478/2012 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions; Statistical Reports 1504/2013 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions; Statistical Reports 1528/2014 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions; Statistical Reports 1551/2015 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions). First table refers to the general form of the offence and the second to the qualified form.

Figure 1: Convicted adult persons by penalties for fraud in economic business operations

	total	Women	Suspended	5-10 years	3-5 years	2-3 years	1-2 years	6-12 months	3-6 months	2-3 months	30 days
2010	70	10	58	-	-	-	6	42	20	2	-
2011	70	6	58	-	1	1	5	34	26	2	1
2012	78	9	62	-	-	-	7	43	28	-	-
2013	103	13	69	-	-	-	7	69	27	-	-
2014	97	11	69	-	-	-	7	69	20	1	-

The only imposed penalty for fraud in economic business operations is imprisonment, in most cases suspended imprisonment (from 66% to 82%) in length from six to twelve months (from 48% to 71%) and three to six months (from 20% to 37%). Imprisonment from one to two years is imposed rarely (from 6% to 8%) and from three to five years only in individual cases.

Figure 2: Convicted adult persons by penalties for qualified form of fraud in economic business operations

	total	Women	Suspended	5-10 years	3-5 years	2-3 years	1-2 years	6-12 months	3-6 months	2-3 months	30 days
2010	110	9	53	2	2	4	32	59	10	-	1
2011	124	16	67	-	-	4	31	83	6	-	-
2012	172	17	71	1	3	6	45	96	21	-	-
2013	139	14	54	1	1	7	37	84	9	-	-
2014	109	8	43	1	-	5	27	73	3	-	-

Regarding qualified form of fraud in economic business operations, predominant penalties are imprisonment from six to twelve months (from 53% to 66%) and from one to two years (from 24% to 29%). Suspended imprisonment is imposed in large scale, but less often than for the general offence (from 39% to 54%).

When comparing the data of the Croatian Bureau of Statistics and the ones acquired by own research, the same high percentage of suspended imprisonment dominates.

It should be noted that fine is imposed in none of the cases. This should be discussed bearing in mind that Criminal Code prescribes in Art. 40 Para 5 possibility to impose fine as supplementary punishment for the offences committed by greed even when it is not prescribed or when the law prescribes that the offender will be punished by imprisonment or a fine and the court imposes imprisonment as the principle punishment. As the fraud in economic business operations is definitely an offence committed in most of the cases by greed, fine as “bounce penalty” should have the best special preventive impact, surely more effective than suspended sentence. In this way, contemporary approach to the principle of individualization of punishment would be achieved (Cvitanović, 1999, p. 342, Kurtović Mišić, Milivojević, Strinić, 2009, pp. 629-686).

Namely, if someone commits an offence by greed or with a special aim of acquiring illegal material benefit, then the most effective penalty is a fine. But, when imposing a fine besides imprisonment, the courts should very carefully evaluate all circumstances of the concrete case, personal and financial situation of the offender and only when they can justify it, impose both the penalties cumulative, besides confiscation of property gain or an award of property claims as *condicio sine qua non*. A fine in this regard should not privilege nor discriminate offenders on the basis of their financial situation. It should be imposed when the court considers that it will have the most effective influence on the offender to refrain in future from committing offences.

Official data do not present amount of damage caused in committing these offences as well as what kind of subsidiary penalties (if any) have been imposed to the offenders. Namely, Croatian Criminal Code prescribes special security measures with an aim to remove the circumstances that enable or encourage the offender to commit new criminal offence (Art. 65-77). For example, prohibition of performance of certain duties or activities. Although this measure requests special concern regarding constitutional right to work, it should be imposed at least in cases of concurrence and reconvictions for the same offence (Art 55 of the Constitution of the Republic of Croatia, Official Gazette 56/90, 135/97, 8/98, 113/00, 124/00, 28/01, 41/01, 55/01, 76/10, 85/10, 05/14, or. Art. 6. of the International Covenant on Economic, Social and Cultural

Rights). Security measure of total or partial prohibition of performance of certain duties or activities can be imposed according the Art 71 when the offence is committed in performing duties or activities if the danger exists that the offender will commit a criminal offence again abusing these duties or activities. Measure can be imposed in a term from one to ten years. During the prohibition, convicted person is not allowed to perform certain duties or activities independently, for another person, in the legal person, in the name of some other person, nor authorise other person to perform such duties or activities in his name or under his directions (Art 71 Para 4). When imposing this measure, the court shall inform authority that has competence to maintain a register of persons performing such duties or activities (Sokanović, 2015, pp. 167-186).

Special obligations that the court can order when imposing a suspended or partially suspended sentence in the certain period are: compensation of damage caused by committing offense and payment of certain amount of money to the public institution, to humanitarian or charitable purposes or to the fund for compensation for the victims of the criminal offenses if it is appropriate due to committed crime and personality of the offender (Art. 62-65. CC). According to the *Act on the responsibility of legal persons for the criminal offences* (Art 15) certain security measures can be imposed apart from other penalties on the legal person: prohibition of performance of certain duties or activities; prohibition on obtaining of licenses, authorizations, concessions or subsidies; prohibition of transactions with beneficiaries of the state or local budgets and confiscation of items.

On the basis of the above discussion, it is obvious that the courts do not use all legal resources available when imposing imprisonment for the offenders of fraud in economic business operations taking into account objectives of special and general prevention. That is why it is hardly to believe that during execution of the prison sentence some specific measures can be accomplished in order to achieve these objectives. To be more specific, according to the Art 49 Para 1 of the *Act on Execution of Prison Sentence*, convicts sentenced to prison sentence for less than six months and convicts who have to serve the remainder of their prison sentence not exceeding six months shall be sent to the jail nearest to the place of their permanent residence (Official Gazette 128/99, 55/00, 129/00, 59/01, 67/01, 11/02, 190/03, 76/07, 27/08, 83/09, 18/11, 48/11, 125/11, 56/13, 150/13). But, from the Report on the conditions of life in prison drafted by the Constitutional Court of the Republic of Croatia (Constitutional Court of the Republic of Croatia, Report on the conditions of life in prison, Official Gazette 86/14) capacity rate in Croatian prisons in most of the cases largely exceeds 100%: jail in Bjelovar 160,38%,

Dubrovnik 110,53%, Gospić 120%, Karlovac 158,33%, Osijek 208%, Požega 131,34%, Pula 142,86%, Rijeka 134,55%, Sisak 132,61%, Split 147,06%, Šibenik 147,67%, Varaždin 164,94%, Zadar 128,13%, Zagreb 148,32% (*Idem.* §7.4).

Normative aspect offers again satisfactorily solutions when prescribing individual program for execution of prison sentence as a set of pedagogic, labour, occupational, health, psychological and safety acts and measures with the aim to achieve the purpose of the execution of prison sentence from the Art. 2, to enable person for life in freedom in accordance with law and social rules, respecting human treatment and dignity of the person serving prison sentence. Individual program is regulated in Art 69 of the Act on Execution of Prison Sentence. The number of constitutional claims of person serving prison sentences or detention in custody or investigation prison even after two decisions from 2008 and 2009 of the Constitutional Court is increasing. Arguments for the claims consist of discrepancy with health, hygienic and spatial standards as a result of overpopulation in jails and prisons. Extracting two major problems: overpopulation in jails and prisons and insufficient number of qualified persons for rehabilitation and treatment together with the brevity of time for the convicts for fraud in economic business operations suggest impossibility of the effective rehabilitation.

4. CONCLUSION

Imprisonment for fraud in economic business operations is burdened with three major problems. First consists in deficiencies in legal definition of the offence and related problems (2.2.) together with the absence of thoughtful State politics on the purpose of the punishment. The second problem constitute lenient punishments for the perpetrators: suspended short term imprisonment that does not offer realisation of special nor general prevention. Such lenient imposed punishments do not deter the perpetrator from committing criminal offences in future, nor the others. The extant of the community's condemnation towards the committed criminal offences in this manner fails to increase the consciousness of citizens of the danger of criminal offences and frustration of the citizens, victims especially towards the fairness of punishing perpetrators. Short term imprisonment by itself does not guarantee effectiveness of the rehabilitation, especially if it is followed by overpopulation in jails and insufficient number of qualified persons.

The third problem is refraining in consuming all legal resources available when imposing imprisonment with emphases on security measures and special obligations.

In addition this article is a plea for thoroughly research that would give an appropriate answer to the survey of the reasons for committing fraud in economic business operations, extent of the caused damages and its impact on Croatian economy, amount of the recovered damages and effectiveness of judiciary.

LITERATURE:

1. Achenbach, H., Ransiek, A. (ed.)(2012). *Handbuch Wirtschaftsstrafrecht*. C.F. Müller.
2. Bačić, F., Pavlović, Š. (2004). *Komentar Kaznenog zakona. Zakon o odgovornosti pravnih osoba za kaznena djela. Posebno kazneno zakonodavstvo*. Organizator. Zagreb.
3. Bedi, D. (2013). *Analiza suzbijanja gospodarskih prijevара u Republici Hrvatskoj*. Policijska sigurnost. Zagreb. 22/3. Pp. 412-429.
4. *Croatian Bureau of Statistics* (2011). Statistical Reports 1451/2011 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions. Zagreb
5. *Croatian Bureau of Statistics* (2012). Statistical Reports 1478/2012 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions. Zagreb.
6. *Croatian Bureau of Statistics* (2013). Statistical Reports 1504/2013 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions. Zagreb.
7. *Croatian Bureau of Statistics* (2014). Statistical Reports 1528/2014 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions. Zagreb.
8. *Croatian Bureau of Statistics* (2015). Statistical Reports 1551/2015 – Adult Perpetrators of Criminal Offences, Reports, Accusations and Convictions. Zagreb.
9. Cvitanović, L. (1999). *Svrha kažnjavanja u suvremenom kaznenom pravu*. Ministarstvo unutarnjih poslova Republike Hrvatske. Zagreb.
10. Derenčinović, D., Novosel, D. (2012). *Zakon o odgovornosti pravnih osoba za kaznena djela – prolazne dječje bolesti ili (ne)rješiva kvadratura kruga*. HLJKPP. Vol. 19. Nr. 2. Zagreb. Pp. 585-615.
11. Eder-Rieder, M. (2011). *Einführung in das Wirtschaftsstrafrecht*. NWV. Wien. Graz.
12. Heerden, A., Weller, F., Weidinger, G. (2013). *Wirtschaftskriminalität in Grossunternehmen und dem Mittelstand, Deutschland, Österreich und Schweiz im Vergleich*. Retrieved 28.1.2016. from <http://www.kpmg.at/uploads/media/pub-20130313-wirtschaftskriminalitaet-de.pdf>.
13. Horvatić, Ž., Šeparović, Z. (ed.)(1999). *Kazneno pravo. Posebni dio*. Masmedia. Zagreb.
14. Kurtović Mišić, A., Milivojević, L., Strinić, V. (2009). *Novosti u propisivanju, izricanju i izvršenju novčane kazne*. HLJKPP. Vol. 16. Nr. 2. Zagreb. Pp. 629-687.

15. Novoselec, P. (ed.)(2007). *Posebni dio kaznenog prava*. Pravni fakultet Sveučilišta u Zagrebu.
16. Novoselec, P. (2009). *Uvod u gospodarsko kazneno pravo*. Pravni fakultet Sveučilišta u Zagrebu.
17. Novoselec, P., Roksandić Vidlička, S. (2010). *Gospodarska kaznena djela u novom Kaznenom zakonu*. HLJKPP. Vol. 17. Nr. 2. Zagreb. Pp. 699-729.
18. Novoselec, P., Bojanić, I. (2013). *Opći dio kaznenog prava*. Sveučilište u Zagrebu.
19. Orlović, A. (2013). *Gospodarski kriminalitet u Republici Hrvatskoj*. Redak. Split.
20. Sokanović, L. (2014). *Frauds in criminal law*. Doctoral thesis. University of Zagreb – Faculty of law.
21. Sokanović, L. (2015). *Sigurnosna mjera zabrane obavljanja određene dužnosti ili djelatnosti između diskriminacije počinitelja i specijalne prevencije*. Pravni fakultet. Univerzitet u Prištini. Kosovska Mitrovica. Pp. 167-187.
22. Turković, K. *et al.* (2013). *Komentar Kaznenog zakona*. Narodne novine. Zagreb

CONFISCATION OF THE PROPERTY OF THE JEWS IN OSIJEK AFTER WORLD WAR II

Miro Gardas

*Faculty of Law Osijek,
mgardas@pravos.hr*

Ana Gavran

a.gavran1989@gmail.com

ABSTRACT

*After the end of World War II, the new communist government acceded to the procedure of confiscation of property. This procedure was implemented by applying the institute of confiscation, and the excuse was economic cooperation with the occupier. In this way, many factories and workshops were confiscated as well as private properties of wealthy individuals. In these proceedings, assets of a larger number of Jews in Osijek, who were the owners of a large number of companies before World War II, were confiscated. Paradoxically, the Jews were in fact punished twice, i.e. their property was confiscated twice. The first time was when their property was nationalized during the war in the NDH, and the second when after the war the new government instead of correcting the wrongs that had been done against the Jews, confiscated their assets once again. It is particularly ironic that the large number of former Jewish owners were taken in the German concentration camps and killed there, and the new government seized their property because of the economic cooperation with the German forces. **Keywords:** confiscation, Jews, economic operators, concentration camps.*

1. ECONOMIC SITUATION IN OSIJEK BEFORE THE SECOND WORLD WAR

In this paper we would like to show how the communist government in Osijek treated the Jews after World War II. On the basis of archival documents from the National Archives in Osijek we would try to show how the opportunity to at least partially address injustice that was done to the Jews during the Independent State of Croatia (hereinafter NDH) was not only missed but, on the contrary, the same property that had already been confiscated was once again taken away from them. By taking away the property from Jews because of "collaboration with the occupier" the new communist authorities showed, in an ironic and sometimes morbid fashion, that they were not driven by any just, or even ideological motives but simply by the desire for financial gain and property grabbing for the state fund.

At the beginning of the twentieth century Osijek was a commercial and crafts center and a city with a strongly developed industry and a large number of craft workshops that have their roots back to the 18th and 19th centuries when Osijek was one of the most economically developed cities in this part of the Habsburg Empire.

In the second half of the 18th and the 19th century there were many famous economic fairs that were held all over the Austrian monarchy, and where people sold goods from all over the empire and the world, and which brought great financial gain to the city. The importance of these fairs laid in the proximity of the border with the Ottoman Empire, wherefrom a lot of oriental goods entered the Austrian Empire, but whereto a great deal of craft and industrial goods were also exported.

There were some factories operating in Osijek that within its scope of work had a leading position in the region and which exported their products all over the world, for example Drava - matches factory, OLT - Osijek foundry and machine factory and others.

Osijek was, therefore, in the first decades of the twentieth century a city with a very long tradition of trade and commerce, and with the industry in the ascending line.

2. CONFISCATION OF JEWISH PROPERTY DURING THE NDH

After the establishment of NDH it came to significant changes in the structure of economic entities in Osijek because a significant number of those entities in Osijek and Slavonia was owned by Jews. NDH government followed the policy of the Third Reich against the Jews, and they used that actually to seize valuable assets which would sell them for personal financial gain or to reward certain members.

In order for this to be carried out, very soon after the establishment of NDH, it was necessary to adopt several legal provisions, some of which were crucial for the seizure (nationalization) of Jewish property¹: Legal provision on nationalization of Jewish property, legal provision about nationalization of economic enterprises² and statutory provision on nationalization on the territory of the Independent Croatian State³.

Based on these legal provisions NDH entwined effective network that engulfed the entire property of Jews, but of the Gentile property it could have expropriated whatever and whenever they considered it necessary.

To this date I was not able to trace in the Osijek State Archives any decisions on nationalization of Jewish property, or the nationalization of Gentile property, but in a number of court decisions on the confiscation after World War II, it is stated that the individual firm or company was nationalized and sold to the new owners by NDH.

3. CONFISCATION OF JEWISH PROPERTY AFTER WORLD WAR II

At the head of the then "Anti-Fascist Council of National Liberation of Yugoslavia" was a lawyer Dr. Ivan Ribar, who tried to put the seized property into the legal framework, so that the confiscation of assets would fall under the Law on Confiscation and Execution of Confiscation, which was passed on June 9, 1945.

In addition to this law, there were many other legal regulations that enabled a wide circle of persons to be found guilty whose property would hence be seized. This is primarily the Law on Crimes Against the People and the Country of August 25, 1945⁴, the Decision on the Protection of National Honor of Croats and Serbs in Croatia of April 24, 1945⁵, Law on transfer of the enemy property into the state property and the sequestration of the property of absent persons of July 31, 1946⁶, and the law on the treatment of the assets that the owners had to abandon during the occupation and of the property that was taken from them by the occupiers and their collaborators of August 2, 1946⁷.

In 1948, the Law on Amendments to the Law on nationalization of private economic enterprises was passed which was a tool for the nationalization of all those companies which according to their meaning or capacity had general significance for federal or republican economy.⁸

For this purpose, in addition to this law, there shall be passed a series of regulations that regulated this issue, so there were still many legal regulations that allowed the wide circle of persons to be found guilty and whose property would consequently be seized. In Article 2 of the Law on Compensation for Property Taken During the Yugoslav Communist Rule⁹ there are

¹ Official Gazette No. 246 of October 30, 1942

² Official Gazette No. 118 of September 3, 1941

³ Official Gazette No. 30 of May 17, 1941

⁴ Official journal DFJ, No. 18/1945

⁵ "Vjesnik"- newsletter of JNOF of Croatia, of June 28, 1945

⁶ Official Gazette of the SFRY, no. 63/1946

⁷ Official Gazette of the SFRY, no. 63/1946

⁸ Official Gazette of the SFRY, no. 35/1948.

⁹ Official Gazette No. 92/1996

32 such regulations listed, and some authors even allege the existence of fifty. (See more: Crnić, 1991) In this way it was once again re-woven a network of legal regulations through which no one whose property was of interest to the new authorities could pass. In the first years after World War II in Osijek there were many bodies that were judging people who had violated the provisions of the above regulations. These were primarily District Court in Osijek, then the District People's Court in Osijek, the Military Court of Osijek Military District in Osijek, and in particular the Court to protect national honor of Croats and Serbs in Croatia for the districts of Osijek and Virovitica - Osijek.¹⁰ Archives created during the work of these bodies is largely preserved in the State Archives in Osijek, and is quite well arranged and available to researchers. There are many examples of the confiscation of Jewish property after the Second World War, and on this occasion we will show only a few which show us the way in which the proceedings were conducted and which outline the injustice caused to the former owners.

4. EXAMPLES OF CONFISCATION OF JEWISH PROPERTY IN OSIJEK AFTER THE WORLD WAR II

1. OSIJEK LEATHER FACTORY LLC

Osijek leather factory LLC was established with 2 million crowns share capital, and its main purpose was the production of a variety of leather goods. The capital of this company is mixed, mostly domestic, and 20% of foreign share.

Osijek leather factory LLC had a steam-power for 150 hp machines. The company employed 70 workers and 10 clerks. (Lakatoš, 1924 ,p. 283-289)

The company "Osijek leather factory LLC " was Jewish property, and since after the World War II, no one have reported in terms of the Law on handling the abandoned or seized property the procedure for confiscation was initiated.

The company was confiscated by the judgment of the Court for protection of national honor of Croats and Serbs in Croatia number Kz-193/45, according to which V. F. from Osijek and J.H. from Osijek were found guilty, the first one as a director and member of the administrative committee and the second one as a member of the administrative committee for putting voluntarily the overall industrial enterprises of Osijek leather factory LLC at the disposal of the German forces. Both were sentenced to various time penalty, the penalty of confiscation of personal property and the penalty of confiscation of all property of Osijek leather factory LLC. Confiscation was carried out by the judgment of the District People's Court in Osijek, R-806/46.¹¹ According to the enclosed court case on confiscation of Osijek leather factory LLC the paid up capital of the Company was divided into 10,000 shares of nominal value of 300 dinars. So the entire share capital would be amounted to 3,000,000 dinars. Out of the total number of shares 200 were the property of a convicted Director V.F., 1300 shares were in the hands of different shareholders, and the rest to the total number of 10,000 was in the property of a Jew. Ž.D. from Osijek.¹²

¹⁰„Archive funds and collections in SFRY - Croatia”, Belgrade 1984, section of the Historical Archives in Osijek, p. 176

¹¹DAO, fund OJT, box 47, file 1/50, report of 3 December 1946, also DAO, fund Court for protection of national honour of Croats and Serbs in Croatia, file Kz-193/1945

¹²DAO, fund Court for protection of national honour..., file Kz-193/1945, Declaration of 11October1940, annexed to the file on confiscation.

2. "DUBRAVKA" THE KNITWEAR FACTORY IN OSIJEK:

The knitwear factory "Dubravka" was owned by Jews B.R. and K.R., who were in 1942 shipped to Germany since when they have been missing. That same year the company was nationalized and sold by the NDH to S.M. and M.M.

According to the judgment of the District People's Court in Osijek No. Kz-235/45, for the economic cooperation with the enemy B.R., K.R. and M.M., the owners and managers of the knitwear factory "Dubravka" were the first ones to be sentenced to confiscation of all their property. For this act as well as for the act from the judgement of the Military Court No. 2840/45, he was sentenced to deprivation of freedom with hard labor for a period of 20 years, the loss of civil and political rights for 10 years and the confiscation of all property, and the persecution from the city of Osijek for a period of 5 years.

The verdict includes confiscation of all the property of the knitwear factory "Dubravka" in Osijek. Against the accused K.R. and B.R. the cases proceeded in their absence, and they were sent a public call for the hearing.¹³

3. ELECTRICAL MILL GAŠTAJGER AND ŠMIT:

Before the war, the mill co-owners were T.G. and Ž.M. Ž.M. was a Jew and he was sent to a camp, where in 1942 he committed suicide. Its share in the mill was nationalized and redeemed by the Germans J.Š. and M.Š.

With the decision of the commission for confiscation in the city NO-Osijek of September 18, 1945, number 686/45, T.G.'s and his family's share was confiscated and their property was nationalized. Šmit's share was not nationalized and it is placed under the management of state mills.¹⁴

4. "FARMACIJA" – CARDBOARD FACTORY IN OSIJEK:

Company "Farmacija" was founded in 1925 by Jews A.N. and D.R. In 1941 the company was nationalized and in 1942 NDH sold it to P.K. for 1,092.105 Kuna. Being the Jews the former owners A.N. and D.R. were taken to Germany 1942 wherefrom they never returned.

Charges were brought against the previous owners for economic cooperation with the enemy, and through the public announcement the absentee owners were called to make themselves known within three days.

According to the judgment of the District People's Court in Osijek No. Kz-236/45, A.N., D.R., and P.K. as owners and managers of the company "Farmacija", were accused of economic cooperation with the occupier. The first two A.N., and D.R. were sentenced to confiscation of all property, and the third one, P.K. was sentenced to confiscation of all property, and in connection with the case of the Military Court in Osijek number 305/45, to a sentence of deprivation of freedom for 15 years with hard labor, the loss of civil and political rights for 10 years and the expulsion from the city Osijek for a period of 5 years. The verdict also included confiscation of all assets of the cardboard company "Farmacija".¹⁵

^{13.}ibidem

^{14.}ibidem

^{15.}ibidem

5. RUDOLF MERK I J. BOŽIĆ – FURNITURE FACTORY:

Before the war, the factory was owned by a Jew dr. H.Š. who was in 1942 taken to Auschwitz, where he remained until the end of the war. By the decision of the District People's Court in Osijek, R-732/45 the factory was returned to the owner H.Š.¹⁶

According to the judgment of the District People's Court in Osijek, No. Kz-242/45 R.M., the owner of the furniture factory "Božić" was sentenced to deprivation of freedom with hard labor for a period of three years for the economic cooperation with the enemy.

The sentence also includes the loss of civil and political rights for a period of three years as well as the confiscation of all assets of the furniture company "Božić".¹⁷

6. "REX" – FACTORY FOR STOVES AND IRON FURNITURE:

Before World War II the company was owned by a Jew D.V., who was in 1942 shipped to the concentration camp, from where he did not return. The company was nationalized and in 1943 it was purchased from NDH by J.P. Having established economic cooperation with the enemy, the charges were brought against J.P. and the former owner D.V., who would be called by the public announcement.¹⁸ Because of economic cooperation with the enemy as well as for the act from the verdict of the Military Court in Osijek No 91/45 according to the judgment of the District People's Court in Osijek, No. Kz-243/45, as a supervisory commissioner and later administrative commissioner, and finally, from 1943, the owner of the furniture factory "Rex" in Osijek J.P. was sentenced to a deprivation of freedom with hard labor for a period of 8 years and 5 months as well as to confiscation of the entire property and the loss of political and civil rights for a period of 5 years. Also he was sentenced to confiscation of all assets of the furniture company "Rex" in Osijek.¹⁹

7. "RIS" – THE KNITWEAR FACTORY:

Before World War II the company was owned by Jews K.R. and O.R. After the establishment of NDH the company was nationalized. In order to prove economic cooperation with the enemy charges were brought against the owners K.R. and O.R.²⁰

Because of economic cooperation with the enemy according to the judgment of the District People's Court in Osijek, No. Kz-234/45, as a co-owner of the company "Ris" K.R. was sentenced to deprivation of freedom with hard labour for a period of six months on probation for one year. At the same time he was sentenced to confiscation of the entire asset of the knitwear company "Ris" in Osijek as well as the wholesale haberdashery of short and woven goods in Osijek.²¹

Real estates, where the factories were located, were confiscated by court decision of the District People's Court in Osijek, No. R-1739/46 and nationalized by FPRY.²²

¹⁶ibidem, report of November 15, 1945

¹⁷This confiscation, which was rendered to a Jew who managed to survive and return from Auschwitz upon which he was convicted for economic cooperation with Germans, might be the most absurd case among all mentioned cases.

¹⁸DAQ, fund OJT, box No. 47, file 1/50, report of November 15,

1945 ¹⁹ibidem, report of November 30, 1945

²⁰ibidem, report of November 15, 1945

²¹Ibidem, report of November 30, 1945

²²ibidem, report of December 3, 1946

8. SANATORIUM “BATORY - WEISSMANN”:

The co-owners of the sanatorium in Osijek were Dr. J.B. and Dr. K.W. The first was charged for criminal acts of political cooperation with the enemy, and others for assisting the enemy. Because of political cooperation with the enemy according to the judgment of the District People's Court in Osijek, No. Kz-277/45, dr. J.B. was sentenced to force labor without deprivation of freedom for a period of one year. Among other things, he was sentenced because he bought off half of sanatoria, which was confiscated from a Jew K.W. by NDH. The second accused dr. K.W. was acquitted because as a Jew he was persecuted by the occupiers. That he was a doctor in the camp Jaska contains no output of the crime because there in the camp were only Serbian and Jewish children.

The sentence also included confiscation of the whole sanatorium.²³

9. “VIKTORIJA” – PASTEBOARD FACTORY IN OSIJEK:

Before the war, the factory was owned by V.L. in the proportion of 60%, and A.L. in the proportion of 40%. A.L. was a Jew and his wife V.L. Austrian by birth, but declared herself a Croat. During the war NDH nationalized A.L.'s part, but his wife purchased it in 1942 and became the sole owner of the company.

Becausue of economic cooperation with the enemy charges were brought against V.L.²⁴

According to the judgment of the District People's Court in Osijek, No Kz-231/45, the accused were sentenced as follows: V.L., and AL, against whom the charges on the main trial hed been extended to economic cooperation with the enemy, were sentenced to deprivation of freedom with hard labor for a period of one year, on probation for two years, and as a special punishment they were sentenced to confiscation of all assets of the pasteboard company "Viktoria".²⁵

10. “MARA” – THE KNITWER AND UNDERWARE FACTORY OSIJEK:

Before World War II the company was the Jewish property. The owners H.K., D.K. and Dr. P.K. were in 1942 sent to the camp, since when they were missing.

The company was nationalized and sold by NDH in 1943 to J.P., M.P. and S.V., and the same year the part of J.P. was transferred to F.B.

The authorities brought charges against the former owners and they issued a proclamation to report to the court.²⁶

According to the judgment of the District People's Court in Osijek, No. Kz-238/45 as a co-owner of the factory of knitwear "Mara" in Osijek F.B. was sentenced for the economic cooperation with the enemy to deprivation of freedom with hard labor for a period of one year, on probation for two years. He was also sentenced to confiscation of all assets of the company knitwear "Mara" in Osijek.

The defendant F.B. was tried in absentia, thus, a public call to report to the court was issued. He was also appointed a counsel.²⁷

²³,
²⁴ibidem

²⁴ibidem, report of November 15, 1945

²⁵ibidem, report of November 30, 1945

²⁶ibidem, report of October 15, 1945

²⁷ibidem, report of November 30, 1945

11. "MURSA MILL" PAPER GOODS FACTORY:

Factory "Mursa Mill" was before World War II owned by a Jew S.D. During the war the owner remained in Osijek, where he was repeatedly arrested and released.

According to the decision of the District People's Court in Osijek, R-417/45, the factory was returned to its owner.

Having established economic cooperation of the company with the enemy institutions, charges were brought against the owner S.D. According to the judgment of the District People's Court in Osijek, No. Kz-233/45, as the owner of "Mursa Mill" D.S. was accused for the cooperation with the enemy and sentenced to one year of deprivation of freedom with hard labor, on probation for one year. The sentence also included confiscation of all the property of paper goods factory "Mursa Mill" in Osijek.²⁸ The sentence also included the confiscation of property of the company paper goods, "Mursa Mill" in Osijek

12. "PATRIA" – CARDBOARD FACTORY:

Co-owners of the company were Dr. M.Š. in a ratio of 47.5%, D. B. in a ratio of 17.5%, and O. T. in a ratio of 35%.

According to the decision of the District People's Court, No. R-185/45, parts of assets were returned to Dr. M.Š. and D.B., and a part of the late O.T was committed to the management of D.B. as the testamentary heiress.

The public persecutor of Osijek District supervisory filed an appeal against this conclusion number G-779/45, and examined the company's business during the occupation.²⁹

According to the judgment of the District People's Court in Osijek from November 24, 1945, No. Kz-242/45, R.M. from Osijek, as the owner of the furniture shop "Božić", and J.S from Osijek, as the owner and manager of "Patria" cardboard factory, were accused of economic cooperation with the enemy and sentenced to deprivation of freedom with hard labor, each for a term of 3 years and 3 years of loss of civil and political rights. The sentence also included confiscation of all property of "Patria" and "Božić" company.

The charges against Dr. M. Š. and D. B., who were charged as being co-owners, was dismissed and the two of them were released. R.M. and J.S. were tried in absentia, provided that a public call was issued.³⁰ Property belonging to the factory were confiscated by the decision of the District People's Court, No. R-1931 / 45.³¹

13. OSIJEK FACTORY OF SWEETS AND CHOCOLATE JOSIP OREŠKOVIĆ:

Before the war the company was Jewish property, in one half of the E.K. and the second half of Lj.K. and M.K.

²⁸ibidem

²⁹ibidem, report of November 15, 1945

³⁰ibidem, report of November 30, 1945

³¹ibidem, report of December 3, 1946

On April 10, 1941 J.O. bought the part of E.K. In 1942 NDH nationalized parts of minors Lj.K. and M.K., and the same year J.O. purchased it from the state. According to the judgment of the Court to protect national honor of Croats and Serbs in Croatia, No. Kz-54/45, J.O. was sentenced for engaging in commercial collaboration with the enemy and for grabbing Jewish property. According to the decision of the District People's Court in Osijek half of the company was returned to Lj.K. and M.K., and the second half to L.T., the daughter of the late co-owner E.K.

The District Attorney of Osijek County filed a supervisory appeal against that decision claiming that this half was purchased on the basis of free contract and that it should not have been allowed for it to be recovered to the heiress of L.T., because this half became the property of J.O. based on valid legal transaction.³² At the hearing, it turned up that J.O. also became the owner of the other half of the company based on valid legal transaction.

In fact, even before the part of minors Lj.K. and M.K. was nationalized there had been an agreement between them and J.O. (who was their stepfather) on the purchase of their parts. The opposition could not register the contract in the Land Registry Office and in the meantime, NDH nationalized this company as being Jewish. On the basis of previously reached understandings with co-owners O.J. bought that part from NDH.

On September 28, 1945 an appeal was sent to Zagreb.³³

In all documents relating to the Osijek factory of sweets and chocolate it is pointed out that the confiscation was carried out according to the verdict of the Court to protect national honor no Kz-54/45, which we have previously mentioned. It would certainly be interesting to find out how this legal dilemma was resolved, whether the plant was returned to the previous owners or it was confiscated. It is deliberately said "that a legal dilemma was resolved" because it is well known what the situation in reality was, the factory was confiscated.

14. "OSIJEK FACTORY OF BRUSHES SIVA"

Before the war, the company was owned by Jews K.A. and S.V., who during the occupation were taken away and disappeared. Half of the company was returned to the widow of the late co-owner S.V., and regarding the second half of the company a proceeding was held before the County People's Court in Osijek in order to restore the ownership right to the children of the late co-owner K.A.³⁴

According to the judgment of the District People's Court in Osijek, No. Kz-241/45, the defendants D.S. and J.S., as trustees who managed the overall operation and performance of the company "Siva", were accused for the crime of collaboration with the enemy, thus sentenced to deprivation of freedom with hard work for a period of six months, on probation for one year. The sentence also included confiscation of all assets of the company of brushes "Siva".³⁵

Confiscation of the factory was made according to the judgment of the District People's Court in Osijek, No 241/45, and the verdict was final. Property belonging to the factory were partially registered as the property of NDH, and the part which was registered as the property of the company "Siva" was placed in the confiscation proceedings before the County People's Court in Osijek, No. R-1737/45.³⁶

³²This is of course not a question of any altruism, but the desire to consolidate the ownership of a person which had already been accused of economical cooperation with the enemy.

³³PAQ, fund OJT, box 47, file No. 1/50, report of November 30,

1945 ³⁴ibidem, report of November 15, 1945

³⁵ibidem, report of November 30, 1945

³⁶ibidem, report of December 3, 1946

5. CONCLUSION

As seen from the above examples after the Second World War new authorities regarded the property of Jews in the same way as the property of all other owners. Companies or craft workshops owned by Jews were nationalized during the NDH and sold or assigned to the management of new owners or persons and they normally continued with their operations during the war. According to the interpretation of the new government they committed a crime of cooperation with the occupier thus had to face the law. With fewer prison sentences, often on probation, they were also sentenced to confiscation of individual factories or craft workshops.

The authorities have initiated proceedings against the owners who had bought the nationalized factory during the NDH, the manager who was appointed by the government of NDH, but also, just in case, against former owners from whom the property had already been seized by NDH.

It is ironic that in the case of Osijek Jews it was mostly about people who were in time of war taken to concentration camps by the government of NDH or German troops, who were from when missing. To accuse such persons of collaboration with the occupier is at least ironic and possibly morbid. Such a performance of the new communist government in Osijek, but also in the rest of Croatia, shows that their only desire was to nationalize valuable assets of individuals, while at the same time ignoring any moral dilemmas.

LITERATURE:

1. Crnić, J., (1991), Kako vratiti oduzeto nacionalizacijom, konfiskacijom, agrarnom reformom [How to reclaim the property seized by nationalization, confiscation and agrarian reform], Official Gazette, Zagreb
2. Lakatoš, J., Industrija Hrvatske i Slavonije, Zagreb

JURISDICTION AND APPLICABLE LAW IN CROWDFUNDING

Ivana Kunda

Faculty of Law of the University of Rijeka, Croatia
ikunda@pravri.hr

ABSTRACT

As a process of raising monetary contributions from a large number of persons, crowdfunding may take many forms: from traditional benefit events and television fundraising campaigns to increasingly popular internet platform fundraising. The online environment in which the newest forms of CF emerge facilitates its unprecedented ability to cross borders and attract persons from various countries. This having been said, the same environment complicates legal assessment. The issues that inevitably arise in cross-border dealing are particularly intricate: which court decides and which law applies? At the outset, one must differentiate between various types of CF models. Furthermore, the tripartite structure of the CF model involving the specialised internet platforms adds another layer of complexity because the conflict of laws analysis demands the preliminary identification of legal relationships and their legal characterisation. Finally, there is a constant debate about whether investors may be legally characterised as consumers or not, which may significantly affect conclusions on jurisdiction and applicable law.

*In answering these questions, the author considers national and supranational legal instruments containing provisions on international jurisdiction and applicable law, with the focus on the EU ones. In the course of legal analysis, the interpretational principles set by the Court of Justice of the European Union will be taken into account. Since no such principle is directly related to the internet-based CF, they need to be assessed in terms of their relevancy and potential to be used as starting points in analogical reasoning. Besides drawing a clearer image about the conflict of laws issues for participants in CF, the aim of this article is also to assess the validity of some of the legal terms under which these participants join the CF process. **Keywords:** alternative financing, applicable law, crowdfunding, conflict of laws, European law, international jurisdiction, internet, legal characterisation.*

1. INTRODUCTION

Crowdfunding (CF) can be defined as “a collective effort by people who network and pool their money together, usually via the internet, in order to invest in and support efforts initiated by other people or organizations” (Ordanini et al., 2009, 444). Because these means of raising capital are mostly employed by innovators, entrepreneurs and business owners, some authors tend to restrict the notion of CF to the process of raising equity, or ownership capital for a startup or small business firm from a relatively large number of small investors (Cunningham, 2012, 17). Although the concept of raising money from people for a specific purpose is not new, the technological progress and evolving internet user mind-set empowering the phenomenon of Web 2.0, widely open the doors to development of new business models such as CF. Today, the vast majority of CF activities are internet-related and occurring through crowdfunding platforms (CFP). The total global CF industry estimated fundraising volume in 2015 at the level of \$34 Billion (*Massolution Crowdfunding Industry 2015 Report*, 2015). This is largely facilitated by enabling communication across large distances at ultimately low costs, growing importance of online social networks, and rise of online payment systems (Danmayr, 2014, 12). The fact that Europe is a birthplace of CF is owed largely to the specific set of market conditions, in particular, the combination of strong and fast growing levels of entrepreneurial activity, a shortage of seed capital, and the dispersion of wealth. (Lynn & De Buysere, 2014, 204).

Investigation in the structure of the CF reveals the main participating actors and typical interrelations created among them. Both actors and their relations affect the degree of complexity of a particular CF model, not just on the social and economic levels, but also on the legal level. Although the recent comparative analysis of the cross-border CF stresses a legal risk related likewise to public and private law (*Crowdfunding Crossing Borders*, 2016, 5), the legal literature focusing particularly on these issues is scarce. The analysis in this paper intends to provide an insight into the specific private law questions under the EU law: which court has competence to decide on and which law is applicable to the specific aspect of the CF process? Prior to that, it is necessary to understand the inner architecture of the process in order to enable legal characterisation.

2. ARCHITECTURE OF THE CF PROCESS

Legal characterisation is concerned with subsuming a social and economic activity under a specific legal regime. In this process, lawyers assign legal names to social-economic relations among humans. Whenever the social-economic reality changes, the lawyers have to characterise new developments in order to be able to know the pertinent legal regulation. The correct legal characterisation depends on understanding the key features of a given social-economic relationship. In the context of CF, this entails identifying the participating actors and their interrelations.

2.1. Participating actors

Three actors are involved in a typical online CF process: project owners or creators, funders or investors and the CFPs (De Buysere et al. 2012, 12). While this is essentially a tripartite structure, each of the actors is in a bilateral relationship with the other two, as portrayed in the triangular figure below.

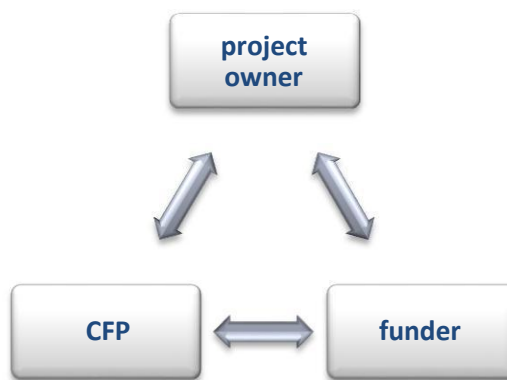


Figure 1: Triangular structure of relationships among CF participating actors

The three relationships are: first, between the project owner and the funder; second, between the project owner and the CFP; and third, between the funder and the CFP. The second and third relationships will usually be alike in all CF situations, while the variations in CF models reflect the difference in relationship between the project owner and the funder as explained in a subchapter below.

Regardless of the role one assumes in the CF process, awareness of the legal regulations pertaining to such activity may prove very important. For instance, a donor may not know that under the laws of certain countries it may have the right to receive back what was donated in case the project owner is ungrateful. Or, the project owner may not be aware that the delivery abroad of the product prototype in return for the investment may constitute an infringement under the respective foreign intellectual property laws. Or, the CFP may not know that it

sometimes may be sued before the courts of a foreign country, such as the country of the clients' habitual residence. As in all other transactions, knowing the relevant jurisdiction and applicable law enables one to calculate in advance the risk of engaging in a particular activity. It is to be presumed that the lower the amount which one is putting into (funders)/expecting from (project owners) this activity, the lower the awareness of the legal regulation. Additionally, the larger the difference between the individual amounts paid by the funders and the total amount received by the project owner, the higher the degree of informational asymmetry. These are inescapable consequence of the need to minimise the transaction costs.

2.2. CF models

Several CF models distinguishable based on various criteria are currently employed in practice. In determining legal characterisation for the purpose of the topic of this paper, the Hemmer's list seems very useful. It differentiates among the following basic CF models (Hemmer, 2011, 13-14):

- Crowd donations: Donors give money without expecting anything material in return, but the gratitude expressed in a form of a thank-you note, a promotional item (t-shirt or calendar), an invitation to backstage of a film-set or a mention of the donor's name on the respective product.
- Crowd sponsoring: Project owner and sponsor agree that no financial return is due for the money paid; instead, the project owner is obliged to give the sponsor a defined reward. Such reward usually serves as a preliminary test of the market value and may take different forms of marketing of the sponsor, such as through the bulletin board.
- Crowd pre-selling: This model facilitates producing something (printer, CD etc.) and the project owner is obliged to deliver to the funder an early version or a prototype product in return for the money paid.
- Crowd lending: This is the most popular model participating with more than 70% in the total CF industry (*Massolution Crowdfunding Industry 2015 Report*, 2015). The funder lends the money to the project owner who, upon expiration of the lending period, has to return the same amount plus certain interest. An often employed alternative to this is a long-term lending based on the revenue sharing principle. Instead of frequent payment of interest, he gets a predefined amount, including an agreed share of the venture's earnings. Because the lender participates in the business risk, this amount could range from a total loss – in case of bad performance – up to a multiple of the original amount loaned. In cases of loan-based CF, often the funder received a participative note which is not legally characterised as a security instrument.
- Crowd investing: This type is often referred to as the equity-based CF. Against the investment of equity; the funders receive shares, dividends and/or voting rights. This model has two submodels: profit-share streams (with the right to participate in the profits based on the contract or ownership of equity) and securities-based investing (with the rights deriving from the securities held by the funder). This CF model is subject to stricter legislative limitations than other models, in particular where it triggers the operation of securities regulatory framework.

Able to choose among the variety of basic CF models, CFPs sometimes offer several models for simultaneous use. This is one of the features of the CFP's efforts to provide tailored products to satisfy a specific project and project owner's needs. It is expected that the growing

commercial importance of CF and the competition between the CFPs will also contribute to the advancement of the CF models in the future. (Esposti, 2014, 44).

3. LEGAL CHARACTERISATION

Legal characterisation in this chapter is provided, not to pinpoint the substantive law defining the parties' rights and obligations, but to identify legal provisions on international jurisdiction and applicable law within the EU. The assessment thus focuses on three main EU legal instruments in the field:

- Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I bis Regulation),
- Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I) and
- Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II).

3.1. Contractual versus non-contractual

The legal relationship between the CF participating actors may in principle be characterised either as a contractual or a non-contractual (tort and quasi-delict). Hence, in situation of dispute, the aggrieved party has to decide whether to base its claim on contract or tort, although in many EU Member States procedural rules permit cumulating these two types of legal basis. Both, the term “contractual” and the term “non-contractual” are autonomously and coherently interpreted in Brussels I bis, Rome I and Rome II, meaning that no national concepts may be invoked and that the same terms in different instruments should be construed in the same vein. In its rulings, the Court of Justice of the European Union (CJEU) held that the contractual relationship in the meaning of Article 7(1) of Brussels I bis exists in a situation in which there is an obligation freely assumed by one party towards another (*Handte*, C-26/91, EU:C:1992:268, paragraph 15).

More recently, the CJEU restated that the contractual relation “presupposes the establishment of a legal obligation freely consented to by one person towards another and on which the claimant’s action is based” (*Engler*, C-27/02, EU:C:2005:33, paragraph 51). On the other hand, the dispute is to be classified as non-contractual if it seeks to establish the liability of a defendant that is not related to a contract (*Kalfelis*, C-189/87, EU:C:1988:459, para. 18). By applying these definitions to typical CF situations, it becomes evident that often there will be as many contractual relations as there are relations in the triangular structure: first, between the project owner and the funder, second, between the project owner and the CFP, and third, between the funder and the CFP. As for the non-contractual, these are relationships in which the parties’ encounter is fortuitous without the potential to agree on the distribution of the related risk (Mankowski, 2016, 164). For instance, where there is a non-contractual obligation of the CFP arising out of the prospectus liability or where there is an unfair commercial practice on the part of the CFP (*Crowdfunding Crossing Borders*, 2016, 15). This seems to be confirmed by the recent CJEU judgment where it was held that a consumer, who has acquired a bearer bond from a third party professional, without a contract having been concluded between that consumer and the issuer of the bond, may not invoke jurisdiction in contracts (or the purpose of consumer protective jurisdiction) if suing the issuer of the bond on the basis of the bond conditions, breach of the information and control obligations and liability for the prospectus (*Kolassa*, ECLI:EU:C:2015:37). In addition to direct lawsuit against the tortfeasor, there might be an option to rely on an insurance covering this risk of liability arising out of prospectus, but this issue falls outside the scope of this article.

3.2. Particular contracts

Once the characterisation shows that a specific relationship is contractual, the type of contract may be relevant for the purpose of special jurisdiction or applicable law. Under Article 7(1) of Brussels I bis and Article 4(1) of Rome I, the relevant differentiation is among contract for the sale of goods, contract for the provision of services, and all other contracts. Under Article 4(1) of Rome I, one has to differentiate among contract for the sale of goods, contract for the provision of services, contract concluded within a multilateral system, and all other contracts. Contract for the sale of goods and contract for the provision of services should have the same meaning for the purpose of both instruments. Contract for the sale of goods (Articles 7(1) of Brussels I and 4(1)(a) of Rome I) is understood as contractual exchange of goods against money, involving a transfer of property over goods (Mankowski, 2016, 191). This would encompass a typical pre-selling CF arrangement in which a project owner is obliged to deliver to the funder an early version or a prototype product in return for the money paid. Such arrangement might be considered as a sale of goods with an advance payment. Contract for the provision of services (Articles 7(1) of Brussels I and 4(1)(b) of Rome I) implies that the party who is providing the service carries out a particular activity in return for the remuneration (*Falco*, ECLI:EU:C:2009:257, para. 29). The concept is wide enough to encompass the relationship between the project owner and the CPF since the CPF is actually a CF service provider for the project owner (see by analogy the situations mentioned by Mankowski, 2016, 200-201).

Under Article 4(1)(h) of Rome I, there is a type of contract potentially relevant for the purpose of relationships in the CF triangle. This is the contract concluded within a multilateral system which brings together or facilitates the bringing together of multiple third party buying and selling interest in financial instruments. The concept of “financial instruments” is defined under the Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID) and covers a wide range of instruments such as shares, bonds, options, futures, swaps derivatives etc. The MiFID governs the provision of investment services in financial instruments by banks and investment firms and the operation of traditional stock exchanges and alternative trading venues, and may require the CFP to obtain license to operate in a certain Member State, which is a public law issue outside the scope of this paper. Its importance in interpreting the Rome I provision reaches only to cover the investment-based CF. The dilemma as to whether the provision of Article 4(1)(h) applies only to contracts between acquirers and sellers or also to back-to-back contracts within the multilateral system, seems to be resolved by taking account of the intention to cover the whole chain of transactions. Thus, a contract for the sale of securities will be covered, but not the contract for the provision of services by the CFP to enable sale or purchase of securities. Although there are some contrary opinions, the latter would probably be categorised as contracts for the provision of services (see McParland, 2015, 410–411).

Under the default third category of contracts, the scholarship lists *inter alia* the loan contracts and agreements concerning corporate matters, agreement for contributions to the common venture, share deals and asset deals for acquiring a business, sale of securities (see Mankowski, 2016, 206 and 244). Thus, also donations contract, sponsorship contracts, contracts concluded within a multilateral system and alike are subject to the third category of all other contracts in Article 7(1)(a) of Brussels I bis. Although the default categories in Brussels I bis and Rome I are mostly the same, the contracts concluded within a multilateral system fall within this general default category in Brussels I bis, but not in Rome I.

3.3. Consumer Contracts

Private international law in the EU attempts to create a fairer playing field for consumers who are in a particularly vulnerable position towards the professionals due to their uneven

bargaining power. This is done through special protective provisions on international jurisdiction in Section 4 of Brussels I bis and conflict of laws in Article 6 of Rome I, which exclude the application of the formerly discussed provisions on contracts. In both legal instruments the principal requirement of application of the protective provisions is that the contract is concluded between the consumer and the professional. These terms are autonomously interpreted without any reference to a particular national law. A consumer is understood to be a natural person acting for his or her private purpose, while a professional is acting in the exercise of trade or profession. A mixed contract, in which a person is acting in both capacities, may be considered a consumer contract provided the professional capacity is negligible (*Gruber*, ECLI:EU:C:2005:32). According to the definition provided by the CJEU, there has to be a “concordance of intention between the two parties [giving] rise to reciprocal and interdependent obligations” (*Ilsinger*, ECLI:EU:C:2009:303, para. 43).

Additionally, the contract has to fall under one of the purposes listed in the provision. (*Gabriel*, ECLI:EU:C:2002:436, para. 49; *Engler*, ECLI:EU:C:2005:33, para. 34; *Ilsinger*, ECLI:EU:C:2009:303, para. 43). Under Brussels I the additional criteria are: a) a contract is for the sale of goods on instalment credit terms; b) a contract is for a loan repayable by instalments, or other form of credit, made to finance the sale of goods; or c) in all other cases, the contract is concluded with a person who pursues commercial/professional activities in the Member State of the consumer’s domicile or directs such activities there. Under Rome I the additional requirements are that the professional: a) pursues his commercial/professional activities in the country of the consumer’s habitual residence, or b) directs such activities to that country.

Interpretation of the latter requirement in the online context has been given in CJEU case law (see *Pammer* and *Alpenhof*, ECLI:EU:C:2010:740). Common requirement to all these instances under both Brussels I bis and Rome I is that the contract falls within the scope of such activities, yet no causal link is necessary (*Emrek*, ECLI:EU:C:2013:666, para. 24).

However, not all consumer contracts are covered by the protective provisions because specific exclusions are provided in the Rome I. Particularly relevant for the CF transactions are: a) a contract for the supply of services where the services are to be supplied to the consumer exclusively in a country of his or her habitual residence; d) rights and obligations which constitute a financial instrument and rights and obligations constituting the terms and conditions governing the issuance or offer to the public and public take-over bids of transferable securities, and the subscription and redemption of units in collective investment undertakings in so far as these activities do not constitute provision of a financial service; or e) a contract concluded within the multilateral system referred to above.

Turning to the above-described CF structure and models, one may notice that the answer whether a particular relationship within a particular CF model is covered by the consumer protective provisions or not depends on the specific circumstances. The assessment has to be made separately for the purpose of Brussels I and Rome I.

In respect to the first relationship between the project owner and the funder, the variations are plentiful. Regarding the first hurdle – the definition of a consumer and a professional, a typical situation is where a project owner is a professional and the funder is a consumer. It is nevertheless possible that their roles are reversed: A company is donating a small amount of money for a private project of installing the non-profit solar-energy system on the roof of a project owner’s household. Should this also be understood as a consumer contract, in which the project owner is a consumer and the funder is a professional? It seems that in the majority of cases this would not be a proper construction. Rather than acting in the exercise of its trade or profession (such as where a transporting company is carrying the goods or purchasing a truck, or clothes retailer is selling a clothing item or leasing a business premises), the professional’s donation would be an act of sympathy or support. If however, the professional’s activity is to support innovative ideas or finance projects, careful assessment of circumstances might lead to

the conclusion that the requirement is fulfilled. The assessment is made based on the nature of the person's profession or trade, as well as nature and regularity of activities which are at stake in a particular contract (compare McParland, 2015, 536–538). In a different situation of investment-based CF model, this first relationship will fall under the Brussels I and Rome I protective regimes if the funder is a natural person acting outside his or her professional sphere, the professional does or directs its activities to the country of funder's habitual residence, and their contract falls within such activities. However, the same contract would fall outside the Rome I protective regime if it is concluded within the above-described multilateral system.

The second relationship between the project owner and the CFP will usually lack the character of a consumer contract again because of inability to pass the very first hurdle – definition of a consumer. Whereas the CFP, the provider of CF services in this relationship, will always be considered a professional, the project owner, even if a natural person, will rarely be acting for his or her private purpose. One of those rare situations is the above household solar-energy project.

Given that the CFP is a professional, the application of the consumer protective provisions to the third relationship between the funder and the CFP will primarily depend on the legal nature of the funder and the capacity in which he or she is acting. If the funder is a natural person and engages into donating, sponsoring, pre-purchasing, lending or investing, outside his or her trade or profession, he or she would be characterised as a consumer. On the contrary, if the funder is a legal person or a natural person acting within his or her trade or profession, no characterisation as a consumer is possible.

The final issue which needs to be mentioned is the submission that a natural person who is investing his or her privately owned money into an equity-based CF cannot be regarded as a consumer under the current EU financial market and consumer protection regimes. This argument is mainly developed in respect to the substantive law, where it is submitted that retail investors receive adequate and balanced protections through the financial market legal scheme, and are thus do not need the consumer protection legislation. Although voices are increasingly louder to extend the benefits of consumer protection to retail investors (Cherednychenko, 2010), including at the level of the collective redress as a guarantee of access to justice (Amato & Perfumi, 2012), this is still a matter of an ongoing debate. It would be worth investigating into this issue from the private international law perspective. The arguments in the context of substantive law cannot be translated into the private international law because of no special rules on protecting the investors. Passive private investors would thus enjoy no special protection under Brussels I bis and Rome I, unless they are considered consumers.

4. INTERNATIONAL JURISDICTION

In Brussels I bis, there are special rules applicable to consumer contracts, while majority of the provisions are common to other contracts and torts in general, the difference being only in relation to special jurisdiction under Articles 7(1) and (2).

4.1. Consumer contracts

Pursuant to Article 18 of Brussels I bis, a consumer may bring proceedings against the other party to a contract in the courts of the Member State of that party's domicile or the consumer's domicile. However, a consumer may be sued only in the courts of the consumer's domicile.

The exception is provided for the right to bring a counterclaim in the court in which the original claim is pending. Options to depart from these provisions by parties' agreement on the choice of court are limited to three alternative situations under Article 19. A further condition for the prorogations agreement in consumer contracts to survive is that it is not considered an unfair contract term under the Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. Where a defendant enters an appearance and does not contest jurisdiction

and no other court has exclusive jurisdiction under Article 24, the court which otherwise would have no jurisdiction is considered to have one, based on Article 26 of Brussels I on tacit prorogation. If a consumer is the defendant, the court has to ensure that he or she is properly informed of these provisions.

4.2. Non-consumer contracts and torts

Article 4 of Brussels I bis on general jurisdiction provides for the jurisdiction of the courts of the Member State of the defendant's domicile. Instead, a plaintiff may choose a special jurisdiction in matters related to a contract under Article 7(1) or tort or quasi-delict under Article 7(2). Thus, in the case of the sale of goods, in the place in a Member State where, under the contract, the goods were delivered or should have been delivered, and in the case of the provision of services, the place in a Member State where, under the contract, the services were provided or should have been provided. In all other contracts, the lawsuit may be brought before the courts for the place of performance of the obligation in question, i.e. the obligation which is the subject matter of the dispute. Article 7(2) conveys special jurisdiction torts and quasi-delicts to courts of the place where the harmful event occurred or may occur.

Pursuant to Article 7(3) of Brussels I bis, it is further possible to rely on the jurisdiction in criminal proceedings, while Article 7(5) provides basis for jurisdiction regarding a dispute arising out of the operations of a branch, agency or other establishment. There are also options for joinder of the parties under Article 8 of Brussels I bis. A parties' agreement to the contrary may override these provisions, provided the conditions set in Article 25 of the Brussels I are met. Whereas the cited Brussels I bis provision defines conditions for formal validity, the substantive validity is subject to the law of the Member State whose courts have been chosen. Priority to any of the above heads of jurisdiction is given to tacit prorogation under Article 26(1) of Brussels I.

5. APPLICABLE LAW

Like under Brussels I bis, the distinction has to be made between contractual and non-contractual relationships, and in the former category between the consumer contracts and non-consumer contracts.

5.1. Consumer contracts

Special conflicts of law provisions exist for consumer contracts under Article 6 of Rome I, which have precedence over the general provisions addressed in the next subchapter. The parties to consumer contracts may agree on the applicable law, but the choice may not deprive the consumer of the protection afforded to him by mandatory provisions of the law which would have otherwise been applicable. The law governing the consumer contract in the absence of the parties' choice is the law of the country of the consumer's habitual residence. Pursuant to Article 11(4) of Rome I, the law of the country of the consumer's residence is exclusively applicable to formal validity of consumer contracts.

5.2. Non-consumer contracts

Under Article 3, the primary connecting factor for contracts in the Rome I Regulation is party autonomy. This is subject to certain limitations, and its substantive validity is governed by the chosen law. In the absence of choice, Article 4(1) lists the contract on the sale of goods, the contract on the provisions of services and the contract concluded within the multilateral system. The two former contracts are governed by the law of the country of the habitual residence of the seller and the service provider, respectively. The third contract concluded within the multilateral system, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments in accordance with non-discretionary

rules and governed by a single law, is subject to that law. In all other contracts concluded in the context of CF, the provision of Article 4(2) applies. The applicable law is that of the habitual residence of a party required to perform the characteristic performance. The reference to the above laws law is not final where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country, as provided under Article 4(3). The wording of this escape clause shows that it is reserved for exceptional situations in which narrow interpretation is required. And finally Article 4(4) provides that, where the characteristic performance cannot be determined, such as in case of barter agreements, the contract is governed by the law of the country with which it is most closely connected. The formal validity of a contract is regulated in Article 11.

5.3. Non-contractual obligations

Rome II determines the applicable law for non-contractual obligations involving a conflict of laws. In the context of CF, the most common probably would be the application of the general provisions. Under Article 14 of Rome II, the parties may agree on applicable law provided that: a) all the parties are pursuing a commercial activity and an agreement is freely negotiated before the event giving rise to the damage occurred; or b) in all other situations, an agreement on choice of law is entered into after the event giving rise to the damage occurred. Other conditions are parallel to those under the abovementioned Article 3 of Rome I. In the absence of choice, the applicable law is determined pursuant to Article 4 of Rome II. The applicable law is the law of the country in which the direct damage occurs. However, common habitual residence of the person claimed to be liable and the person sustaining damage at the time when the damage occurs takes precedence. Finally, the escape clause enables application of the other law which is manifestly more closely connected with a tort. Such connection might be based in particular on a relevant pre-existing relationship. That might be a respective contract within the CF structure. For instance, in case of non-contractual prospectus liability claimed by the funder against the project owner, such relationship might be manifestly more closely connected to the contract between them existing in relation to equity-based investment.

6. CONSLUSION

Being a business model with a huge potential for future development, CF warrants attention in the legal literature. Because of its contemporary reliance on internet-mediated registries, the cross-border character of the relationships among the three main actors in the CF structure is virtually inevitable. In such situations all actors need to be aware that their CF-related activities will often be subject to the laws different from their own and that they may find defending themselves before foreign courts. In determining the jurisdiction and applicable law, legal characterisation is a preliminary issue because different rules are provided for different types of legal relationships. In the CF context these may be non-contractual or contractual. Contracts are divided to consumer and non-consumer contracts, the latter being further divided based on their different purposes, such as sale or provision of services. These characterisations enable the determination of the entire set of rules in EU legislation (Brussels I bis, Rome I and Rome II) which create the basic legal framework for the cross-border CF practices.

ACKNOWLEDGEMENT:

This paper is written under the support of the Croatian Science Foundation project no. 9366 “Legal Aspects of Corporate Acquisitions and Knowledge Driven Companies’ Restructuring”

LITERATURE:

1. Amato, C. & Perfumi, Ch. (2012). Financial investors as consumers: recent Italian legislation from a European perspective. In: Devenney, J. & Kenny, M. *Consumer Credit, Debt and Investment in Europe*. Cambridge: Cambridge University Press (pp. 279–305).

2. Cherednychenko, O. O. (2010). The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights? In: 33 *Journal of Consumer Policy* (pp. 403– 424).
3. CJEU, *Falco Privatstiftung and Thomas Rabitsch v Gisela Weller-Lindhorst*, C-533/07, ECLI:EU:C:2009:257.
4. CJEU, *Harald Kolassa v Barclays Bank plc*, C-375/13, 28 January 2015, ECLI:EU:C:2015:37.
5. CJEU, *Johann Gruber v Bay Wa AG*, C-464/01, 20 January 2005, ECLI:EU:C:2005:32.
6. CJEU, *Lokman Emrek v Vlado Sabranovic*, C-218/12, 17 October 2013, ECLI:EU:C:2013:666.
7. CJEU, *Peter Pammer v Reederei Karl Schlüter GmbH & Co. KG and Hotel Alpenhof GesmbH v Oliver Heller*, C-585/08 and C-144/09, 7 December 2010, ECLI:EU:C:2010:740.
8. CJEU, *Petra Engler v Janus Versand GmbH*, C-27/02, 20 January 2005, ECLI:EU:C:2005:33.
9. CJEU, *Renate Ilsinger v Martin Dreschers*, C-180/06, 14 May 2009, ECLI:EU:C:2009:303.
10. CJEU, *Rudolf Gabriel*, C-96/00, 11 July 2002, ECLI:EU:C:2002:436;
11. Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts. OJ L 95, 21.4.1993, (pp. 29–34).
12. *Crowdfunding Crossing Borders 2016: An Overview of Liability Risks Associated with Cross Border Crowdfunding Investments* (2016). Retrieved 29.07.2016 from <http://www.fglawyersamsterdam.com/wp-content/uploads/2016/03/20160331-Crowdfunding-Crossing-Borders-Report.pdf>.
13. Cunningham, W. M. (2012). *The JOBS Act: Crowdfunding for Small Businesses and Startups*. New York: Apress.
14. Danmayr, F. (2014). *Archetypes of Crowdfunding Platforms.: A Multidimensional Comparison*. Wiesbaden: Springer Gabler.
15. De Buysere, K., Gajda, O., Kleverlaan, R. & Marom, D. (2012). *A Framework for European Crowdfunding*. Retrieved 29.07.2016 from www.crowdfundingframework.eu.
16. Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC. OJ L 145, 30.4.2004, (pp.1–44).
17. Esposti, C. (2014). Statistical View of Crowdfunding. In: Dresner, S. (ed.), *Crowdfunding: A Guide to Raising Capital on the Internet*. (pp. 31–45) Hoboken, New Jersey: John Wiley and Sons.
18. Hemer, J. (2011). *A Snapshot on Crowdfunding. Working paper firms and region, No R2/2011*. Retrieved 29.07.2016 from <http://hdl.handle.net/10419/52302>.
19. Lynn, J. & De Buysere, K. (2014). Crowdfunding Laws Based on Global Jurisdiction. In: Dresner, S. (ed.), *Crowdfunding: A Guide to Raising Capital on the Internet*. (pp. 199–211) Hoboken, New Jersey: John Wiley and Sons.
20. Mankowski, P. (2016). In: Magnus, U. & Mankowski, P. (eds.), *Brussels Ibis Regulation*. Köln: Otto Schmidt.

21. *Massolution Crowdfunding Industry 2015 Report (2016)*. Retrieved 29.07.2016 from <http://crowdexpert.com/crowdfunding-industry-statistics/>.
22. McParland, M. (2015). *The Rome I Regulation on the law applicable to contractual obligations*. Oxford: Oxford University Press.
23. Ordanini, A., Miceli L., Pizzetti, M. & Parasuraman, A. (2009), Crowd-funding: transforming customers into investors through innovative service platforms, In: 22 *Journal of Service Management*, (pp. 443–470). Retrieved 27.07.2016 from <http://www.emeraldinsight.com/doi/pdfplus/10.1108/09564231111155079>.
24. Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I). OJ L 177, 4.7.2008 (pp. 6–16).
25. Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (Rome II). OJ L 199, 31.7.2007 (pp. 40–49).
26. Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (Brussels I bis). OJ L 351, 20.12.2012 (pp. 1–32).

IMPLEMENTATION OF THE ODR (ONLINE DISPUTE RESOLUTION) PLATFORM ACCORDING TO THE REGULATION (EU) NO 524/2013 ON ONLINE DISPUTE RESOLUTION FOR CONSUMER DISPUTES

Ivana Markovinovic Zunko

Law Firm Vedriš & Partners Ltd, Croatia

ivana.markovinovic@vedris-partners.hr

ABSTRACT

Efficient protection of the consumers as the weaker contractual party has always been in the focus of the EU legislation, but development of e-commerce emerged with the new challenges. One of them is widely present perception that any dispute arising from on-line cross-border transaction would remain unsolved due to expensiveness and inefficiency of potential court procedure. Such lack of confidence that often prevents consumers from on-line shopping and creates a serious obstacle to the development of the internal market corresponds with the growing understanding that the alternative dispute resolution provides numerous advantages compared to the classic litigation. Such development has been recognized in the ADR Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC which provides improved mechanisms for functioning of the ADR in the cross-border transactions. One of the designated mechanism is on-line platform for dispute resolution imposed by Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Regulation on consumer ODR). In February 2016 the European Commission launched web-based platform that enables on-line submission of the disputes and their transmission to the dispute resolution entities in the Member States. The aim of this paper is to provide the insight into functioning of this mechanism and its background and to discuss the challenges of its on-going implementation in the EU countries.

Keywords: *alternative dispute resolution, consumers, cross-border transaction, online dispute resolution.*

1. INTRODUCTION

Although recognized in the ancient Greek and Roman times as effective alternative, out-of-court method for resolving disputes, up to date the mediation has not reached its full potential, neither globally nor within EU territory. The paper will try to provide an insight behind the reasons for such failure, particularly from the EU legislation perspective as introduction to more narrow subject of the paper, namely the specific aspect of the consumer protection – dispute resolution efficiency by alternative means (particularly online), as enabled by the most recent EU authorities' achievements in this field. In order to ensure better understanding of the topic, some general remarks on consumer protection will be provided, as this is quite complex and incoherent area in the EU legislation. The general purpose is to assess whether the potential of the newly established mechanisms is sufficient for the improvement of clearly unsatisfactory alternative dispute resolution environment from the consumer protection aspect and for boosting confidence into cross-border transactions that are inevitable in the contemporary world.

2. MEDIATION AS ALTERNATIVE WAY OF DISPUTE RESOLUTION – GENERAL REMARKS

In order to understand the alternative dispute resolution problematic, in practice usually referred to by the acronym "ADR", it might be useful to define the term firstly and to provide some general context of it.

2.1. Definition and main advantages

According to the Green Paper on alternative dispute resolution in civil and commercial law of the European Commission the alternative methods of dispute resolution are defined as out-of-court dispute resolution processes conducted by a neutral third party, excluding arbitration proper.

In the Green Paper the Commission recalled that the development of these forms of dispute settlement was not to be regarded as a means of remedying deficiencies in the operation of the courts but as an alternative, more consensus-based form of social peace-keeping and conflict and dispute resolution which in many cases would be more appropriate than the resolution of disputes by a third party as through the courts or by arbitration. Alternative dispute resolution techniques such as mediation allow the parties to resume dialogue and come to a real solution to their dispute through negotiation instead of getting locked into a logic of conflict and confrontation with a winner and a loser at the end. The importance of this is highly obvious, for instance, in family disputes, but it is potentially very valuable in many other types of dispute.

It is used increasingly in complex commercial disputes where the parties, whilst wishing to resolve a conflict, also wish to retain as far as possible a continuing commercial relationship. It is becoming increasingly common in disputes arising out of medical accidents where mediation can lead to the adoption of an innovative resolution of what are often very sensitive conflicts and provide creative remedies which may be beyond the powers of the courts.

2.2. Historical background

Although originally mediation was broadly used in Greek and Roman times and used America's Great Depression in the 1930s, milestone of the modern ADR is commonly found in the lecture of Harvard scholar Frank E.A. Sander who introduced the idea that a dispute resolution should not be limited to the state-governed judicial system. As very important event – sort of mediation Big Bang - scholars usually point out the 1976 Pound Conference held in St Paul, Minnesota. On that seminal occasion in St Paul, Minnesota, many leading American educators and jurists addressed the causes and remedies of popular dissatisfaction with the administration of justice in the US, recognizing what Dean Roscoe Pound had famously described as tinkering where comprehensive reform was. The idea was welcomed by both by judges who were questioning the ability of the legal systems to process all cases timely and potential consumers who were seeking the system of dispute resolving that would enable them different involvement with better control of the process.

Although originated in the United States of America, ADR has spread to the Old Continent. At the 1999 meeting of EU political leaders in Tampere, Finland it was formally decided that ADR in civil and commercial disputes was beneficial and should be promoted via legislation. The European Commission published in 2002 the Green Paper on alternative dispute resolution in civil and commercial law that resulted with more intensive work on ADR. The Green Paper itself pointed out three main reasons for promoting ADR in the EU context: the increasing awareness of ADR as a means of improving general access to justice in everyday life; fact that ADR was adopted in the legislation of some of the Member States and recognition of the ADR as political priority by European Institutions.

In 2004 the European Code of Conduct for Mediators was drafted in cooperation with a large number of scholars and practitioners. It lays down various norms and principles which must be applied in mediation practice and which should be adhered to by mediation organizations. The same year, the Commission proposal for directive following the Green Paper was adopted and four years later the full recognition of the mediation as valuable way of solving disputes by the EU authorities was formally confirmed by adopting the Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters, known as Mediation Directive 2008.

2.3. Mediation Directive impact

According to its Article 1, the main objective is to facilitate access to alternative dispute resolution and to promote amicable settlement of disputes by encouraging the use of mediation and by ensuring a balanced relationship between mediation and judicial proceedings (so called BRTN). The BRTN suggests that there should be a minimum number or percentage of cases to be mediated in each country. To reach the goal of the BRTN, the Directive essentially sets forth rules dealing with mediation quality standards such as: allowing judicial referrals; ensuring enforcement of mediated settlements and protecting confidentiality. Each Member State, however, is allowed to choose the appropriate legal tools to reach its own BRTN based on various macro-economic data such as how effective the public justice system is and other relevant criteria.

However, the application of 2008 Mediation Directive has not resulted with achievement of the estimated goals in the practice. Apparently, despite its obvious advantages, mediation in civil and commercial matters after 5 years of the Mediation Directive had been adopted was still used in less than 1% of the cases in the EU. In 2011 European Parliament commissioned a study “Quantifying the Cost of Not Using Mediation—a Data Analysis” - experts from all over the EU were asked to estimate how much it would cost, and how long it would take, to mediate that very same dispute in their country. The study has showed that the break-even point for time savings was 19% and the break-even point for cost-savings was 24% when all Member States’ data was averaged. These numbers led to the expression “the European Mediation Paradox”— if increasing the use of mediation brings such significant time and cost savings to the parties why were Member States experiencing such low rates of mediation? (Canessa; De Palo, 2014, p.716).

Therefore the European Parliament's Committee on Legal Affairs requested a study assessing the limited impact of implementation of the Mediation Directive and proposing measures to increase the number of mediations in EU. The result is the study called “Rebooting’ the mediation directive: assessing the limited impact of its implementation and proposing measures to increase the number of mediations in the EU” launched in 2014. The study prepared by more than 800 experts from all over the Europe shows that disappointing results are caused by weak pro-mediation policies in the Member States but also by non-mandatory nature of this instrument. So the majority suggested that introducing of mandatory elements would be the solution. It should be pointed out that the study itself has gained some negative critics and being considered as being pure handy manual on mediation instead of deep study as the study neither explains the causes for the limited impact of mediation in the EU, nor provides any concrete measure to increase the number of mediations in the EU.

The idea of mandatory mediation seems quite controversial – there is even opinion expressed that is a sort of oxymoron – nobody can force people to negotiate. This might be true, but still the unbinding meeting with the mediator that can save years of litigations is hardly to be considered as obligation that is burden to someone.

It should be also mentioned that unsatisfactory level of mediation implementation is not solely EU problem, but apparently United States of America experience is the same despite of the fact that that country can be considered as mediation homeland.

Anyhow, it is clear that today we have reached the point where mediation needs another Big Bang– that is why for the period 2016-17 the new Global Pound Conference on the Causes and Remedies of Popular Dissatisfaction with Cross-Border Dispute Resolution is organized. It should attract various active stakeholders and the central issue on the agenda is the resolution of cross-border dispute as those are becoming more important than local ones due to the constant growth of the Internet. This might help to finally find Prince Charming who will wake the Sleeping Beauty as the mediation is so often called by the scholars.

3. ADR IN THE CONTEXT OF CONSUMER CONTRACTS

Efficient consumer protection has been recognized by EU institutions as one of the priorities in establishing proper functioning of the internal market ever since of founding treaties.

3.1 History of EU consumer protection policy

Although not explicitly elaborated in the 1957 Treaty of Rome, EU consumer policy is strongly rooted in its preamble stressing out the efforts for the improvement of the living and working conditions. The Council adopted its first special programme for consumer protection and information policy in 1975. when it became clear that market mechanism alone are not sufficient for realization of the mentioned goal. Specific consumer protection was also influenced by joining of the UK and Denmark where the consumer movement was particularly strong. The programme the right to protection of health and safety, the right to protection of economic interests, the right to claim for damages, the right to an education, and the right to legal representation (or the right otherwise to be heard). The Maastricht Treaty for the first time included a contribution to the strengthening of consumer protection among the legitimate activities of the Community and provided a specific provision on the consumer protection. Finally, Article 169(1) and point (a) of Article 169(2) of the Treaty on the Functioning of the European Union (TFEU) provide that the Union is to contribute to the attainment of a high level of consumer protection through measures adopted pursuant to Article 114 TFEU and Article 38 of the Charter of Fundamental Rights of the European Union provides that Union policies are to ensure a high level of consumer protection.

3.2. Present status and future challenges

At the moment, more than 90 EU directives cover consumer protection issues, but despite of great numbers, the general assessment is that EU consumer protection has still not reached the adequate level - it is too complex and sometimes inconsistent and mostly remains on a minimum harmonization level. One of the reasons lays in the legal nature of directives as prevailing source – they are transposed into national laws differently so it is argued that regulations could be more appropriate to ensure a coherent and accessible legal framework for consumer transactions in the internal market.

Furthermore, the proposal for change suggests that EU action should concentrate on the cross-border context, and more particularly on transactions concluded by distance means, mainly in the context of e-commerce. E-commerce has been in focus of the EU legislation as constant technology developments rapidly change the way consumers interact and shop online and consumer protection in the digital single market is one of the main priorities of European policy makers. In this respect important act of more general nature have been passed (Directive 2011/83/EU on consumer rights which primarily focuses on information requirements and the right of withdrawal, Directive 2006/114/EC concerning misleading and comparative advertising and Directive 95/46/EC on the protection of individuals with regard to the

processing of personal data and on the free movement of such data), but also some more specific as Directive 2000/31/EC on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market; Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services; Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector; Regulation (EU) No 524/2013 on online dispute resolution for consumer disputes; and Directive 2002/65/EC concerning the distance marketing of consumer financial services.

The European Commission adopted in 2012 the European Consumer Agenda - its strategic vision for EU consumer policy with the aim to maximise consumer participation and trust in the market which defined sectors of particular importance (namely food, transport, electronic communications and financial services), based on the fact that they affect the basic interests of all consumers in essential goods and services and identified six objectives: improving the regulatory framework on product and service safety and enhancing the market surveillance framework; reinforcing safety in the food chain; improving information and raising awareness of consumer rights and interests among both consumers and traders; building knowledge and capacity for more effective consumer participation in the market; effectively enforcing consumer law, focusing on key sectors; and giving consumers efficient ways to solve disputes.

3.3. ADR Benefits for consumers

As summarized in the official United Kingdom response to the consultation on the implementing ADR Directive, to, the benefits of ADR are the following: ADR offer a cheaper and quicker alternative to the courts for disputes where a consumer is not able to resolve their complaint directly with the business from whom they made their purchase; a large number of consumer complaints do not get resolved and the court system can be a daunting and expensive prospect and finally, feedback from consumers who have used ADR tends to be positive.

Extensive research into consumer dispute resolution (CDR) systems by a team from the Centre for Socio-Legal Studies, Oxford, and consensus from a conference held in September 2013 highlighted the following objectives of CDR arrangements: resolving many small disputes more quickly and at lower cost than courts; capturing many more consumers to business (C2B) claims than are attracted through existing systems (courts, small claims, collective actions) by providing more user-friendly, cheaper, and quicker pathways for C2B disputes; achieving significant savings in public expenditure on courts by providing CDR facilities, which in some Member States may involve significant private funding; providing effective and efficient mechanisms for collective redress by enabling mass issues to be identified and then resolved by applying generic solutions to multiple similar individual claims; providing a source of expert advice to consumers, through a triage function prior to examination of any claim; providing an enhanced market surveillance and feedback mechanism that can inform surveillance authorities, traders, and consumers about emerging trends and significant issues. (Creutzfeldt; Hodges, 2013, p.2)

4. ADR DIRECTIVE AND ODR REGULATION

As explicitly stated in the Preamble of the ADR Directive, given the increasing importance of online commerce and in particular cross-border trade as a pillar of EU economic activity, a properly functioning ADR infrastructure for consumer disputes and a properly integrated online dispute resolution (ODR) framework for consumer dispute arising from online transactions are necessary in order to achieve the Single Market Act's aim of boosting citizens' confidence in the internal market.

4.1. Development of ADR and ODR awariness

It seems that lack of confidence and trust that in general represents great obstacle for development of the cross-border transaction has been even more present in context of e-commerce. One of the most problematic aspect of this issue is uncertainty concerning potential dispute resolution – the general impress is that on-line buyers simply take the risk, without counting on any solution if the problem arises. ADR Directive Preamble explicitly stress out the lack of awareness of the existing out-of-court redress mechanisms and the problem is even more present in the context of ODR. Although it seems obvious that disputes arisen in on-line transaction should be solved on-line and despite of the fact that ODR has been widely discussed drawn by many scholars since the late 1990s and despite of the large increase of e-commerce, ODR has not become reality yet. There are only few examples such as World Intellectual Property Organization's on-line service for solving disputes concerning domain name.

The some of the most important reasons for such situation, beside lack of awareness, are the the lack of legal standards –no accreditation services for ADR nor ODR; the expensiveness of ODR technology; the reluctance of traders to use ODR due to the lack of incentives, the lack of the enforceability of agreements to use ODR (Cortes, Lodder, 2013, p. 19). The need to change the present status has been recognized globally – besides various discussions such as annual International Forum on ODR, also some more formal achievements have been accomplished. In 2014 the United Nations Commission for International Trade Law (UNCITRAL) established a Working Group on ODR with the aim of providing a legal framework on ODR to facilitate the settlement of low-value disputes between businesses, and between consumers and traders. At the same time, EU authorities intensively works on the problem and addresses the problem in its acts. It has been so stated in the Preamble of Directive 2000/31/EC on e -commerce that the Member States shall ensure that, in the event of disagreement between an information society service provider and the recipient of the service, their legislation does not hamper the use of out-of-court schemes, available under national law, for dispute settlement, including appropriate electronic means. The most significant achievements are ADR Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC which provides improved mechanisms for functioning of the ADR in the cross-border transaction and Regulation (EU) No 524/2013 of the European Parliament and of the Council of 21 May 2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC (Regulation on consumer ODR).

4.2. New EU regulatory framework for ADR and ODR

On 18 June 2013 the Official Journal of the EU published the Directive on Consumer ADR and the Regulation on Consumer ODR were published. The new laws came into effect 20 days after publication, on 8 July, 2013. Those should remove the identified obstacles for development of the internal market by ensuring access to simple, efficient, fast and low-cost ways of resolving domestic and cross-border disputes which arise from sales or service contracts.

4.2.1. Main ADR Directive features

The Preamble of the Directive stresses out the unsatisfactory ADR status – it has been stated that ADR is not yet sufficiently and consistently developed across the Union and that it is not running satisfactorily in all geographical areas or business sectors un the EU. The disparities in ADR coverage, quality and awareness in Member States constitute a barrier to the internal market and are among the reasons why many consumers abstain from shopping across borders and why they lack confidence that potential disputes with traders can be resolved in an easy, fast and inexpensive way. For the same reasons, traders might abstain from selling to consumers in other Member States where there is no sufficient access to high-quality ADR procedures.The

ADR Directive requires Member States to ensure the provision of ADR entities to resolve national and cross-border contractual complaints between consumers and traders with the exception of disputes related to health services or higher education. It describes ADR entities as adjudicative and consensual extrajudicial processes created on a durable basis and it excludes complaints handling mechanisms established by the trader, direct negotiation between the consumer and the trader, and judicial settlement. The traders will be legally obliged to inform consumers about the ADR entities that are competent to deal with potential disputes – this means that traders must inform consumers when they have voluntarily adhered to an ADR/ODR scheme, and when the law requires them to do so (e.g. ombudsman). All traders, irrespective of whether they are obliged to or intend to use an ADR entity, must also provide information on paper or another durable medium about ADR entities that could handle the consumers' complaints. When doing so, traders must advise whether or not they intend to participate in the ADR process. Member States will be required to monitor the compliance of these information obligations by traders, but also the functioning of ADR entities, which will be required to notify the public authorities of their rules and performance. In order to ensure compliance, Member States will be able to issue proportionate penalties to traders and ADR entities that do not comply with the information requirements. According to the new Directive, all ADR entities that decide to be accredited and linked to the EU ODR Platform must comply with the following six procedural principles: Expertise, Independence and Impartiality- third neutral parties must be competent and cannot have conflicts of interest, while collegial bodies must have equal stakeholder representation of consumers and traders; Transparency - ADR entities must publish annual reports and have a website that displays information to the parties before they agree to participate in the process; Effectiveness- all ADR entities must offer easy access regardless of their location; they cannot require legal representation; the ADR process must be free of charge or at moderate costs for consumers; and disputes should be resolved within 90 days – though in complex disputes ADR entities will be able to extend this period; Fairness - Member States must ensure that parties are aware of their rights and the consequences of participating in an ADR procedure. Outcomes must be reasoned and in writing, be provided in paper or on a durable medium (e.g. email), and before consumers agree to a proposed settlement they must be given the opportunity to reflect before they consent to an amicable solution; Liberty - contractual agreements to participate in an adjudicative process must be reached with a consumer after the dispute arises if the binding adjudicative process precludes consumers from bringing a legal action before the courts – that is, agreements to go to arbitration must be carried out post-dispute and finally Legality - it states that those processes that impose solutions cannot result in the consumer being offered a lower level of protection than that guaranteed by the mandatory law where the consumer is habitually resident.

4.2.2. Main ODR Regulation features

On 15 February 2016, the European platform for solving disputes arising out of online purchases (ODR Platform) based on ODR Regulation was officially launched. The ODR Platform works in the form of interactive website offering a single point of entry to consumers and traders seeking to resolve disputes out-of-court which have arisen from online transactions. The platform enables EU consumers and traders to settle their disputes by putting them in touch with the ADR providers selected by Member States. As the Preamble of the ADR Directive explicitly refers to the general lack of awareness of the existing out-of-court redress mechanisms, the ODR Regulation requires that all traders have a link to a relevant ADR entity on their website and in their general terms and conditions of sales contracts or service contracts. Further, in situations where disputes have arisen with customers, traders must direct their clients to an appropriate certified ADR provider and must indicate whether or not they intend to use that provider, but firstly before submitting their complaint to an ADR entity through the ODR

platform, the consumers should be encouraged by Member States to contact the trader by any appropriate means, with the aim of resolving the dispute amicably.

5. CONSLUSION

Protection of the consumers and promotion of alternative dispute resolution both seem to be very important topics in the EU. Their encounter was clearly inevitable and hopefully seminal - meeting point was adoption of ADR Directive and accompanying ODR Regulation back in 2013. Those instruments suppose to remove the identified obstacles for development of the internal market – most obvious the lack of the consumer's confidence and trust with regard to the efficient dispute resolution. As indicated in the ODR Regulation Preamble ODR should offer a simple, efficient, fast and low-cost out-of-court solution to disputes arising from online transactions. Whether this will be accomplished is too early to say as the ODR Platform was launched only half year ago. However, one of the biggest challenges related to the ADR community in general is the lack of the awareness so it is of utmost importance that the consumers and small business owners are informed about the dispute resolution solutions now available to them. It seems that ADR Directive and ODR Regulation have established firm grounds for achievement of those goals and maybe the Prince Charming that ADR has been waiting for so long has finally been on his way to wake this Sleeping Beauty up.

LITERATURE:

1. Greco Morasso, S. (2011). *Argumentation in dispute resolution: A reasonable way to handle conflict*. Amsterdam: John Benjamins Publishing.
2. Creutzfeldt, N., Hodges, C. (2013). *Implementing the Consumer ADR Directive*. Oxford: The Foundation for Law, Justice and Society.
3. Canessa, R., De Palo, G. (2014). Sleeping? Comatose? Only mandatory consideration of mediation can awake sleeping beauty in the European Union. *Cardozo Journal of Conflict Resolution* (pp. 713-731). New York: Benjamin N. Cardozo School of Law.
4. Cortes, P., Lodder, A. R. (2014), Consumer Dispute Resolution Goes Online: Reflections on the Evolution of European Law for Out-of-Court Redress. *Maastricht Journal of European and Comparative Law*. (pp.1-29). Maastricht.
5. De Palo, G. (2014). A False 'Prince Charming' Keeps 'Sleeping Beauty' in a Coma: On Voluntary Mediation Being the True Oxymoron of Dispute Resolution Policy. Retrieved 01.08.2016. from <http://kluwermediationblog.com/2014/04/15/a-false-prince-charming-keeps-sleeping-beauty-in-a-coma-on-voluntary-mediation-being-the-true-oxymoron-of-dispute-resolution-policy/>
6. Leathes M., Masucci D. (2014). Time for Another Big Bang in Alternative Dispute Resolution - The World Needs a Global Pound Conference. Retrieved 01.08.2016. from <http://www.mediate.com/articles/poundconference.cfm>
7. Reade, E. (2016). Changing the dispute resolution culture – will the EU consumer disputes legislation lead to an increased awareness of ADR in Member States? Retrieved 01.08.2016. from <http://kluwermediationblog.com/2016/04/04/changing-the-dispute-resolution-culture-will-the-eu-consumer-disputes-legislation-lead-to-an-increased-awareness-of-adr-in-member-states-2/>
8. Carver, T.B., Vondra A. (1994) Alternative Dispute Resolution: Why It Doesn't Work and Why It Does. *Harvard Business review*. Retrieved 16.06.2016. from <https://hbr.org/1994/05/alternative-dispute-resolution-why-it-doesnt-work-and-why-it-does>

9. Rebooting the Mediation Directive: Assessing the limited impact of its implementation, and proposing measures to increase the number of mediations in the EU. (2014). Retrieved 01.08.2016. from <http://adrresources.com/adr-news/925/rebooting-eu-mediation-directive-assessing-limited-impact>
10. EC Consumer Policy (2015). Retrieved 03.08.2016. from http://europa.eu/rapid/press-release_MEMO-92-68_en.htm?locale=en

BANKRUPTCY POLICY, STATE ATTITUDE TOWARDS BANKRUPTCY AND STATE INTERVENTIONISM

Dejan Bodul

Faculty of Law, University of Rijeka
dbodul@pravri.hr

ABSTRACT

In recent years, which are characterized by the crisis in the whole world, inconsistent government policies of EU member states ranged from the proclaimed liberalism to ad hoc interventionism. Doctrinal analyses indicate that this is a result of non-compliance of the state economic powers and its existing obligations towards its citizens and other economic subjects. Furthermore, they indicate that states are trying to fulfil their expected social, economic and political function by rescuing big companies, which they perceive as the “backbone” of the national development (economic and social) policy, from liquidation bankruptcy. In this context, it is the purpose of this paper to identify the paradigm for such relationship. This issue will be contemplated based on the analysis of a case study of bankruptcy/privatization/change in the status of the Institute of Immunology, Inc. Working thesis is that the modalities of bankruptcy are a necessary part of a market economy and that they can ensure the safety and options for the creditors, giving them a modus operandi for the recovery of subjects with financial difficulties through bankruptcy plan or quick restorations of blocked funds on the market through the process of bankruptcy liquidation.

Keywords: *bankruptcy, interventionism, intellectual capital, case study.*

1. GENESIS OF THE PROBLEM

In 1302, when the Ammanti Bank in Italy became insolvent and when its branch in Rome was closed, there was a panic among its creditors. The main debtors were in Spain, England, Portugal, Germany and France and creditors were desperately looking for the intervention and help from Pope Boniface the VIII. Since much of the financially injured parties were from the clergy, Pope banned the disposal of property by bank owners (Sajter, 2008, p. 43). Yet state intervention as an interference in economic and legal relations is a phenomenon that was a particular characteristic of the 1920's and 1930's. The USA policy of Roosevelt's New Deal marked a new direction for the biggest capitalist power of the modern world, but also created a model of state interventionism in the country which advocated principals of economic liberalism (Tufano, 1997, pp. 1-40). On the other hand, the situation was similar in Europe, with the exception that state intervention was limited in scope, in a way that it was more restrictive intervention rather than one justified by the aim of "public benefit". *Exempli causa*, during the Nazi period, the German and Austrian banks and insurance companies were obliged to buy a large number of government bonds, which became worthless after the Second World War. In the end, all of them were bankrupt, but the state couldn't allow the collapse of the entire economy, which led to various forms of state interventionism (Weber, 1985, pp. 123-141). In the former state of Yugoslavia the situation wasn't different. In 1931 there were 536 bankruptcies and 835 compulsory settlements. Already in 1932 the usage of the interventionism as a model for saving insolvent subjects declined, which lead to bankruptcy of 11 banks, 117 industrial and institutional companies and 514 wholesale trade operations (Bilandžić, 1973, p. 212). In other words, the crisis that led to a collapse of the concept of liberal economy also brought about measures of state intervention. In fact, the market deficiencies were often used as economic, legal and political arguments for the activity of the state and for its intervention in all areas of economy and law.

2. INTERVENTIONISM AND BANKRUPTCY REGULATIONS UNTIL 1997 AND THE ADOPTION OF MODERN BANKRUPTCY ACT IN 1997

Doctrinal analysis indicates that the legislative regulation in the economic field, which certainly encompasses bankruptcy, was, at least until 1997 and the adoption of the first modern Bankruptcy Act, inadequate in legal (and nomotechnical) terms (Bodul, *et al.*, 2013, p. 911. *et seq.*; Falke, 2003, p. 43). This allowed for free interpretations and often misinterpretations by the national authorities, at the expense of business factors. The doctrine also indicates that the former bankruptcy law didn't recognize bankruptcy plan as a model of bankruptcy proceedings, but only an institute of compulsory settlement. This procedure of compulsory settlement aimed at creating positive equity for firms in bankruptcy, in terms of accounting, but didn't seek to identify and address the essential reasons which had created the conditions for the initiation of bankruptcy proceedings. Of course that these accounting and technical combinations did not result in rehabilitation of companies. On the contrary, in a very short period, after the formal exit from the bankruptcy, the companies would again be in the zone of negative value of equity and compulsory settlement proceedings would have to be renewed. It should be noted that in many companies this procedure was done several times and that compulsory settlement proceedings practically lasted over ten years (Dika, 1988). It is perhaps needless to talk about the practical negative consequences of this approach if we know that the very laws were not being applied and that the state and politics had taken the role of "arbitrator" who had a decisive influence on all economic relationships. Moreover, in some former socialist countries, the state went so far that it prohibited initiation of bankruptcy process, *exempli causa*, in Russia (Lambert Mogiliansky, *et al.*, 2003). Yet the adoption of the Bankruptcy Act in Croatia in 1997, modelled after the German insolvency law (*Insolvenzordnung*) from 05. December 1994 (Bundesgesetzblatt 1994, I, p. 2866; last change Bundesgesetzblatt, 2011, I, p. 2854.) and the termination of the Law on Forced Settlement, Bankruptcy and Liquidation (Official Gazette, 53/91 and 54/94) represented a radical change in the way bankruptcy proceedings were conducted in Croatia.

3. WAS THE IMPLEMENTATION OF THE (MODERN) BANKRUPTCY ACT IN 1997 A TURNING POINT?

Theory indicates that the legal framework for the organization and operations of the business entities, first set by the Enterprise Act, and later by the Companies Act was, to some extent, acceptable for the transition period. On the other hand, bankruptcy legislation and practice are an example of resistance of the political structures towards modern bankruptcy law. This systematic way of resolving business problems of insolvent companies through socialization of their losses has logical repercussions on the micro level where business entities lose their motivation to behave economically rationally by identifying business problems that can be overcome by the restructuring process. Furthermore, the fact that the Bankruptcy Act was passed in 1997 (Official Gazette, 44/96) showed "fear" of strict enforcement of bankruptcy reasons for the commencement of bankruptcy proceedings on a huge number of state-owned enterprises, thus leading to the formal termination of thousands of fictively employment contracts. In the opinion of the author, among a large number of novelties which were implemented by a new Bankruptcy Act (1997), perhaps the most important one was a credibility of bankruptcy reasons on which the court can and must make its decision to open bankruptcy proceedings (Dika, 1996, pp. 1-35, Dika, 1996, pp. 114-117).

3.1. A brief overview of the development of bankruptcy legislation (and the interventionism) from 1997th to 2016th

The adoption of the Bankruptcy Act in May 1996, whose implementation started on January 1st 1997, improved the bankruptcy process by decreasing its duration. However, statistical data showed that bankruptcy process in Croatia was considerably longer and more expensive than an equivalent procedure in the average European country. Our view of the problem of functioning bankruptcy system is based on the analysis of indicators of efficiency of the bankruptcy proceedings, as follows: (1) duration of bankruptcy process, (2) the degree of satisfaction of creditors' claims (3) the cost of conducting bankruptcy proceedings. These indicators are also the best way of monitoring the fulfilment of the objectives of bankruptcy proceedings (Tomas Žikovic, et al., 2014, pp. 318-351). Therefore, in order to overcome the "acute" problems in practice and to improve the system of bankruptcy protection, by accelerating and reducing the cost of bankruptcy proceedings, the legislators amended the Bankruptcy act eight times (Dick, 1996, pp. 60-64.). In reality problematic system of legal remedies, the passivity of creditors, the ineffectiveness of the enforcement of court orders, insufficient control over the work of the bankruptcy administrator and the inconsistent application of the law, as well as many other institutional factors lead to a perception that the bankruptcy is a "death" of the subject. As an anachronism of the socialist system, whose ideology did not recognize a failure of business enterprises, the bankruptcy regulations wasn't radically changed, and paradoxically, the result is not an excessive number of the bankruptcy proceedings, but the fact that, due to the actual state non-intervention, there are still thousands of business entities that were obliged to open bankruptcy proceedings but did not do so. Moreover, the analyses indicate that only 5% of insolvent legal persons opened bankruptcy proceedings on time, while for others it has been tolerated to operate in deep insolvency, although it is legally considered a criminal offense (Sajter, 2007, pp. 31-42.). For the market, it was a socialization of losses, by covering insolvency of individual companies through many forms of budget funding.

However, frequent financial crisis caused the need for a radical reform of the bankruptcy legislation. The impetus for further reforms, not only in Croatia, but also in the whole of Eastern Europe, was the process of joining the EU, because in order to become a member one must meet the so-called "Copenhagen and Madrid criteria" which implies the harmonization of legislation and practices of a candidate country with the *acquis communautaire* of the EU (e.g. functioning market economy, effective protection of civil rights, the rule of law, political stability). Since the techniques of conducting bankruptcy didn't result in progress and that a bankruptcy liquidation was a rule, (there was no reorganization plan), there was a need for the implementation the new law, the Law on Financial transactions and pre-bankruptcy settlement (Official Gazette, 108/12, 144/12, 81/13, 112/13, 71/15 and 78/15 - heir and after: ZFPPN). The first aim was, based on the models of European bankruptcy legislation (Bodul, *et al.*, 2013), to force creditors to make, within a reasonable time, the key decisions about the fate of the debtor. The second, but equally important aim was to have only bankrupt companies which have exhausted all other possibilities of rehabilitation and have failed to reach an agreement with creditors, go into bankruptcy liquidation procedure. But the problem was the body of the pre-bankruptcy procedure, the so-called Pre-bankruptcy Council. This body consisted of two members and the president of the council. The idea was that the pre-settlement procedure which was carried out before the Financial agency (heir and after: FINA) will fully depend on the willingness of creditors and debtors to settle. We also have to bear in mind that the Pre-bankruptcy Council has only a formal role in the process of the pre-bankruptcy settlement, e.g. it is not up to the Pre-bankruptcy Council to decide whether the parties will reach pre-settlement agreement, because the Council only has a role of a responsible mediator to create conditions and lead the process in which the debtor and creditor will be able to negotiate and reach an

agreement. On the other hand, appointments of the Pre-bankruptcy Council by the Minister of Finance is also controversial mainly because the members of the Council are generally employees of the Ministry of Finance and they could be potentially subjective and biased in conducting the process of pre-bankruptcy settlement in which Ministry is regularly on the side of the creditors as a party in the process. Moreover, in the process of appointment of the members of the Pre-bankruptcy Council the candidates were not required to pass any certification exam. *Exempli causa*, since the requirements for the position of the Pre-bankruptcy Council member depend entirely on the discretion of the Minister of Finance, there are no obstacles for the trainees of these bodies to be appointed to the function (art. 33. ZFPPN). In addition, the author cannot overlook the fact that the State, as a party to the pre-settlement proceedings, is normally the biggest creditor and it is, thus, reasonable to raise the question of objectivity and impartiality of the persons who are members of the Pre-bankruptcy Council. The members of the Council are appointed by one of the parties in the case, i.e. the State, who is often the creditor with the largest rights on the property of a pre-bankruptcy debtor. Accordingly, the application of certain norms of ZFPPN may represent state aid in cases where the creditor is as State, local and regional governments and companies in state ownership. There is also the danger that Pre-bankruptcy Council concludes that this is not a state aid, which afterwards can be proven false. Such funds allocated by the state are considered illegal state aid on the basis of the State Aid Act (Official Gazette, 47/14.) The Agency for Protection of Competition (CCA) then must order a recovery of state aid plus the reference rate and the basis points. Any state aid granted without the authorization of the CCA shall be considered an illegal state aid (Janes, 2012, p. 44). This indicates that the efficiency of the Pre-bankruptcy settlement process cannot be measured by the number of initiated proceedings. Even the viability of a business through the bankruptcy plan or the pre-bankruptcy settlement cannot be a valid measure, since it may show only the results of the government subsidies which are often illegal (Bodul, Vuković, 2016, pp. 12-14.). Although the adoption of ZFPPN in 2012 has significantly altered the way the bankruptcy proceedings are conducted in the Republic of Croatia, in its three-year practical application a number of problems were noted in the interpretation and effects of certain provisions of the institute, which the government will try to eliminate by adopting the new Bankruptcy Act (Official Gazette, 71/15 – here and after: BA). Perhaps the biggest legislative change were the provisions on the pre-bankruptcy settlements that have been taken from ZFPPN into the new Bankruptcy Act and renamed a pre-bankruptcy proceedings (Chapter II (art. 21 to 74)). The bodies of pre-bankruptcy proceedings are the judge and the commissioner (art. 21) while FINA became a technical and administrative service of the court (art. 44). The pressure for such reforms and for a stronger role of the court in conducting pre-court settlements came from Art. 6, no. 1. of the European Convention for the Protection of Human and Fundamental Freedoms (Official Gazette, 18/97, 6/99, 14/02, 13/03, 9/05, 1/06 and 2/10.) (*Right to a fair trial: 1. In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly but the press and public may be excluded from all or part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice*). This resulted in an alteration of the legislative solutions according to which FINA *de facto* and *de jure* decided in the pre-bankruptcy settlement procedures. Along with a number of innovations brought about by the new BA in the domain of basic legal effects of the procedure, it is certainly important to consider those related to the position of tax claims or the position of the state and its tax claims in pre-bankruptcy and bankruptcy proceedings. Furthermore, no practice is necessary to raise awareness and call for

caution since the modes of forgiveness of tax debt as an instrument of State aid are part of a very detailed and complex system of state aid rules (Regulation on the conditions, manner and procedure for disposal of claims with titles in the pre-tax debt and bankruptcy procedure (Official Gazette, 122/15)).

Certainly we consider important to mention The Law on Securing Workers' Claims in the event of bankruptcy of the employer (Official Gazette, 86/08, 80/13 and 82/15). The workers who have legitimate claims against the company where they worked and which found itself in bankruptcy, have a possibility to receive a certain amount of unpaid salaries, outside and before the bankruptcy proceedings, and regardless of the fate of the bankruptcy estate. Their claims are taken over by a (newly) established Insurance Agency for workers' claims. Moreover, in addition to the existing system of protection of the substantive rights of workers in case of bankruptcy of the employer, the latest amendments protect the livelihood of workers and payment of minimum wages by the Agency in case that the employer is unable to cover the salaries (Chapter II, art. 4c, 4d and 4e.). Furthermore, this system is financed from the state budget, therefore, from taxpayers. So, the question remains – Is this legal structure a good solution? On the one hand, unlike in the normal capitalist economy, in which the claims of the employees to the company in which they work cannot exceed one month gross salary, in (post)transition economies these claims can be perennial, so it makes sense, for social reasons, to intensify and accelerate payment for these claims. On the other hand, the doctrine suggests that the mentioned problem is a current issue and that it doesn't make sense to address a temporary problem with a permanent solution which will remain in force after the normalization of economic markets. In addition, we do not see why the taxpayers, many of which live below the poverty line, should finance the payment of private claims of private persons for their private bankrupt companies. For, the budgetary financing debts in bankruptcy is a classic example of economic interventionism (Bodul, *et al.*, 2013, pp. 525-560.).

Furthermore, although the anecdotal evidence suggests that the desired objectives for functionalization of bankruptcy law protection have not yet been reached, the legislators have the new / old task - to implement the institutes of consumer bankruptcy through the Bankruptcy Consumer Act (Official Gazette, 100/15 - heir and after: BCA). The aim is to solve the social problems through the institute of bankruptcy. For now it is too early to evaluate the success or failure of such solutions, however, the anecdotal evidences show that the German consumer bankruptcy proceedings, whose solutions had been transplanted into BCA, have a low success rate of resolved bankruptcy cases (2-3%) while procedures lasted up to 11 years (Lechner, 2011, pp. 59-81.). In March of 2006, a proposal for the discussion entitled "Draft law on exemption of debts for people without any means and on amendments to insolvency proceedings for consumers" was forwarded to the members of the working group of the Bund-Länder by the German Federal Ministry of Justice (Reform des Verbraucherinsolvenzrechts, 2005.). This paper is still a proposal.

4. CASE STUDY OF THE INSTITUTE OF IMMUNOLOGY, INC. ZAGREB

The Institute of Immunology, Inc. Zagreb (hereinafter: the Institute) is substantially determined by three components: 1) monopoly position in the Republic of Croatia in the production of viral vaccines, 2) own "know-how" as an intellectual property in the broad sense and 3) the company's strategic importance for Croatia (Decision on establishing the list of companies and other legal entities of strategic and special interest for the Republic of Croatia (Official Gazettes, 120/13, from 27 September of 2013). However, despite the obvious comparative advantages, in accordance with the Bankruptcy Act (Official Gazettes, 44/96, 29/99, 129/00, 123/03, 82/06, 116/10, 25/12, 133/12, and 45/13) the Commercial court, with its Decision no. 3rd St-1719 / 2013-6 from December 20th 2013, initiated the bankruptcy proceeding and the bankruptcy judge appointed a preliminary bankruptcy trustee. However, not long after, a

proposal for opening a bankruptcy proceeding was withdrawn by its applicant? The reasons for such action remain unknown because the information is not accessible to the interested scientific and professional community. For now, everything indicates that this has been done because of the state interventionism. The base for the present thesis on state interventionism is found in the provisions of our bankruptcy legislation in the part related to the suspension of the bankruptcy proceedings. The suspension of the bankruptcy proceedings occurs due to the inadequacy of the bankruptcy estate, and that certainly is not the case in bankruptcy proceedings against the Institute which has assets (bankruptcy estate) of high monetary value. Specifically, in Chapter V subsection 4 (art. 203 to 212) BA deals with the matter of suspension of the bankruptcy proceedings. The suspension is possible if there are following reasons for the suspension: 1) suspension due to the lack of bankruptcy mass to cover the costs of the bankruptcy proceedings (art. 203); 2) The suspension due to insufficiency of the masses for the fulfilment of other obligations of the bankruptcy estate (art. 204); 3) suspension for subsequent disappearance of the reason for bankruptcy (art. 208) and 4) suspension with the consent of creditors (art. 209). Suspension ad. 1) and 2) refer to the suspension of the bankruptcy proceedings against the debtor legal entity, while the suspension ad. 3) and 4) relate to the suspension of the bankruptcy proceedings against the property of the individual. In the BA there are no other reason for suspension of an already initiated bankruptcy reason, so it is a closed circle of reasons for the suspension (*numerus clausus*). In essence, there are two very similar suspension procedures. Yet the Government, regardless of the existence of grounds for bankruptcy reasons, tried to privatize the Institute. The main idea was that the resources owned by the state should be transformed into a more efficient form of ownership - private ownership, in order to create a clear ownership structure, and indirectly to force investors to take risk in the attempt to preserve and improve the funds that they have invested. However, it is important to note that the privatization is a fundamentally different procedure, both from the standpoint of the nature of the procedure and the reasons for its initiation, and finally from the aspect of responsibilities and positions of the participants in the process. But after the failed privatization during which the government rejected what was seen as an unsatisfactory offer to buy the state portfolio in the Institute, it was decided that the Institute shall be transformed to a facility for carrying out activities related to health. It will be the property of the state and under the jurisdiction of the Ministry of Health, which will, along with the State office for state property management, be in charge of its legal transformation (Regulation on the establishment of the Institute as a Public health Institution which is of strategic and general economic interest for Republic of Croatia (Official Gazettes, 91/2015)).

5. COMPARATIVE EXPERIENCE WITH COMPANIES IN BANKRUPTCY AND MODELS OF INTERVENTIONISM

In 2002 the board of British Energy, which is a private company, decided that it will stop the delivery of supply of electricity to the Great Britain unless it receives emergency financial aid from the British government. On one hand, the government could choose between respecting market laws, which would leave this company to market sanctions, bankruptcy, and, by extension, millions of citizens would be left in dark, or, on the other hand, it could approve the requested loan of one billion Euros. The British government chose the second solution and gained control of 65% of shares (Bujišić-Petrovic, 2006, pp. 281-288.).

Similar action was taken by the French government in order to rescue a private company Alstom. If the government had not intervened, the potential loss of banks, French and foreign, would have amounted to around 17 billion euros. In this case too, the state was obliged, in accordance with the proclaimed liberal principles, to leave the private corporation to market sanctions, but the consequences of that bankruptcy would have been unforeseeable for the state and its citizens (Bujišić-Petrovic, 2006, pp. 281-288.). It is interesting to mention that during

this process Siemens gave an offer to bail out banks, but it was estimated that for the stability of the French economy it was important to keep French "nationality" of Alstrom and certain banks. When it intervenes to preserve the "nationality" of domestic companies, the state does so mainly in order to keep companies which are important pillars of the development policy, employment and regionalization on their territory (Bujišić-Petrovic, 2006, pp. 281-288.).

Here we can point out to the positive example of General Motors, which managed to overcome the crisis thanks to restructuring, which was realized with the help of the state. Thus the government bought most of the capital stock which helped to restore this capital and led to the restructuring of GM. In this case, the state, Government of the United States, became the majority shareholder which ultimately led to the rescue of that motor giant (Roe, *et al.*, 2013).

6. CONCLUDING REMARKS

We have to be aware that often the economic categories do not coincide with the legal categories. In mentioned examples, the subjects and their businesses were practically structuring the fabric of the country by employing hundreds of people, gathering highly qualified experts, carrying out innovation activities. Thus, if these companies had been taken over by foreign owners, the state policy in all areas would have remained without the support and it would have been significantly more difficult, and in some cases even impossible, to conduct it. Therefore, the ability to conduct social and economic policy development, which is still considered to be under the jurisdiction of the country, is significantly narrowed. On the other hand, while analysing these cases *de lege lata* we have to stress out that the bankruptcy proceedings can offer two possible solutions for the conclusion of the bankruptcy proceedings: a) liquidation and b) the bankruptcy plan. The liquidation shall be carried out after all of the debtor's bankruptcy estate is sold and divided among the creditors, while the bankruptcy plan is a modus of rescuing company by implementing series of measures of economic, financial and legal nature. From this simple definition, we can see the physiognomy of bankruptcy proceeding. The only reason for opening bankruptcy proceeding is that the subject is not able to pay the claims, while the aim of the bankruptcy proceedings is to satisfy creditors' claims in the best possible way. For companies whose activities are of strategic (national) interests, which is certainly true in the case of the Institute, we could *de lege ferenda* prescribe that the bankruptcy is forbidden and that its founders and members are jointly liable for its obligations. The alternative is for the bankruptcy to be impossible in case of a person whose activities are of national interest, unless there is a prior consent of the ministry in charge. If the ministry doesn't withhold its approval, within 30 days it is considered that the consent is given. If the ministry refuses to give its consent, the obligations of the debtor are matched by a State.

Acknowledgement: *This work has been supported by the Croatian Science Foundation under the project 6558 Business and Personal Insolvency – The Ways to Overcome Excessive Indebtedness.*

LITERATURE:

1. Bilandžić, D. (1973). *Ideje i praksa društvenog razvoja Jugoslavije*, Komunist, Beograd, p. 212.
2. Bodul, D., Vuković, A. (2016). Uredba o uvjetima, načinu i postupku raspolaganja tražbinama s naslova poreznog duga u predstečajnom i stečajnom postupku, *Informator*, 6404, pp. 12-14.
3. Bodul, D., Vuković, A., Bartulović, Ž. (2013). Pravnopovijesni i poredbenopravni prikaz razvoja stečajnog postupka, *Zbornik Pravnog fakulteta Sveučilišta u Rijeci*, 34(2), pp. 911-941.

4. Bodul, D., Vuković, A., Smokvina, V. (2013). O načelu socijalnog postupanja u stečajnom postupku s naglaskom na prava radnika, *Zbornik Pravnog fakulteta Sveučilišta u Rijeci*, 34(1), pp. 525-560.
 5. Bodul, D., Vuković, A., Vrbanac, D. (2013). Institut stečajnog plana i predstečajne nagodbe u hrvatskom pravu u kontekstu regionalnog i međunarodnog razvoja, *Podjetje in delo*, 4, pp. 377.-396
 6. Bujišić-Petrović, B. (2006). *Nacionalna država i Nadnacionalni biznis*, Biznis i država, Institut društvenih nauka - Centar za ekonomska istraživanja, Beograd, pp. 281-288.
 7. Dika, M. (1996). Novo hrvatsko stečajno pravo: stečajni razlozi, *Računovodstvo i financije*, 42(6), pp. 114-117.
 8. Dika, M. (1996). Novo ovršno pravo: neki temeljni instituti, u: Dika, M. (ur.), *Novo ovršno i stečajno pravo*, Organizator, Zagreb, pp. 1-35.
 9. Dika, M. (1988). (ur.), Sanacija i stečaj organizacija udruženog rada, *Zbornik radova*, Pravni fakultet - Centar za stručno usavršavanje i suradnju s udruženim radom, Zagreb.
 10. Janeš, Z. (2012). Državne potpore i predstečajna nagodba, *Računovodstvo, revizija i financije*, 12(12), p. 44.
 11. Lambert Mogiliansky, A., Sonin, K., Zhuravskaya, E. (2003), Capture Of Bankruptcy: Theory And Evidence From Russia, Working Papers w0038, Center for Economic and Financial Research (CEFIR), Retrieved from: <https://ideas.repec.org/s/cfr/cefirw.html> (12.02.2016.).
 12. Lechner, G. (2011), *The German Consumer Bankruptcy Process - (Not) A Rational Solution for All Filers for Bankruptcy*, u: Anderson, R.; Dubois, H.; Koark, A.; Lechner, G.; Ramsay, I.; Roethe, T.; Micklitz, H.-W. (eds.), *Consumer Bankruptcy in Europe - Different Paths for Debtors and Creditors*, European University Institute - Department of Law, Florence, pp. 59-81.
 13. Reform des Verbraucherinsolvenzrechts (2005), Arbeitsgemeinschaft Insolvenzrecht und Sanierung im Deutschen Anwaltverein. Retrieved from: <http://www.arge-insolvenzrecht.de/aktuelles> (17.05.2016.).
 14. Roe, M. J., Chung, J.-H. (2013), How the Chrysler Reorganization differed from prior Practice, *Journal of Legal Analysis Advance Access*, published August 30, Retrieved from: <http://jla.oxfordjournals.org/reports/most-read> (12.02.2015.).
 15. Sajter, D. (2007). Regionalna indiciranost stečajeve u Republici Hrvatskoj, *Ekonomski vjesnik*, 1/2, pp. 31-42.
 16. Sajter, D. (2008). *Ekonomski aspekti stečaja i restrukturiranje u stečaju - Ekonomska perspektiva pravnih elemenata stečajnog postupka u RH*, Ekonomski fakultet, Osijek, p. 43.
 17. Tomas Žiković, I., Žiković, S., Bodul, D. (2014)., Novosti i problemi u provedbi stečajnog zakonodavstva u Republici Hrvatskoj, *Ekonomski pregled*, 65(4), pp. 318-351.
 18. Tufano, P. (1997), Business Failure, Judicial Intervention, and Financial Innovation: Restructuring U.S. Railroads in the Nineteenth Century, *Business History Review*, 71(1), pp. 1-40.
 19. Weber, F. (1985), Die österreichische Bankenkrise und ihre Auswirkungen auf die niederösterreichische Industrie, u: Kusternig, A. (ed.), *Beiträge über die Krise der Industrie Niederösterreichs zwischen den beiden Weltkriegen*, Wien: NÖ Institut für Landeskunde, pp. 123-141.
- European Convention for the Protection of Human Rights and Fundamental Freedoms (Official Gazettes, 18/1997, 6/1999, 14/2002, 13/2003, 9/2005, 1/2006, 2/2010.)
 - Decision on establishing a list of companies and other legal entities of strategic and special interest for the Republic of Croatia (Official Gazettes, 120/2013)

- Bankruptcy Act (Official Gazettes, 71/2015)
- Regulation on the conditions, manner and procedure for disposal of tax claims in the pre-bankruptcy and bankruptcy proceedings (Official Gazettes, 122/2015)
- Law on Securing Workers' Claims in the event of bankruptcy of the employer (Official Gazettes, 86/2008, 80/2013, 82/2015)
- State Aid Act (Official Gazettes, 47/2001)
- Law on financial transactions and pre-bankruptcy settlement (Official Gazettes, 108/2012, 144/2012, 81/2013, 112/2013, 71/2015, 78/2015)
- The Law on Forced Settlement, Bankruptcy and Liquidation (Official Gazettes, 53/1991, 54/1994).
- Consumer Bankruptcy Act (Official Gazettes, 100/2015)
- Bankruptcy Act (Official Gazettes, 44/1996, 29/1999, 129/2000, 123/2003, 82/2006, 116/2010, 25/2012, 133/2012, 45/2013)
- Insolvency Act (Insolvenzordnung) from 5. September in 1994. (Bundesgesetzblatt, 1994, I, p. 2866; last change Bundesgesetzblatt, 2011, I, p. 2854.)
- Regulation on the establishment of the Institute as a Public health Institution which is of strategic and general economic interest for Republic of Croatia (Official Gazettes, 91/2015)

CIVIL PROTECTION OF THE HUMAN RIGHT TO A SAFE AND HEALTHY ENVIRONMENT

Maja Proso

*Faculty of Law, University of
Split Domovinskog rata 8, 21000
Split Republic of Croatia
maja.proso@gmail.com*

ABSTRACT

*Third-generation human rights show that human rights are not merely legal institutions but they are developing and changing. On the other hand, through them, we can identify new problems that threaten the right to life of all people. Therefore, these rights should seek and find their place in the catalogue of human rights. Standards of human life should be based on the capabilities of natural environment without exhausting resources that should retain unchanged quality and level of exploitation for future generations. In this paper, the author reflects on one of the fundamental human rights of the third generation, the right to a safe and healthy environment, basic domestic and international legal sources of that human right. The central part of the paper is devoted to the civil law mechanisms of protection of the right to a safe and healthy environment such as responsibility for the damage and liabilities of compensation resulting from the pollution of the environment de lege lata and de lege ferenda. **Keywords:** civil responsibility for pollution of the environment, damages, liabilities of compensation, right to a safe and healthy environment.*

1. INTRODUCTION

"All men are born free, with equal dignity and rights," says the article 1. of The Universal Declaration on human rights. Human rights are guaranteed to every person on the basis of his existence as a human being and they are inalienable. Human rights encompass many different areas of human coexistence. They can be divided into multiple groups, but often are classified into three categories: 1. Civil and political rights, 2. Social and economic rights and 3. Third-generation rights. (Manual on human rights and environment, 2012, p.11). The first generation of human rights include civil and political rights such as the right to freedom of expression, freedom of enjoyment, the right to life, right to a fair trial, etc. The second generation of human rights includes economic, social and cultural rights such as the right to an adequate standard of living, the right to health, the right to education and similar rights. The third generation of human rights refers to the collective rights of society or peoples such as the right to sustainable development, peace or a healthy environment. Ecological Lexicon sustainable development define as "access to utilization of available resources and managing them so as to meet today's needs, but without of impairment of future generations to meet their needs." (Đikić; Glavač, 2001, p.164) The increase of the population and its concentration in the cities, the great growth in industrial production and the overall activity of mankind are changing the image of the planet Earth and harmful impact on the environment. It was already in question the survival of many plant and animal species, and even the survival of man as an intelligent species. Human activity embraces the whole of the biosphere so that it becomes a global threat to the entire planet. This issue deals with the so-called. the third generation of human rights. It puts into the Centre of the question-how to preserve and protect natural resources for future generations? In this paper, the author reflects on one of the fundamental human rights of the third generation, the right to a safe and healthy environment, basic domestic and international legal sources of that human right. The central part of the work is devoted to the civil law mechanisms of protection of the right to a safe and healthy environment, de lege lata and de lege ferenda.

2. THE CONCEPT OF A RIGHT TO A HEALTHY AND SAFE ENVIRONMENT

The concept of a right to a healthy and safe environment has generated debate and contradictory developments since the first efforts were made to use international human rights law and procedures to enhance environmental protection. Nonetheless, the recognition that human survival depends upon a safe and healthy environment places the claim of a right to environment fully on the human rights agenda. Moreover, recognizing a right to environment could encompass elements of nature protection and ecological balance, substantive areas not generally protected under human rights law because of its anthropocentric focus. The human rights treaties provide a “framework” containing the basic guarantees on which international, national and local laws and policies are elaborated. More than 100 constitutions throughout the world guarantee a right to a clean and healthy environment, impose a duty on the state to prevent environmental harm, or mention the protection of the environment or natural resources. (Sands; Peel, 2012, p.779) Over half of the constitutions, including nearly all adopted since 1992, explicitly recognize the right to a clean and healthy environment (Earthjustice, Issue paper on human rights and the environment, 2004, p. 1-5)

3. LEGISLATIVE FRAMEWORK FOR A RIGHT TO A HEALTHY AND SAFE ENVIRONMENT

The right to live in a healthy environment is one of the rights guaranteed in the Constitution of the Republic, however, many residents on the extremely polluted areas in the Republic of Croatia it is roughly violated. Until the beginning of the seventies of the 20th century law and politics of the environment were rather unknown concepts. The concept of the environment among the first, was defined by Estonian scientist in the field of theoretical biology, Jakob von Uexküll (1864-1944), precisely in the book *Surrounding and the inner world of animals*. (Swan; Gordon; Seckbach, 2012, p. 453) According to him, "the environment is a whole which man sees through their specific, anthropogenic stop and you make the surrounding media (atmosphere, water, Earth, the geographic location, climate, etc.) like all other living organisms (plant and animal)." (Kolednjak; Šantalab, 2013, p. 324)

According to the Law on the protection of the environment of the Republic of Croatia "the environment is the natural environment: air, soil, water and the sea, climate, flora and fauna in the totality of the mutual action and cultural heritage as part of the environment that is created by man." In historical context it is possible to extract certain international documents that are as crucial goal had the care of the environment. The first international treaties on the protection and preservation of the environment were included in the international rivers and lakes. After the Vienna Congress of 1815, in accordance with the principles laid down in this Convention, many international agreements were concluded; on the Division of fishing rights on the rivers, about the monitoring of navigation and on regulating other modes of use and exploitation of international rivers, in which the sets and in environmental issues. Later, in the international agreements on the rivers entered also explicit clauses which were directly related to pollution and waste expulsion, and were prohibited in the border waterways. These are, for example. the contracts of the Grand Duchy of Baden and Switzerland from 1869 and 1875, France and Switzerland from 1880, and Italy and France from 1882.(Kolednjak; Šantalab, 2013, p. 324) Over the years it became increasingly clear how, for the purpose of effective protection of all endangered environment takes a systematic, planned and coordinated action at the international level. The first program dedicated to the environment was a United Nations Conference about the man and the biosphere, which held from 5 -16th June 1972. in Stockholm (Sweden). The Conference in Stockholm ended with the adoption of the Declaration, which, for the first time, questions of the human environment puts at the Centre of political negotiations. Declaration on the human environment consisted of 26 principles for protection, preservation and enhancement of the human environment, and an action program which contained 109 recommendations for

concrete actions of States for the protection and preservation of the environment in the framework of the UN system. (Kosor, 2012., p.2)

The UN General Assembly established the world Environment day. Ever since 1974 each June the 5th, world environment day is celebrated in the world in a variety of ways: conferences, international actions related to environmental issues, environmental cleanup, etc. The main objective is the creation and deepening of consciousness about the environment. At the UN Conference on environment and development held in 1992. in Rio de Janeiro, Brasil. (Conference is known as the Earth Summit) leaders and senior officials of Governments gathered, also from Croatia. At the meeting, world leaders adopted the "Program for the 21st century., popularly called Agenda 21. The program suggests a mutually coordinated actions that will make the development of the economic, social and environmentally sustainable. The standards of human life must be based on the capabilities of the natural environment without the exhaustion of the resource for future generations, should remain unchanged, and the quality of the degree of efficiency .It should also be mentioned the so-called Green Paper on damages to the environment. It is the document of the European Union under the name "Green Paper" which represent the results of research that the European Commission report to the Council, Parliament and the EU's competent committees on specific ecological issues.(Wilde, 2002, p.174)

4. SOURCES OF THE CIVIL LAW OF ENVIRONMENTAL PROTECTION IN THE REPUBLIC OF CROATIA

Article 3. of the Constitution of the Republic of Croatia stipulates freedom, equality, national equalit yand equality of the sexes, peacemaking, social justice, respect for the rights of man, the inviolability of ownership, conservation of nature and man's environment, the rule of law and democratic system – the highest values of the constitutional order of the Republic of Croatia and the Foundation for the interpretation of the Constitution. The provision of article 69, paragraph 1. The Constitution contains that everyone in the Republic of Croatia has the right to a healthy life. Paragraph 2. the same article stipulates the obligation of States to ensure conditions for a healthy environment, while prescribed the duty of everyone to as part of its powers and activities, particular care is devoted to the protection of human health, nature and the human environment. The legislator is not fixed by what covers the concept of healthy life. So, it could be concluded that the right to a healthy life special constitutional and legal expression of a wider right that is called the right to a healthy environment. Declaration on the protection of the environment in the Republic of Croatia of June the 5th 1992 expresses the firm commitment to fully ensure the balanced environmental and economic development for the purpose of permanent preservation of the national heritage for present and future generations and of the implementation of the constitutional rights of Croatian citizens in a healthy life, worthy of the standards environment. The Declaration establishes the will towards this end, insist on the construction of legal system in accordance with international agreements and standards of the European and world community, which will fully ensure a permanent, systematic and efficient protection of the environment, and that by going to: rational wield land and forests, to implement measures to protect air quality, while preserving all the sources of drinking water, to implement immediate measures to protect the coastline and seabed of the Adriatic , watch over the cultural heritage and the fundamental values of the natural national treasure, etc. Finally, the Declaration establishes that the Republic of Croatia recognises the exceptional and long term meaning to improve plans and programs of all levels of education, under the slogan: think globally- act locally, as well as the right of the individual to know and to have access to the latest information about the State of the natural environment and natural resources and the right to be consulted and to participate in a supported decision-making on activities that will have a significant impact on the environment. National environmental

strategy, adopted by the Croatian Parliament, in session on January 25, 2002, is the following document which sets policy to protect the environment, the State of the environment is established, as well as the system of authorities competent for the protection of the environment, as well as the national plan of action on the environment. The national plan of action on the environment brought about by the Government and it shows the current state of the environment, determine the goals and strategies of the participants, identify the problems and priorities, and setting out the objectives and measures to achieve them by sectors (tourism, transport, agriculture) and units (air, biodiversity, waste). The Law on the protection of the environment (hereinafter: ZZO) for the first time in the Republic of Croatia, edits environmental protection systematically and completely. Modeled on the Model Law on the protection of the environment of the Council of Europe and the Convention Preduroux, 2008, p.269), the environment is considered a natural environment: air, soil, water and the sea, climate, flora and fauna in the totality of the mutual action and cultural heritage as part of the environment created by man. The special importance of this Law is that it introduces an information system for monitoring the state of the environment, the pollution of the cadastre, for any state of environment and environmental burdens of log. The Law edits principles of environmental protection in the framework of the concept of sustainable development, the protection of the Bill of materials of the environment and protection of the environment from the impacts of the load, the subjects of environment, documents, sustainable development and environmental protection, environmental instruments, monitoring the situation in the environment, the information system of environmental protection, security of access to environmental information, public participation in environmental matters, insurance rights on access to justice, responsibility for damage to the environment, financing and general instruments of environmental policy, the management and inspection, and other matters in relation to this. The Convention on access to information, public participation in decision-making and access to justice in environmental matters (Aarhus Convention) is another international document essential to a safe and healthy environment, because access to information by the public participation in decision-making in environmental matters, and secured access to justice in the same issues, constitute an essential component of an effective environmental protection.

5. MECHANISMS OF PROTECTION OF CIVIL LAW RIGHTS TO A SAFE AND HEALTHY ENVIRONMENT

Civil protection of the environment in the Republic of Croatia has a dual role Primary role would be of preventive nature (principle of prevention), with the aim to prevent the occurrence of damage in the environment. The other role, of the repressive nature, has the goal of rehabilitation of consequences arising from pollution of the environment. The law on obligations (hereinafter: ZOO) in a large number of the provisions determines measures which prevents the occurrence of the damage to the environment. Article. 10, paragraph 3. stipulate that in order to avoid any risk or danger to the environment when planning or doing procedures with environment should apply all previous measures of environmental protection, which implies the use of good experiences, as well as the use of a product, equipment and devices and the application of production processes and systems maintenance designed parameters of the plant, which are the most favourable for the environment. Provision of article 11, par.1.prescribes the prohibition of diminishing the value of individual parts of the environment, and shall govern the natural sources should strive to be preserved for at the level of quality that is not harmful for man, flora and fauna. The enforcement of environmental protection in the broader sense is defined by Art. 61st to 141st ZOO. Preventive procedural protection relating to the prevention of damage to the environment is provided through three different complaints: 1. complaint about the emissions 2. complaint for trespassing and 3. environmental lawsuit.

Ecological action lawsuit represents anyone can request the other to remove the source of danger which threatens major damage to him or the other, and to refrain from activities resulting from harassment or threat of damage if the harassment or damage can not be prevented in any other suitable way. (Crnić; Matić, 2006, p. 727) This lawsuit is regulated by art. 1047. ZOO.

Undoubtedly, it is precisely this provision that represents *sedes materiae* regarding civil vision of environmental protection, while Law on property (herein after: ZOVO) is a *lex specialis* and applies to cases which are conditioned by the right of ownership. (Kačer, 1996, p. 285) In addition to procedural restrictions on the use of this type of civil law protection of environment

(Šago, 2013, p. 904) there is no limit substantive nature, in situations where the source of danger or harassment occurs in carrying out public benefit activities for which he obtained permission from the competent authorities, can not be required to stop such activities, but only taking socially justified measures to prevent occurrence of damage or its reduction, and the so-called compensation. excessive damage. Undisputed great advantage of this instrument of civil law environmental protection still lies in the fact of existence of “*locus standi*” (*actio popularis*), since everyone has the right to raise it, which significantly expands the circle of persons potential protector of the environment, as well as its protection in general. The second function of civil law protection of the environment relates to the responsibility of certain legal entities for more damage to the environment, to repair the damage and remove pollution. Liability for damage and liability certain forms of repairing damage caused by environmental pollution is probably the most effective means of civil protection of the environment. Civil law Law institute of liability for damage caused by pollution of the environment first has repressive function, although preventive function is not here completely excluded. Repressive function is to repair damage caused to the environment, or in the insurance funds to cover reconstruction of destroyed and damaged the environment. For damage caused by pollution of the environment corresponds to the general rules of the law of obligations. Under the direction of damage is understood removal, compensation or mitigate adverse impacts that have occurred due to certain harmful acts. The provisions on the method of repairing the damage and the amount of fees not included in the ZOO. Here are the general rules ZOO on compensation for damages which stipulate that damage repairs natural restitution, and the re-establishment of the situation as it was before pollution or settlement costs for taking measures that establishes the previous state of the environment and monetary compensation for lesser value of environment due to pollution. Natural restitution means reinstatement, or the establishment of a state that was before the damage occurred. his way of repairing the damage is done only if it is objectively possible. There are three basic forms. The first is an individual restitution, which means coming back to the same thing, or the same state of being. Another form is the generic restitution, and it consists in giving replaceable things instead seized or damaged. The third form of restitution is in the form of costs. According to the ZOO, everyone has the right to require the other to remove the source of danger which threatens major damage to him or a certain number of people. It is also authorized by anyone else asked to refrain from activities that cause disturbance or a risk of damage if the occurrence of harassment or damage can not be prevented by appropriate measures. The application is realized with Lawsuit on leakage, according to article 1047. of ZOO.

6. THE RIGHT TO A REMEDY FOR ENVIRONMENTAL HARM

The constitutional rights granted are increasingly being enforced by courts. Principle 10 of the Rio Declaration provides that “effective access to judicial and administrative proceedings, including redress and remedy, shall be provided.” The Universal Declaration of Human Rights affirms that “everyone has the right to an effective remedy by the competent national tribunals for acts violating the fundamental rights granted him by the constitution or by law.

The International Covenant on Civil and Political Rights also obliges states to provide remedies. Article 6 of the European Convention on Human Rights guarantees a fair and public hearing before a tribunal for the determination of rights and duties. The applicants owned property next to a waste treatment and storage area. Local well water showed contamination by cyanide from the dumpsite. The municipality prohibited use of the water and furnished temporary water supplies. Subsequently, the permissible level of cyanide was raised and the city supply was halted. The applicability of Article 6 was based on the Court's finding that the applicants' claim concerned the environmental conditions of the property and the applicants "could arguably maintain that they were entitled under Swedish law to protection against the water in their well being polluted as a result of VAFAB's activities on the dump." (Zander v. Sweden, 1983). In Zimmermann v. Switzerland the Court found Art. 6 applicable to a complaint about the length of proceedings for compensation for injury caused by noise and air pollution from a nearby airport (Shelton, 2008, p. 1112).

7. CONCLUSION

The man's negative impact on the environment until the early 20th century was insignificant. From his activities ecological system of the Earth was not at serious risk. However, the situation has changed drastically in recent decades. The right to a healthy life and environment is one of the fundamental and universal rights guaranteed by the Constitution (Article 69) and is based on other international documents. Human rights of the third generation are therefore no guarantee that the natural man's living space will not be too damaged or even completely destroyed, but should protect natural resources for generations to come. The Republic of Croatia is a party and signatory to numerous agreements in the field of environmental protection, which is further supported and given the right to a healthy life and environment of all its citizens. It is necessary to work intensively to raise awareness of every individual, every inhabitant of planet Earth because each individual enterprise, or action taken, and the lowest, local level, can produce effects and consequences of broader regional and global scale. Liability for damage and liability for damage incurred by pollution of the environment is the most effective means of civil protection of the environment. Civil law institute of liability for damage caused by pollution of the environment has primarily a repressive function, by which the injured person in a certain way to repair damage. For damage caused by pollution of the environment corresponds to the general rules of the law of obligations. Environmental issues are very complex, necessarily interdisciplinary and interconnected. Significant scientific and research efforts and original technological solutions are needed for their understanding and addressing. In conclusion, we note that Croatian society still needs to work on developing environmental awareness, both within the citizens themselves, but even more with traditional pollutants and the industry in general.

LITERATURE:

1. Agenda 21. Retrieved 15.05.2016. from <https://sustainabledevelopment.un.org/outcomedocuments/agenda21>
2. Convention on access to information, Public Participation in Decision – Making and Access to Justice in environmental Matters, (1998) Narodne novine – Međunarodni ugovori“ no. 1/2007. Retrieved 1.06.2016 from <http://www.unece.org/env/pp/treatytext.htm>
3. Crnić, I.; Matić, J. (2006) Zakon o obveznim odnosima, Napomene, komentari, sudska praksa i prilozi, Organizator, p. 727.
4. Deklaracija o zaštiti okoliša u Republici Hrvatskoj, Narodne novine, no. 34/92
5. Đikić, D.; Glavač, H. (2001) Ekološki leksikon, Ministarstvo zaštite okoliša i prostornog uređenja RH i Barbat, Zagreb, p.164.

6. Earthjustice, "Issue paper: human rights and the environment: materials for the 60th session of the United Nations commission on human rights, Geneva, 15 March-23 April 2004 (Environmental rights report 2004), p. 1-5. Retrieved 13.03.2015 from <http://www.ohchr.org/EN/HRBodies/CHR/60/Pages/Session60.aspx>
7. European Convention for the Protection of Human Rights and Fundamental Freedoms Nov. 4, 1950, 213 U.N.T.S. 222. Retrieved 15.06.2016. from <http://www.echr.coe.int/pages/home.aspx?p=basictexts>
8. International Covenant on Civil and Political rights(1976), (ICCPR) U.N.T.S. No. 14668, vol 999 p. 171. Retrieved 15.06.2016 from <http://www.cirp.org/library/ethics/UN-covenant/>
9. Kačer, H. (1996) „Ekološka tužba – članak 156. Zakona o obveznim odnosima“, Godišnjak 3, Aktualnosti hrvatskog zakonodavstva i pravne prakse, XI. tradicionalno savjetovanje – Opatija, p. 285.
10. Kolednjak, M.; Šantalab, M. (2013) Ljudska prava treće generacije, Tehnički glasnik no. 7, p. 324.
11. Kosor, M. (2012) Kyotski protokol s posebnim osvrtom na pregovore Republike Hrvatske o „baznoj“ godini, Pravnik, 46, 1 (92), p.2.
12. Manual on human rights and environment (2012), Council of Europe publishing, Strasbourg, p.11.
13. Nacionalna strategija zaštite okoliša, Narodne novine, no. 46/02
14. Nacionalni plan djelovanja na okoliš, Narodne novine, no. 46/02
15. Praduroux, S. (2008) The European Convention on Human Rights and Environmental Nuisances, European Review of Private Law 2, Kluwer Law International BV, p. 269 – 281.
16. Sands, P.; Peel, J. (2012) Principles of International environmental law, Cambridge University Press, p.779.
17. Shelton, D. (2008) Regional protection of human rights, Oxford University Press, p.1112
18. Swan, L; Gordon, R; Seckbach, J. (2012) Origin(s) of design in nature, Springer, p. 453.
19. Šago, D. (2013) Ekološka tužba kao instrument građanskopravne zaštite okoliša, Zbornik radova Pravnog fakulteta u Splitu, Vol, 50, No.4, p. 904.
20. Universal Declaration on human rights, by the United Nations General Assembly in Paris on 10 December 1948 General Assembly resolution 217(III). Retrieved 15.03.2016 from <http://www.un.org/en/universal-declaration-human-rights/>
21. UN conference on environment and development. Retrieved 15.06.2016 from <http://www.un.org/geninfo/bp/enviro.html>
22. Ustav Republike Hrvatske, Narodne novine no. 56/90, 135/97, 8/98, 113/00, 124/00, 28/01, 41/01,55/01, 76/10, 85/10, 05/14.
23. Wilde, M. (2002) Civil liability for Enviromental damage:a comparative analysis of Law and Policy in Europe and United States, Kluwer Law international, p. 174.
24. Zander v. Sweden, Application no. 14282/88, Retrieved 15.06.2016 from <http://www.waterlex.org/waterlex-legal-database/index.php?r=legalDocument/customView&id=288>
25. Zimmermann v. Switzerland, Application no. 8737/79, Retrieved 15.06.2016 from <http://www.servat.unibe.ch/dfr/em873779.html>
26. Zakon o obveznim odnosima , Narodne novine no. 35/05, 41/08, 125/11, 78/15.
27. Zakon o zaštiti okoliša, Narodne novine no. 80/13, 153/13, 78/15.
28. Zakon o vlasništvu i drugim stvarnim pravima, Narodne novine, no. 91/96, 68/98, 137/99, 22/00,73/00, 129/00, 114/01, 79/06, 141/06, 146/08, 38/09, 153/09, 143/12, 152/14.

EU GLOBAL STRATEGY ON FOREIGN AND SECURITY POLICY AND THE ROLE OF HIGH REPRESENTATIVE OF THE UNION FOR FOREIGN AFFAIRS AND SECURITY

Dunja Duic

Faculty of Law

Josip Juraj Strossmayer University of Osijek, Croatia

dduic@pravos.hr

ABSTRACT

The European Security Strategy (ESS) was adopted by the European Council in 2003. It provides the conceptual framework for the Common Foreign and Security Policy (CFSP). Now, more than a decade after the adoption thereof, the world has changed dramatically.

The European Council therefore decided to assess the challenges that come with these global challenges. In June 2015 the High Representative was asked to prepare a new EU Global Strategy on Foreign and Security Policy (EUGS) that would be presented to the European Council by June 2016. Prior to analysing the opportunities that the new Global Strategy presents it is important that the paper determine the competences of and control mechanisms for the post that is in charge of strategic planning: the post of the High Representative (the HR).

The Treaty of Lisbon brought substantial changes to the post of the High Representative for Common Foreign and Security Policy that was created under the Treaty of Amsterdam. The High Representative was empowered with a number of new competences. Today, the High Representative is: Vice-President of the European Commission; President of the Foreign Affairs Council; Head of the European Defence Agency; Head of the European External Action Service; responsible for the European Union Special Representatives and participant in the meetings of the European Council when foreign affairs issues are discussed.

The HR is appointed by the European Council and given a managing role within two other important EU institutions. Although the European Council can end the HR term of office acting by a qualified majority, the EU legislation does not define the legal requirements that can lead to this situation. Moreover, the Treaty does not provide for legal mechanisms that control the work of the High Representative.

This leads to the question of who or what can control the person creating the Global Strategy of EU foreign policy. This paper shall analyse the current legal regulation of the post of HR and propose possible solutions for the post of HR that can benefit EU legal order and EU as a global actor.

Keywords: *EU global strategy, EU foreign policy, EU institutions, High Representative.*

1. INTRODUCTION

Everything is about timing. The long-awaited EU Global Strategy on Foreign and Security Policy (EUGS) was presented on 28 June 2016 by the High Representative to the EU leaders at the European Council. Unfortunately, after the British referendum on 23 June, the Strategy, although accepted by the EU leaders, was unjustifiably sidelined. Nonetheless, the Strategy is a 60-page detailed document that brings a revision of the previous outdated European Security Strategy (ESS) that was adopted by the European Council in 2003 and thus far it provided the conceptual framework for the Common Foreign and Security Policy (CFSP). The first chapter of this paper shall emphasize the strengths and weaknesses of the new Strategy. The simple fact that such an important document as is the EU Global Strategy on Foreign and Security Policy (EUGS) is prepared and presented by the High Representative triggers the question of legal regulation of the post of the High Representative. With that in mind, the second chapter of this

paper shall analyse the post of the High Representative. The High Representative is a person appointed by the European Council and is given a managing role within two other important EU institutions (European Commission and Council). Although the European Council can end the HR term of office acting by a qualified majority, the EU legislation does not define the legal requirements that can lead to this situation. Moreover, the Treaty does not provide for legal mechanisms that control the work of the High Representative. The question is who or what can control the person creating the Global Strategy of EU foreign policy? This paper shall analyse the current legal regulation of the post of HR and propose possible solutions for the post of HR that can benefit EU legal order and EU as a global actor.

2. EU GLOBAL STRATEGY ON FOREIGN AND SECURITY POLICY

2.1. The European Security Strategy

The European Security Strategy was based on the assumption that the best protection for our security is a world of well-governed democratic states. Thirteen years later there is evidence that spreading democracy proved more difficult than expected and that the ESS should be characterised as overoptimistic. One should bear in mind that the world and EU have changed dramatically since Javier Solana (former High Representative (HR) for the Union Common Foreign and Security Policy) presented the first report ‘on the Security Strategy of the EU or European Security Strategy titled ‘A secure Europe in a better world’ (ESS) that was adopted by the European Council in Bruxelles on 12 December 2003. The ESS contains a general introduction, an analysis of the new security environment, its broad challenges and specific threats, an articulation of common objectives for the EU to pursue, and a set of general recommendations on how to address the former and achieve the latter. (Missiroli, 2015, pp. 14-39). The importance of the Strategy must be viewed through the prism of political context: at the time the world was just facing modern terrorism after 9/11 and the Iraq war just at its beginning. Many still believed that the world can be influenced and changed by means of soft power instruments and that shared democratic ideas and supranational institution would be accepted in the global society (Toje, 2010, pp. 172, Biscop, 2009, pp. 367-384). With this document, the EU wanted to lay the foundation for a viable, active and influential collective presence (Berenskoetter, 2005, pp. 71-92; Bailes, 2005; Toje, 2005, pp. 117-133).

In 2007, 27 EU Member States invited HR Solana to undertake the first review of the ‘implementation’ of the 2003 ESS. The Report on the implementation of the European Security Strategy was adopted in December 2008, on the verge of the financial crisis. The 2008 Report provides a more comprehensive analysis of the security and more specific policy recommendations than the 2003 ESS. Nonetheless, it lacked political context and adequate commitment of all Member States (Missiroli, 2015, pp. 39-43; Toje, 2010, pp. 171–190).

What followed were the Lisbon changes that increased (at least on paper) the importance of the post of the High Representative and endorsed external actions of the Union in general. However, the first post-Lisbon High Representative (Catherine Margaret Ashton) did not introduce a new post-Lisbon Security Strategy. It is Federica Mogherini, the second post-Lisbon High Representative who will introduce the new 2016 Security Strategy.

2.2. EU Global strategy on foreign and security policy

In June 2015, after she was mandated to prepare the EUGS, Federica Mogherini identified priorities (which were then transformed into 5 main chapters of the new Strategy) that are equally essential to the MSs and the EU: the security of the EU; the neighbourhood (State and Societal Resilience to our East and South); how to deal with war and crisis (An Integrated Approach to Conflicts and Crises); stable regional orders across the globe (Cooperative

Regional Orders); and effective global governance (Cooperative Regional Orders) (Biscop, 2016). The EUGS was then titled: *Shared Vision, Common Action: A Stronger Europe*.

The EUGS introduces a new approach to foreign and security policy, which is a correction of the 2003 European Security Strategy (ESS) and is generally more realistic and modest (compared with the ESS unreached high expectation). The EUGS takes a pragmatic approach to the modern challenges of the global world while taking into account the new geopolitical situation. The Strategy shifts the focus from the unachieved goal of influencing to the promotion of democracy. As Sven Biscop wisely suggest: The EUGS' lowering of the level of ambition in terms of democratization is but the acceptance of reality. This is all about being honest with ourselves. The EU cannot democratize Egypt, so it should not pretend to (Biscop, 2016). Furthermore, the Strategy should be read as the end of the old European Neighbourhood Policy, which was based on the automatic assumption that the governments of ENP countries really wanted change (EUGS, 2016, pp. 23- 28).

The Strategy calls upon the EU's own military autonomy by going beyond NATO: "As Europeans we must take greater responsibility for our security. We must be ready and able to deter, respond to, and protect ourselves against external threats. While NATO exists to defend its members – most of which are European – from external attack, Europeans must be better equipped, trained and organised to contribute decisively to such collective efforts, as well as to act autonomously if and when necessary" (EUGS, 2016, pp. 19). This can be read as the ground for Member States to act with or without the US.

Furthermore, the Strategy calls upon a more operational European Security and Defence Policy. There is a general call in the Strategy for full compliance with international law: "European security and defence must become better equipped to build peace, guarantee security and protect human lives, notably civilians. The EU must be able to respond rapidly, responsibly and decisively to crises, especially to help fight terrorism" (EUGS, 2016, pp. 30). The Strategy also gives concrete suggestions concerning military issues, one being the annual coordinated review process at EU level to discuss Member States' military spending plans (a European semester on defence of sorts.) The EUGS does not call upon launching an EU army, it simply calls for a more rapid capability to deploy EU troops on the ground (Barigazzi, 28/06/16). Lastly we should also bear in mind that the UK leaving the Union (due to the outcome of the Brexit referendum) opened the door to pursuing a goal that UK would never accept: expanding the European Union's integration to include military policy.

In the regional chapter, the Strategy emphasises the aspect of all regional policies and the relation with Russia should be read as most interesting. The Strategy's approach to Russia is a pragmatic one, stressing that managing the relationship with Russia represents a key strategic challenge and that a consistent and united approach must remain the cornerstone of EU policy towards Russia (Techau, 1/07/16). The Strategy calls upon substantial changes in EU and Russia relations that are premised upon full respect for international law and the principles underpinning the European security order, including the Helsinki Final Act and the Paris Charter. Although it indicates the continuance of sanctions, this approach is more or less an open window for a shift in the relationship.

The EUGS was introduced in an environment that was completely different politically than that of the 2003 ESS and it should be viewed through that prism: the EU is still recovering from the financial crisis and going through the migration crisis. There is also great division among Member States (just three days before the presentation of EUGS, the people of the UK decided to leave the Union), terrorism has become a reality in the EU (whereas in 2003 it was perceived as something that could never happen in Europe). Lastly, the Lisbon changes that were introduced in the field of the EU external relations are still a far cry from a genuine and comprehensive implementation.

The Strategy emphasis: the security of the Union, the neighbourhood, and a new approach to conflict and crises. It must be noted that the EUGS contains a large number of concrete proposals regarding policy planning that are not just good intentions, but defined precisely enough to point toward action. The idea of the Strategy is to become a toll that encourages different actors to work together in order to achieve the EU external actions aims and finally act in accordance with the Lisbon Treaty regulation in this field (Missiroli, 2015, pp. 117) . On the first Foreign Affairs Council, following the adoption of EUGS, that took place on 18 July 2016, the EU foreign ministers had a discussion on the operational follow-up. Ministers welcomed the document and expressed their readiness to continue the work in the implementation phase and the High Representative underlined her intent to present in the autumn a framework with processes and timelines. She stressed, that this framework will detailed the work to come to operationalise the vision set out in the strategy, on strands such as security and defence, but also policy coherence and civilian policies including sustainable development and migration, as well as the link between development and humanitarian aid. (FAC, 18/07/2016) Nevertheless, it is up to Member States (and not the High Representative) to implement it. This lands on the question of the legitimacy and the competences of the High Representative – the post tasked with authoring the document that is of great importance to the security of the Union.

3. THE ROLE OF HIGH REPRESENTATIVE OF THE UNION FOR FOREIGN AFFAIRS AND SECURITY

3.1. Historical framework

The post of the High Representative for Common Foreign and Security Policy was created under the Amsterdam Treaty. Article J 8(3) and J 16 of the Amsterdam Treaty stipulate that the Presidency shall be assisted by the Secretary-General of the Council who shall exercise the function of High Representative (HR) for the Common Foreign and Security Policy (CFSP) and that the HR shall assist the Council in matters falling under the scope of the CFSP, in particular through contributing to the formulation, preparation and implementation of policy decisions, and, when appropriate and acting on behalf of the Council at the request of the Presidency, through conducting political dialogue with third parties.

It was Javier Solana who was appointed to the post of the High Representative in 1999 (Müller-Brandeck, 2011). As it often is the case with political functions, the personality of an individual plays a role in the development of the function he or she holds. Owing to his hard work and a network of international relations, the EU foreign policy managed to leave a mark on the international scene for the first time (and to this day the only time). However, this institutional solution, i.e. such legal framework for the conduct of the HR has shown that despite the excellent positioning of Javier Solana on the foreign policy scene there are still certain shortcomings. The lack of coherence and continuity in foreign policy actions surfaced first. Furthermore, even though Solana had good relations with the Commissioners for External Relations, the coexistence of the two political roles and the communication of their bureaucracy was difficult and made the foreign political action ineffective (Gauttier, 2004, pp. 34; Spence, 2006, pp. 370; Cardwell, 2012, pp. 162-166). In spite of Solana's strong personality, the task of the HR to be the Secretary-General of the Council as prescribed by the Treaty (which is really an administrative function) certainly weakened his influence in regard to the political functions of the Commissioner for External Relations and the Presidency.

Pursuant to the above, it comes as no surprise that the changes related to the HR were one of the main topics upon subsequent Treaty amendments. There were a number of ideas on the amendments relating to the High Representative, but they all indicated that the role of the HR

should be separated from the administrative role of the Secretary-General of the Council (The European Convention Final report of Working Group VII, 2002). It was ultimately the proposal to create the function of a "Minister of EU Foreign Affairs" that would consolidate the functions of the High Representative and the Commissioner for External Relations that was accepted. Thus, the High Representative would again have a "dual function". This solution (save for the title "Minister of EU Foreign Affairs") was adopted by the Lisbon Treaty and is still in force. In contrast to the previous administrative and political role, in this case the administrative work was removed from the domain of work of the HR. Nevertheless, the duality of this position will be the subject of the analysis below.

3.2. Current Treaty regulation regarding HR

As mentioned previously, the Treaty of Lisbon brought substantial changes to the post of the High Representative. The post was given the title High Representative of the Union for Foreign Affairs and Security Policy and it came with the role of conducting the foreign policy of the European Union. Article 18 (1) TEU regulates the appointment of the HR prescribing that The European Council, acting by a qualified majority, with the agreement of the President of the Commission, shall appoint the High Representative of the Union for Foreign Affairs and Security Policy. The European Council may end his term of office by the same procedure.

Following the entering into force of the Lisbon Treaty, the post of HR was held for two mandates by Catherine Margaret Ashton (from 2009 til 2014). Federica Mogherini replaced Ashton in November 2014.

In order to understand the reasons for the appointment of Catherine Ashton as the High Representative it is necessary to explain the political background of the High Representative and President of the European Council elections. On 19 November 2009, the European Council appointed Herman Van Rompuy as President of the European Council and Catherine Ashton as the new High Representative. (At the time of his first appointment, Van Rompuy was Prime Minister of Belgium.) Catherine Margaret Ashton is a baroness and a British Labour politician. Prior to commencing her current service, Ashton was Trade Commissioner. Both appointments sparked criticism, but more of the criticism was directed towards the appointment of Catherine Ashton. The appointment of Herman van Rompuy was justified by his multilingualism, political experience as well as by his ability to defuse tensions on the Belgian political scene. However, the criticism was sparked by the fact that Van Rompuy is from a country that is considered as a small MS as well as from the lack of experience on the foreign policy scene. Also, former British Prime Minister Tony Blair was also a candidate in the election for the President of the European Council and he was predicted better success than Herman van Rompuy. This is precisely why it is said that Ashton was a consolation prize of sorts to the British and Blair's political group in the European Parliament (Barber, 2009, pp. 56). We can say that the overall situation around the first election for these two important functions was marked by political compromises, which in turn ultimately affected the two functions. It should be noted that the President of the European Council and the High Representative are appointed behind closed doors between the 28 (then 27) of heads of state. The Treaty does not stipulate the necessary and detailed qualifications for the High Representative. Although the European Council can appoint him or her, it can also end the HR term of office acting by a qualified majority, but the EU legislation does not define legal requirements that can lead to the latter situation. It follows that one way that would help make the selection transparent, would be the option that involves a sort of "job interview" of the candidates for the position in front of the members of the European Council. However, the High Representative needs to be confirmed by the European Parliament as a member of the Commission. This might not be a big step in the reducing of the democratic deficit in the Union, but it is certainly more democratic than the selection of the President of the European Council (Barber, 2009, pp.56-67; Howorth, 2011, pp. 303-323).

The Lisbon Treaty introduces the main regulation pertaining to the High Representative in two articles: Article 18 TEU and Article 27 TEU. Functions of the HR can be listed as follows: conducts the foreign policy of the European Union (Article 18 TEU); represents the Union for matters relating to the common foreign and security policy (Article 27 TEU); conducts political dialogue with third parties on the Union's behalf and expresses the Union's position in international organisations and at international conferences (Article 27 TEU); is participant in the meetings of the European Council when foreign affairs issues are discussed (Article 15(2) TEU)). She is Vice-President of the European Commission (Article 27 TEU) and is responsible within the Commission for responsibilities incumbent on it in external relations and for coordinating other aspects of the Union's external action. Furthermore, she is President of the Foreign Affairs Council (Article 18 TEU); Head of the European External Action Service (Article 27 TEU) and Head of the European Defence Agency (Article 45 (2) TEU. In fulfilling his mandate, the High Representative is assisted by a European External Action Service (Article 27 (3) TEU).

We shall focus on the provisions of Article 18 TEU which clearly indicates that the role of the High Representative should represent a bridge that connects the Council and the Commission and strengthens inter-agency cooperation. A large number of authors explore the dual role of the High Representative who – pursuant to Article 18 TEU – is Vice President of the Commission who chairs the Foreign Affairs Council (Marangoni, 2012; Missiroli, 2010, pp. 427-452; Blanke, Mangiameli, 2013). We shall analyse the relation of the High Representative with the two institutions below. The analysis should provide the answer to the question of whether the HR brings together or separates the two institutions.

Article 18 TEU prescribes that the HR chairs the Foreign Affairs Council and conducts the foreign policy of the European Union and contributes by his proposals to the development of that policy, which he or she carries out as mandated by the Council. Article 27(1) TEU adds that along with the above the HR is tasked with ensuring implementation of the decisions adopted by the European Council and the Council. The provisions of the two articles are confirmed by those of Article 24(1) TEU that prescribes that the High Representative (and Member States) shall put into effect the Common Foreign and Security Policy (CFSP). If we observe the scale of relations in the area of the CFSP, the High Representative ranks lower than the European Council and the Council who are authorized to bring decisions that the High Representative and MSs are obligated to implement. However, at this point it is necessary to refer to Article 15(6) that governs the relation between the HR and President of the European Council.

Article 15(6) prescribes that the President of the European Council shall, at his level and in that capacity, ensure the external representation of the Union on issues concerning its common foreign and security policy, without prejudice to the powers of the High Representative of the Union for Foreign Affairs and Security Policy. Such wording surely speaks in favour of the High Representative, but instead of bringing harmony among foreign relations actors, it paves the way for further tension. Above giving the President of the European Council the power to represent the Union, in its Article 27(2) the Lisbon Treaty gives the same powers to the High Representative. On top of the power to represent, the HR has the power to conduct political dialogue with third parties on the Union's behalf and express the Union's position in international organisations and at international conferences. However, the fact that the European Council appoints the High Representative and extends his or her mandate indicates that the HR depends on the European Council finding him or her suitable. At this moment, following the expiration of the term of office of Van Rompuy and Ashton and the appointment of Tusk and Mogherini, the circumstances have become more clear and they indicate that the President of the European Council has established himself more as the face of EU foreign policy, whereas the HR has positioned herself as more of an operative who is not the face of

EU foreign policy but rather carries out her work "on the field" (visits regions that are experiencing difficulties, conducts peace talks etc.). This state of affairs is contrary to the Treaty; it follows that the High Representative conducts herself in a way that does not prejudice the powers of the President of the European Council. In terms of high political functions such as these two, positioning depends primarily on the person's character. Such overlapping of powers should be mended in subsequent amendments to the Treaty. With that in mind, the President of the European Council should keep the power of external representation of the Union, whereas the High Representative should expand his or her influence with a view to strengthening the position of the Union in the field (conducting of political dialogue, the presence of the Union in crisis situations etc.).

In its Article 18(4) TEU, the Lisbon Treaty stipulates that the High Representative is one of the Vice-Presidents of the Commission. As important as this provision is for the strengthening of coherence, it is also one of the causes of interinstitutional tension. It should be noted that the President of the Commission selects his own Commission apart from one Vice President who is appointed by the Council of the EU. This regulation thereby strengthens the influence of the Council of the EU, but weakens the influence of the President of the European Commission, thereby leading to possible (i.e. existing) tension between the Commission and the High Representative. Also, the new function of the High Representative as a "special" commissioner undermines the cohesion among the commissioners who were equal among each other and in rank up to the Lisbon Treaty. Additionally, it is clear that the High Representative reports to the European Council whereas all other commissioners report to the President of the European Commission (Gaspers, 2008, pp. 25).

For example, the practice in the work of Barroso's Commission has confirmed this tension: High Representative Ashton positioned herself more as the Head of the European External Action Service and as Chair of the Foreign Affairs Council. In the framework of work of the Commission, President Barroso made an effort to reduce her influence. Again, there is a conflict between two characters that are extremely important in terms of political functions. The conclusion should therefore be that the appointment of the High Representative as a member of the Commission has not contributed to the strengthening of interinstitutional cooperation in the area of external actions. This is mainly because of the fact that provisions of the Lisbon Treaty do not provide that the Commission have the power of external representation of the Union in the area of CFSP (whereas it has powers in all other areas of external action) (Article 17(1) TEU). Although the current relationship between Jean-Claude Juncker and Federica Mogherini is much better, it has stayed on the foundations set by the Barroso Commission. It can be said that the High Representative as Vice-President of the Commission does not represent the Union in CFSP issues when acting as Vice-President of the Commission, yet Article 27(2) TEU prescribes that one of the roles of the HR is to represent the Union for matters relating to the CFSP. This means that the Lisbon Treaty reduced the powers of the Commission related to the CFSP, strengthened the powers of the High Representative and created legal ambiguity in terms of the function of the High Representative in which he or she should act. All of the above indicates that the High Representative should either be relieved of the duties relating to representing the Union for matters relating to the CFSP in one of the next Treaty amendments and simply give the said power to the President of the European Council or remove the HR from the Commission. Such regulation would surely contribute to the strengthening of the interinstitutional cooperation between the said institutions for the simple reason that it does not bring their powers into direct conflict.

Finally, there is also the question that was asked the beginning of this paper: who or what can control the person that creating the Global Strategy of EU foreign policy?

The only answer can be found in Article 36 that prescribes the control of the work of the HR: the High Representative of the Union for Foreign Affairs and Security Policy shall regularly

consult the European Parliament on the main aspects and the basic choices of the common foreign and security policy and the common security and defence policy and inform it of how those policies evolve. He shall ensure that the views of the European Parliament are duly taken into consideration. Special representatives may be involved in briefing the European Parliament.

The same Article stipulates that the HR shall regularly consult the EP, yet does not define what this "regular" consulting involves. The Rules of Procedure of the European Parliament prescribed that the HR would be invited at least four times a year to participate in the work of the Committee on Foreign Affairs to give a statement and answer questions (Blanke, Mangiameli, 2013, pp. 1122). However, Rule No. 94 has been deleted from the current Rules of Procedure of the EP. Rule No. 96 provides that the HR shall be invited to every plenary debate that involves either foreign policy, where he or she may be asked questions.

We can say that the cooperation between the EP and the High Representative has been strengthened, as a deduction the EP continues to only have the power to control and collect information and the main power in terms of CFSP-related budget. The influence of the EP has certainly been strengthened by the Lisbon Treaty, but it remains sidelined. Nonetheless, the Lisbon amendments certainly lead to the strengthening of interinstitutional cooperation between the European Parliament and the High Representative (Duić, 2014, pp. 131).

4. CONCLUSION

The new EU Security Strategy of June 2016 is a document prepared by the High Representative. This is the second document of that kind: the first one was adopted in 2003. What is evident is that the Strategy, both the one from 2003 and 2016, takes into account the political context. It follows that in the new Strategy the vision has changed from limiting the EU to being a soft power in the mission to spread democracy. The EUGS put the EU on the path to metamorphosis into hard(er) power and the emphasis on the security of the Union, the neighbourhood, and a new approach to conflict and crises. Moreover, the EUGS contains concrete proposals regarding policy planning that are defined precisely enough to point toward action. The overall new Strategy is left to Member States to decide on its implementation, but it is undeniable that this is a document of great importance. This document is drafted by the High Representative, and it was the starting point for questions and answers relating to the competences of this post.

To sum up, the High Representative chairs the Foreign Affairs Council, but has legitimation that is different than that of other members of the Council who are foreign affairs ministers in respective MSs. He is a member of the Commission but his legitimation differs from that of other members of the Commission. The main role of the HR is to implement the CFSP, which requires cooperation with MSs and simultaneously making sure that coherence is ensured. Also, the HR must cooperate with the President of the European Council and the President of the Commission primarily in terms of external representation of the Union and thereby take into account the safety of coherence and avoidance of conflict in the international representation of the Union. In order for the High Representative to succeed in carrying out the duties he was given under the Treaty, he or she must have the trust of the two institutions he is the specific member of. He is not equal to other members, which in itself hinders cooperation. However, no single mechanism ensures his specific status. The High Representative depends on the mandate given by the European Council, meaning that he depends directly on the European Council finding him or her suitable. There is no mechanism of protection or control of decisions brought by the European Council in the selection of the High Representative. This leads to the conclusion that transparent criteria for the control or dismissal of the HR have not yet been prescribed. The only forms of control that the HR is subject to include regularly consulting the European Parliament on the main aspects and the basic choices of the common foreign and security policy and the common security and defence policy and informing it of how those

policies evolve. As a member of the Commission, pursuant to Article 17(8) TEU, the High Representative of the Union for Foreign Affairs and Security Policy must resign from the duties that he carries out in the Commission if the the European Parliament votes on a motion of censure of the Commission. In the individual cases, all members of the Commission except the HR must resign if the President so requests. In contrast to this, the High Representative of the Union for Foreign Affairs and Security Policy must resign in accordance with Article 18(1) TEU i.e. if the European Council acting by a qualified majority ends the term of the High Representative of the Union for Foreign Affairs and Security Policy if the President of the Commission so requests. We can say that the said form of consultation with the European Parliament – albeit helpful in reducing the democratic deficit – is not a strong enough mechanism for the control of an important political function. The tendency should thus be the amending of the Treaty so as to regulate in detail the process of appointment and dismissal of the HR and introduce a form of control over the work that would involve the HR reporting on the work to the European Council that in turn appoints him. If there was a mechanism for the control of the method for selecting the High Representative and if the President of the Commission had greater powers in addition to giving consent for the election of the High Representative, the interinstitutional cooperation would work better. The High Representative was promoted from administrative staff to the President of the Foreign Affairs Council, which strengthens its position and removes unnecessary administrative obligations. However, the Lisbon Treaty puts the High Representative in a dependent position in relation to the European Council that in turn is not subject to any control whatsoever in the process of nomination and election of the High Representative. One of the proposed amendments should therefore be adopted. Option A (this option may be explained by the fact that the HR has not positioned herself as a member of the Commission nor has there been success in the linking of the Commission and the Council in this way): the HR should be dismissed from the post of the Vice-President of the Commission and her role as President of the Foreign Affairs and Head of the European External Action Service should be strengthened. Option B (this option may be explained by the fact that it is necessary that the Commission be unique in its work and that all commissioners be equal): if the HR remained a member of the Commission, the President of the Commission should have a greater role in the selection of the High Representative: the right to nominate candidates for the function. For example, three candidates who would meet the set requirements out of which the European Council would choose the High Representative and the right to veto the choice made by the European Council. In adopting any of the two options, the President of the European Council should retain the the power of external representation of the Union, and the High Representative should expand its influence in the form of strengthening the position of the Union in the field (of political dialogue, the presence of the Union in crisis situations etc.).

If the proposed changes were taken into account, the High Representative would have greater legitimacy and a stronger position, which would in turn contribute to the strengthening of the importance and legitimacy of the EUGS and all future security strategies.

LITERATURE:

1. Bailes, A.J.K. (2005). *The European Security Strategy: An Evolutionary History* (Policy Paper No. 10). Stockholm: Stockholm International Peace Research Institute (SIPRI).
2. Barber, T. (2009). The appointments of Herman Van Rompuy and Catherine Ashton. 48 *Journal of Common Market Studies*, Issue 1, pp. 55-67
3. Blanke, H.J.; Mangiameli, S. *The Treaty on European Union (TEU) commentary*. Heidelberg: Springer.

4. Barigazzi, J. (6/28/16). EU global strategy: 'We must be ready to go beyond NATO'. *Politico*. Retrieved (6/28/16). From: <http://www.politico.eu/article/eu-global-strategy-we-must-be-ready-to-go-beyond-nato-foreign-policy-security-policy/>
5. Berenskoetter, F. S. (2005). Mapping the Mind Gap: A Comparison of US and European Security Strategies. 36 *Security Dialogue*. Issue 1. pp. 71-92.
6. Biscop, S. (2009). Odd Couple or Dynamic Duo? The EU and Strategy in Times of Crisis. 14 *European Foreign Affairs Review*, Issue 3, pp. 367–384
7. Biscop, S. (2016). *The EU Global Strategy: Realpolitik with European Characteristics*. Retrieved, Security Policy Brief No. 75. 01.07.2016. from <http://www.egmontinstitute.be/wp-content/uploads/2016/06/SPB75.pdf>
8. Cardwell, P.J. (2012). *EU external relations law and policy in the post-Lisbon era*. The Hague : T.M.C. Asser Press
9. Duić, D. (2014). Pravni aspekti Zajedničke vanjske i sigurnosne politike EU s posebnim osvrtom na problem koherentnosti (doctoral dissertations). Zagreb: [D. Duić].
10. Outcome of the Foreign Affairs Council meeting 11355/16, 18/06/16, Retrived 19/06/16 from : <http://www.consilium.europa.eu/en/meetings/fac/2016/07/18/>
11. The European Convention Final report of Working Group VII on External Action (2002), CONV 459/02, Retrieved 02/07/16 from: <http://www.europarl.europa.eu/meetdocs/committees/deve/20030218/489393EN.pdf>
12. Global Strategy for the European Union's Foreign and Security Policy. (2016). *Shared Vision, Common Action: A Stronger Europe*
13. Gaspers, J. The quest for European foreign policy consistency and the Treaty of Lisbon, 2 *Humanitas Journal of European Studies*. No: 1, pp. 19-53.
14. Gauttier, pp. (2004). Horizontal Coherence and the External Competences of the European Union. 10 *European Law Journal*. Issue 1. Pp. 23-41.
15. Howorth, J. (2011). The 'New Faces' of Lisbon: Assessing the Performance of Catherine Ashton and Herman van Rompuy on the Global Stage. 16 *European Foreign Affairs Review*; Issue 3. pp. 303-323.
16. Marangoni, A.C. (2012). One Hat Too May for the High Representative-Vice President? The Coherence of Eu's External Policies after Lisbon. *EU External Affairs Review*, pp. 4-17.
17. Missiroli, A. (2010). The New EU 'Foreign Policy' System after Lisbon: A Work in Progress. 15 *European Foreign Affairs Review*. Issue 4. pp. 427-452.
18. Missiroli, A. (2015), *Towards an EU global strategy – Background, process, references* ; Paris : EU Institute for Security Studies (EU ISS)
19. Müller-Brandeck, G. (2011). *The High Representative for the EU Foreign and Security Policy : review and prospects*. Baden-Baden : Nomos.
20. Spence, D. (2006). The Commission and the Common Foreign and Security Policy. In Spence, David ; Edwards, Geoffrey : *The European Commission* (3rd editon) (p. 370). London : John Harper Publishing
21. Techau, J. (01/07/16). The EU's New Global Strategy: Useful or Pointless?. *Carnegie Europe*. Retrieved (01/07/16). from <http://carnegieeurope.eu/strategieurope/?fa=63994>
22. Toje, A. (2005). The 2003 European Union Security Strategy: A Critical Appraisal. 10 *European Foreign Affairs Review*, Issue 1, pp. 117–133.
23. Toje, A. (2010). The EU Security Strategy Revised: Europe Hedging Its Bets. 15 *European Foreign Affairs Review*, Issue 2, pp. 171–190

EFFECTIVE STRATEGIES FOR DETECTING FRAUDULENT CLAIMS IN MOTOR THIRD PARTY LIABILITY INSURANCE

Zeljka Primorac

Faculty of Law University of Split, Croatia
zeljka.primorac@pravst.hr

ABSTRACT

Preventing, detecting and combating insurance fraud are major insurance problems. The author considers current framework combating insurance fraud. Noting on direct effect which insurance fraud have on collaps of the insurance system, the author analyzes financial losses that insurance fraud creates to the insurance industry (affecting on financial and market position of the insurance company) and the economy. The negative effects of insurance fraud are affecting the consumers – the most important factors of economic system since the financial losses developed as a result of insurance fraud carry honest policyholders by paying increased amount of insurance premiums. Pointing to the protection of the consumers economic interests as a fundamental European principles and application of the principle of good faith during the establishment and realization of the insurance relation rights, the author analyzes the legal effects of presenting fraudulent claims in Motor Third Party Liability (MTPL) insurance. In this work it was carried a comparison of the Fraud indicators or Red Flags as a warning signs and fraud alerts of a suspicious insurance claims in USA and Europe. Presenting European origins compulsory MTPL insurance it was pointed to the significance of active and systematic fights against insurance fraud by signing the „Protocol on cooperation to combat insurance fraud“ from 2011 and integration of the Fraud Risk Assessment Form (FRAF) in the claim handling to identify potential fraudulent cases i.e. prove fraudulent insurance claims. Special attention is given in relation to fraudulent activity committed by policyholders - presenting fraudulent insurance claims and identifying irregular activity related to claimant according to FRAF.

Keywords: FRAF, MTPL insurance, Red Flags.

1. INTRODUCTION

Insurance industry is the world's largest business sector and part of the development strategy of the global financial market. According to Insurance Europe official figures in 2015 (European Insurance – Key Facts, 2015, p.9) European insurance industry was the largest in the world (35%), followed by North America (29%) and Asia (28%). Insurance industry is affecting on the financial markets development and is closely related to the countries economic developments. European insurers generate premium income almost €1 100bn investing around €7 700bn in the economy. In turbulent economic times, the stability of the insurance sector has been questioned by the growth of the insurance fraud. Although insurance fraud is part of operational business risk of the insurance companies and harms the entire insurance industry, insurance fraud as a worldwide phenomenon harms state budget and economy of each state. The costs of the fraud to the economy are difficult to gauge, but one fact is clear, fraud amounts to at least £16 billion in the public sector (Button; Johnston; Frimpong and Smith, 2007, p.193). Insurance fraud as an economic response to insurers' „promise“ to pay a claim (Research brief:

General insurance claims fraud, 2009, p.13) represents *serious problems because the level of this phenomenon is between 10% - 20% of the premium income on the particular markets*. In 2013 insurance motor premium are estimated to €123.5bn (€130.8bn in 2014) from which 67% are in 5 largest markets: Germany, France, Italy, the UK and Spain (European Motor Insurance Markets, 2015, p.13-16). Drastic rise of insurance fraud increased insurers financial losses in the period 2010-2012 by 30% (Zitouni and Kallay, 2014, p. 27).

Insurance fraud has direct effect on collapse of the insurance system since the annual financial losses of insurance companies (including those resulting from insurance fraud) carry out the honest policyholders – consumers by paying higher premium. Therefore, the victims of insurance fraud are all honest policyholders – consumers of insurance services. It is difficult to estimate the costs of insurance fraud but it is widely believed that insurance fraud increase the cost of insurance (Viaene; Ayuso; Guillen; Van Gheel and Dedenne, 2007, p.566) costing insurance consumers 2.3 billion USD annually (Mendoza, 2012, p.192) or increased premiums between 400 and 700 USD per year for U.S family (Insurance Fraud, 2016, p.1). In Germany cost of fraud exceeds €4 billion per year and in UK every policyholder pays extra £50 to the premium as consequence of insurer's frauds (Žižmond, 2015, p.2). Due to increasingly sophisticated fraud and protect honest policyholders interests, insurance industry is necessary to require more intensive fight against insurance fraud and effective fraud prevention. Technological advances have made fraud easier to detect (Templeman, 2008, p.217) so insurers in 2011 invest £200 million plus per year in their anti-fraud staff and systems.

2. INSURANCE CONTRACT AND FRAUDULENT INSURANCE CLAIMS

Basic legal character of the insurance contract is also its fundamental principle – the principle of good faith (*lat. bona fides*). Good faith is legal standard based on which from the contracting parties requires that when establish and realise the insurance contract rights guide each other with principle of good faith. It implies openness, honesty and reliability in the mutual relations of the parties at the time of conclusion of the contract and after, until his realisation (Andrijašević and Račić-Žlibar, 1997, p.232). The insurance contracts between insurer and the insured are contracts which are intended to provide insured protection from unwanted losses. Insurance contract isn't ordinary commercial agreement. It is a contract of adhesion because it is usually awarded on the basis of the insurance general conditions which are determined by the insurer in advance and are common to all members of the community (Vidaković Mukić, 2006, p.719). Insurance is *bona fide* agreement, a privat agreement under which an insurers agree to compensate its insured should certain of his or her assets be damaged or destroyed (Mendoza, 2012, p.191). Companies are well aware that claimants and providers may have opportunities and incentives to take advantage of accidents, even fabricate or cause them to happen, to obtain payments they might otherwise not deserve (Derrig, 2002, p.275).

Good faith in insurance contracts means that there must be abstain from fraud. Fraud has a fundamental impact upon the parties' relationship so the duty of utmost good faith continued beyond the making of the insurance contract and applied to the presentation of claims (Macdonald Eggers; Picken and Foss, 2010., p.40). If an insurance claim by the insured is settled, the compromise embodied in the settlement must be *bona fide* and honest (Clarke, 2009., p.881). Innocent misrepresentation or nondisclosure does not defeat a claim, for that there must be fraud (Clarke, 2009, p.882).

A fraudulent claim is one which includes a falsely made claim with the intention of securing an advantage from the insurer to the assured (Macdonald Eggers; Picken and Foss, 2010, p.63). There are 3 broad categories of claims fraud: 1) Fictitious Losses, Incidents or injuries; 2) Staged incidents; 3) Material misrepresentation or exaggeration of loss or personal injury (Dorsey, 2008, p.8). If an assured misrepresents a fact in the presentation or promotion of a claim against the insurer under an insurance policy, and knows that fact to be untrue or is dishonestly reckless in making the misrepresentation, there will be a fraudulent claim (Macdonald Eggers, 2008, p.237). During every week in 2010 british insurers detected more than 2000 fraudulent insurance claims worth more than £16 million (Whitepaper Insurance Fraud in the Digital Age, 2013, p.1). In 2011, in UK £983m of fraud was detected – money that

would otherwise have been lost to fraudsters, 7% higher than the value of fraud detected in 2010 and comprises 138,814 fraudulent insurance claim – 2,670 every week (No Hiding place, Insurance Fraud Exposed, 2012, p.3). In 2011 in France were 35 042 fraudulent insurance claims recorded (The impact of insurance fraud, 2013, p.9-10). In 2014, UK insurers uncovered 130,000 fraudulent claims (equivalent to 350 every day) worth £1.32 billion across all insurance products which represents 3% increase from 2013 (<https://www.abi.org.uk/News/News-releases/2015/07/You-could-no...>). The estimated number of fraudulent claims varies between countries and even regions: in 2013 the average percentage of fraudulent claims was estimated at 3.7% in Slovakia, 1.6% in the UK, in 2014 it was only 0.6% in Sweden and below 0.2% in the Netherlands and Norway while in Italy - the average national percentage of fraudulent claims was estimated at 14%, but with clear regional differences: in the south of the country it can be as high as 24% (European Motor Insurance Markets, 2015, p.54). Between 2009 and 2014 the overall value of frauds detected has risen by 57%.

Fraudulent claim represents a breach of contract, a breach of the duty of good faith and it would permit the insurer to avoid the policy and to escape liability for any claim made under the policy, whether sound or not (Macdonald Eggers; Picken and Foss, 2010, p.65). Most modern legislation provides that any fraud, regardless of whom originated, affect the validity of legal work if the party that has benefit from fraud – knew or should have known for it (Vidaković Mukić, 2006, p.902). If the assured makes a fraudulent insurance claim the insurer is not liable to pay the claim (Merkin and Gürses, 2015, p.1023). But, insurer has heavy burden of proving fraud (Bakes, 2008, p.55).

3. “RED FLAGS“ IN MOTOR THIRD PARTY LIABILITY INSURANCE

The common law recognises five types of fraud in the concept of insurance: 1) loss deliberately caused by the assured; 2) a deliberate or reckless claim where there is no loss or where the amount of the claim is exaggerated; 3) a claim which is honestly believed when initially presented, but the assured subsequently realises that it is exaggerated and continues to maintain it; 4) where a genuine loss has occurred, but the assured seeks to improve or embellish the facts surrounding the claim, by a lie, ie, the use of „fraudulent means and devices“; 5) deliberate suppression of a known defence (Merkin and Gürses, 2015, p.1023). The issue of claimd fraud is a major concern among automobile insurance companies (Tenneyson and Salas-Forn, 2002, p.289) because the most common are false motor claims (54%). Each year, approximately 6% of drivers submit insurance claims for damage to their vehicles (Cole, Maroney, Mccullough and Powell, 2015, p.101).

Most of the analyses agree that approximately 20% of all insurance claims are in some way fraudulent but most of these claimd go unnoticed (Šubelj, Furlan and Bajec, 2011, p.1039). In UK despite insurers detecting more fraud, it is estimated that around £1.9 billion (€2.2 billion) of fraud goes undetected each year. Costs arising from insurance fraud is not a common product of insurance business and representing social harmful costs so insurance companies must apply various methods for the purpose of their minimalization (Njegomir, 2015, p.56). For these reasons, and especially while motor insurance fraud become increasingly a cross-border issue, insurers primarily checks insured previous damages submitted to all insurance companies as fighting measures to combat insurance fraud. Insurer suspicion of insurance fraud exist already with submitting claim if insured requires prior cash payment; insurance subjects are insured to very large amounts; if tduring the investigation showed that the financial situation of the insured was uncommonly bad etc. Although it is difficult to identify fraudulent claims, suspicious claims have common attributes so insurers and fraud investigators have collected common attributes into lists „Red Flags“ or „Fraud Indicators“ to be used to determine whether further investigation might be neccessary, to decide whether a claim is legitimate or false and

fraudulent (International Risk Management Institute, 2012, p.7). It is a work placement confirmed fraudulent actions that may indicate a potential fraudulent situation such as: a) the injured pressing to the payment of claims, rather accepting smaller compensation amount but further or documentation of better quality; b) the insured was well informed about the insurance terminology and practice; c) harmful event was reported with delay; d) the insurer shall be submitted exclusively copies of documents, scanned documents or digital images of questionable quality or resolution; e) complain has occurred immediately after the conclusion of the contract or a long time after conclusion but also at the time when the policy was about to expire; f) the claimant's vehicle is available for inspection only after a significant delay; g) there has been an increase of insured sum immediately before the harmful event; i) when a fire with multiple points of origin is determined in the investigation etc. (Matijević, 2004, p.17-18). Fraud indicators determine which traditional fraud indicators carry good claim sorting information and which augmented features best supplement or replace the fraud indicators (Derrig, 2002, p.283).

3.1. Motor Third Party Liability Insurance Fraud in USA

Fraudulent activities account for 15-20% of all auto insurance payments (California Insurance Code, 2005, section 1871). There is an independent common law rule that if a fraudulent claim is presented, the assured will forfeit any rights associated with that claim (Macdonald Eggers, 2008, p.234).

Red flags of insurance fraud may include any of following: a) The claim is made a short time after inception of the policy, or after an increase or change in the coverage under which the claim is made; b) The insured has a history of many insurance claims and losses; c) Before the incident, the insured asked his insurance agent hypothetical questions about coverage in the event of a loss similar to the actual claim; d) The insured is very pushy and insistent about a fast settlement, and exhibits more than the usual amount of knowledge about insurance coverage and claims procedures, particularly if the claim is not well documented; e) The insured already has receipts and other documentation, witnesses, and duplicate photographs for everything – the claim is to perfect; f) Documentation provided by the insured is irregular or questionable, such as: numbered receipts are from the same store and dated differently or sequentially; documents show signs of alteration in dates, descriptions, or amounts; photocopies of documents are provided and the insurance cannot produce the originals; the amount of the claim differs from the value given by the insured to the police; the physical evidence is inconsistent with the loss claimed by the insured; physical damage to the insured's car is inconsistent with its having been in a collision with an uninsured car; the insured refuses or is unable to answer routine questions; g) Police accident report were submitted by the claimant; h) An automobile was destroyed by a fire in a very remote rural area with no witnesses; the driver claims an electrical shortage in the engine compartment caused the fire etc (Association of Certified Fraud Examiners, 2009, p.6-9).

In USA Red Flags applying to the claimant are: 1) Claimant may use a post office box, multiple addresses, hotel or motel, or perhaps a „drop box“ as an address. Often provides a cell phone number, in which use of „voice messaging“ is common; 2) May provide names of witnesses who are just as elusive; 3) May provide witnesses who are over enthusiastic or perhaps provide scripted statements; 4) May emphasize his/her willingness to accept quick reduced settlements; 5) May threaten extended medical treatments or „seeing“ an attorney; 6) May be unusually familiar with medical care, vehicle or home repair, or insurance terminology; 7) May be experiencing personal, financial, or business difficulties; 8) May refuse or become evasive when asked specific questions; 9) May have an extensive or somewhat unusual claims history; 10) May represent „unsolicited“ business to the agent; 11) May approach an agent sometime

prior to a loss with specific questions regarding coverage; 12) In the case of an automobile accident, claimant's vehicle may not be available for inspection; 13) May be hesitant to be examined by an independent medical provider; 14) May be hesitant to submit to an examination under oath; 15) May use medical and legal providers who may themselves show questionable claims provider histories; 16) May have waited several weeks prior to seeking medical treatment; 17) May have sought treatment for „soft issues“ type injuries and/or extensive chiropractic treatment etc. (Nebraska Department of Insurance, 2013, p.9-10). Potential Red Flags also are: 1) The claimant is unusually calm; 2) The claim occurred soon after the policy was issued or soon after its inception date; 3) The loss occurred when the policy was about to expire; 4) At the time of the loss, the policy was about to be canceled, or advance notice of cancellation or nonrenewal had already been sent; 5) The claimant is represented by an attorney on the day of the loss or immediately after the loss; 6) More than one policy or multiple claims from the same loss event are involved; 7) The claimant has a selective memory, refuses to answer specific questions about the claim, or becomes evasive; 8) Documents supporting the claim are incomplete, illegible, or apparently altered; 9) The insured's evidence and documents that support the claim cannot be verified through other sources; 10) The damaged vehicle is not available for inspection; 11) The claimant's medical and/or legal providers have questionable claims histories; 12) The claimant waited several weeks before seeking medical treatment etc. (International Risk Management Institute, 2012, p.17-18).

The following red flags suggest the possibility of auto insurance claims fraud: 1) The claimant is unusually aggressive in processing for a quick settlement; 2) The claimant demands a quick settlement before much information is available about injuries and the crash; 3) There are noteworthy inconsistencies between the police report and the claimant's version of the crash; 4) Discrepancies exist concerning the number of vehicles or people involved in the accident; 5) There are conflicting statements as to the cause of the accident; 6) The injury occurred when the claimant was facing financial pressures such as home foreclosure, vehicle repossession, or a recent job layoff; 7) The claimant has had frequent job, address, or phone number changes with no logical explanation; 8) The claimant can only be contacted in a bar, a coffee house, or a hotel; 9) The claimant's driver's licence is out of state, expired, or temporary; 10) The claimant avoids or cancels meetings with all claims investigators or claims adjusters; 11) There were unreasonable delays in reporting the claim to an insurance company; 12) The claimant was involved in previous claims for similar injuries, as shown by an insurance company Under Bureau data search (International Risk Management Institute, 2012, p.25).

Several Minnesota courts prescribe the five-part test for fraud: a) a false misrepresentation of a past or present material fact; b) knowledge by the person making the false assertion that it is false or ignorance of the truth of the assertion; c) an intention to induce the claimant to act or to justify the claimant to act; d) the claimant must have been induced to act or justified in acting in reliance on the representation; and e) the claimant must suffer damage proximately caused by the misrepresentation (Ella, 2006, p.2).

3.2. Motor Third Party Liability Insurance Fraud in Europe

Europe has the largest motor market in the world with 334m vehicles on the road. Directive 2009/103/EC of the European parliament and of the Council of 16 September 2009 relating to insurance against civil liability in respect of the use of motor vehicles, and the enforcement of the obligation to insure against such liability (The EU Motor Insurance Directive 2009/103/EC) requires all motor vehicles in the EU to be covered by motor third-party liability (MTPL) insurance.

MTPL insurance is prescribed by the European legal framework as compulsory contract insurance – the oldest and in practice the most common compulsory insurance in traffic. It is a type of proprietary insurance characterized by reimbursing all persons that have suffered damages on a contractual or non-contractual basis due to accidents involving road vehicles (Radionov Radenković, 2008., p. 408) providing financial protection against claims for physical damage and/or bodily injury resulting from traffic accidents.

In 2013 total MTPL insurance claims was €51bn (European Motor Insurance Markets, 2015, p.26). The greatest increase in fraudulent activity was in MTPL insurance - 34% in 2009, 72% in 2010 and 79% in 2012 (Whitepaper Insurance Fraud in the Digital Age, 2013, p.9). Namely, according to the data provided by the Association of British Insurers in 2014. there were 67 000 false claims based on automobile insurance which is an increase of 12% in regard to 2013, while up to ¾ of all fraudulent cases in Spanish insurance industry is related to automobile insurance (Zitouni and Kallay, 2014, p. 27).

3.2.1. Anti Fraud Measures in central Europe

In Croatia, insurance fraud first came into focus in 2002 when the Croatian Insurance Bureau initiated the „Agreement on Cooperation to Combat Motor Insurance Fraud“ and defined the working areas of cooperation across borders (relevant authorities) in a combined effort to combat fraudulent traffic accidents (European Motor Insurance Markets, 2015, p.65). In accordance with the Agreement, the Croatian Insurance Bureau developed a Central Database to maintain data on Motor Third Party and Casco claims submitted to the insurance companies (Croatian Insurance Market, 2010, p.202). It was a first system designed to aid in discovering insurance fraud which, despite the inability of data analyses and a smaller volume of gathered data, had significant success.

The significance of a more serious and systemic approach to solving the problem of insurance fraud was suggested by the Croatian Insurance Bureau on whose initiative (on 12 April 2011 in Zagreb) representatives of the national insurance association of: Croatia (Croatian Insurance Bureau), Hungary (Association of Hungarian Insurance Companies), Montenegro (National Bureau of Montenegro Insurers), Macedonia (National Insurance Bureau of F.Y.R.O.M.), Slovenia (Slovenian Insurance Association) Bosnia and Herzegovina (Association of Insurance Companies in the Federation of Bosnia and Herzegovina; Association of Insurers in the Republika Srpska) and Serbia (Association of Serbian Insurers) signed „Protocol on cooperation to combat insurance fraud“ which has become a international platform for fighting against insurance fraud in these part of Europe. In order to improve and institutionalize the cooperation between European states, the Protocol defines a permanent mutual relationship at the institutional level between the several national associations of insurers, insurance companies, police, the judiciary, the experts and other agencies through cooperation and exchange of information on the activities undertaken to prevent insurance fraud: the exchange of statistical and other available indicators that imply different aspects of presence and consequences of insurance fraud in one's own market, the exchange of information about the systems of insurance fraud detection and prevention that are being developed and implemented by their members (insurance companies) and insurance associations, and data exchange about the development and the implementation of the state legislatures' stipulations which apply to the problem and the current judicial practice. The cooperation is based on an automated

(computer information) system that signals the existence of „Red Flags“ (the database has been enlarged and modified) which can be supplemented by new information on a day-to-day basis. Data checking within the system and a very short-time automatic processing of the processing results make easier indicating the need or no need to conduct an investigation in the case of reasonable doubt for an insurance fraud being perpetrated. Subsequently, the Protocol was

signed by: Czech Republic – 1 September 2011; Romania– 1 November 2011; Austria – 30 March 2012; Switzerland – 16 May 2013 and Bulgaria – 26 March 2014. In Croatia, Hungary, Montenegro, Macedonia, Slovenia, Bosnia and Herzegovina, Serbia, Czech Republic, Romania, Austria, Switzerland and Bulgaria insurers exchange relevant information to help identification of potential frauds. In UK, France and Sweden insurance companies have set up formalised groups to investigate insurance fraud – Insurance Fraud Bureau (The impact of insurance fraud, 2013, p.13).

3.2.2. Fraud Risk Assessment Form (FRAF)

On the 48th General Assembly of the Council of Bureaux (COB), held on 5th June 2014 in Minsk (Belarus), it was presented an action plan for insurers – assuming the indicators Tables for easier reveal of fraud attempts in insurance, integration the Fraud Risk Assessment Form (FRAF) in the claim handling to proven fraudulent insurance claims. The plan was to integrate the FRAF in the claims handling and identify fraud in the claims process. Fraud probability is expressed by scoring the Red Flags to produce risk scores at event, case, claim or account level to facilitate sorting by score (Whitepaper Insurance Fraud in the Digital Age, 2013, p.4). It's a total 27 indicators („Red Flags“) of insurance fraud split into four main wholes: fraud indicators related to accident; fraud indicators related to vehicle(s); fraud indicators related to claimant/representative and fraud indicators related to initial investigation. Since the purpose of this work is to analyse the presumptions and the consequences of filling a fraudulent insurance claim from insured, the author analyses fraud indicators related to claimant.

According to Annex 2: FRAF, a list of fraud indicators related to claimant/representative are: 1) Multiple claimants (>2 claimants from each vehicle); 2) Existence of a (family) relationship between the involved parties; 3) Drivers has a different nationality than the country of registration on the vehicle; 4) Record of claimant(s) shows > 3 injury claims or material damages during the last 2 years; 5) Some legal firm representing claimants from both the fault and non-fault vehicle or the representative of the claimant does not appear on the list of regulated claims management companies or legal firms; 6) Representative ceases to represent claimant(s) for no apparent reason as investigation progresses; 7) Claimant known to have a criminal record or be in prison or have financial problems; 8) Claimant, who was one of a number, withdraws his/her claim for non apparent reason.

Fraud indicators do not prove fraud, they are an essential tool for profiling and scoring claims in order to focus limited resources on those more likely to be fraudulent (Whitepaper Insurance Fraud in the Digital Age, 2013, p.3). FRAF helps insurance claims handlers to identify potential fraudulent cases. According to Annex 2: FRAF, each indicator represents the number of allocated points (if accumulated points are > 50 than the fraud specialist team will review the case; if accumulated point are > 100 than it will be full fraud investigation). 20 allocated points have these fraud indicators: existence of a (family) relationship between the involved parties or drivers has a different nationality than the country of registration on the vehicle. 25 allocated points represents situation where record of claimant(s) shows > 3 injury claims or material damages during the last 2 years or situation where claimant known to have a criminal record or be in prison or have financial problems. Case where representative ceases to represent claimant(s) for no apparent reason as investigation progresses – 50 allocated points. Situation in which there are multiple claimants (>2 claimants from each vehicle) or where claimant who was one of a number, withdraws his/her claim for non apparent reason represents 75 allocated points. The highest number of allocated points (100) represents situation where some legal firm representing claimants from both the fault and non-fault vehicle or the representative of the claimant does not appear on the list of regulated claims management companies or legal firms.

Application of the FRAF is recommended on a voluntary basis, but it is recommended by COB that all 48 national offices of *Green Card Bureaux (all EU member states and most european countries)* support the insurers in their own states in the application of the mentioned indicators. On the 49th General Assembly of the COB, held on 28th May 2015 in Sopot (Poland), presented action plan have been realised – integration of FRAF in the claims handling (Report from the President of the Council of Bureaux on International Motor Insurance System, 2015, p.5).

4. CONSLUSION

Insurance fraud is a worldwide issue and a major problem in the international insurance market which has a negative effect on the stability and the development of the economy. The insurance industry as one of the most significant economy sectors has a considerable impact on the world economy since insurance companies invest in economy. The main goal of insurance, based on duty of good faith, is to reduce risk and increase investment in general and also infrastructure investment. Turbulent economic times have contributed on the fact that in the past 20 years we have increasing number of insurance fraud representing mayor financial problem for insurers and consumers. At the same time the interest in insurance fraud has expanded greatly. Fraudulent (dishonest) insurance claims are causing profite losses for insurance sector in millions of EUR - financial damage, social, economic costs undermining insurance system. While insurance industry has low resistance to fraud, the protection of the users of insurance services (consumers) is also in question. Namely, the fraudulent behaviour based on a concluded insurance contract, ie. filling fraudulent insurance claims also necessary means increasing insurance premiums for all honest policyholders so the ultimate victims are consumers. Because the costs of fraudulent insurance claims are high – the costs of MTPL insurance are high.

Since insurance fraud has become a growing threat in the world, under the pressure of profitability, priorities of insurance industry are detection and prevention of *insurance fraud*. There are number of models preventing and detecting fraudulent insurance claims (anti fraud measures) among which are the worning signs and fraud alerts („Red Flags“ or „Fraud indicators“). Presence of any of these fraud indicators do not indicate that insurance fraud was committed but they indicate a possible fraudulent behavoiur by the insured. MTPL insurance as the most prevailing type of insurance is also the most susceptible to insurance fraud so the majority of fraudulent claims have been made in MTPL insurance. Fight against fraud in MTPL insurance demands a necessary exchange of information on frauds between the insurer and the state institutions, and also the establishment, the improvement and the institutionalization of the international cooperation. Investing in systemic and effective anti-fraud strategy measures, measures of efficient detection of fraudulent insurance claims have purpose to reduce scope of insurance fraud. Difficulties to identify policyholder's fraudulent insurance claims against insurer are over. Action plan on integration the Fraud Risk Assessment Form (FRAF) in the claims handling would help to identify and prove potential fraudulent insurance claims althought application of the FRAF is recommended on a voluntary basis. Further completion of the FRAF will contribute to the reduction of fraudulent claims which is extremely significant considering that the insurance fraud is on the rise and protection of consumer and insurance industry interests necessarily demands successful results coalition against insurance fraud.

LITERATURE:

1. Andrijašević, S.; Račić-Žlibar, T. (1997). Rječnik osiguranja. Masmedia. Zagreb.
2. Association of Certified Fraud Examiners: Insurance Fraud Handbook (2009), USA, p.6-9.
3. Bakes, M. (2008). Pre-contractual information duties and the Law Commissions' Review. In B. Soyer, Reforming Marine and Commercial Insurance Law (P.55). Informa: London, 2008.

4. Button, M.; Johnston L.; Frimpong, K.; Smith, G. (2007). New directions in policing fraud: The emergence of the counter fraud specialist in the United Kingdom. *International Journal of the Sociology of Law*, 2007. (no.35.), p.193.
5. *California Insurance Code (2005), section 1871.*
6. Clarke, M. A. (2009). *The Law of Insurance Contracts* (sixth edition). Informa: London.
7. Cole, C, Maroney, P, McCullough, K, Powell, L. (2015). Automobile Insurance Vehicle Repair Practice: Politics, Economics, and Consumer Interests. *Risk Management and Insurance Review*, 2015 (vol.18, no.1), p.101.
8. Croatian Insurance Market (2010). Croatian Insurance Bureau. Retrived 27.04.2016 from https://www.huo.hr/download_file.php?...croatian-insurance-market-201...
9. Derrig, R. A. (2002). Insurance Fraud. *The Journal of Risk and Insurance*, 2002 (vol.69, no.3), p.275, 283.
10. Directive 2009/103/EC. (2009). Directive 2009/103/EC of the European parliament and of the Council of 16 September 2009 relating to insurance against civil liability in respect of the use of motor vehicles, and the enforcement of the obligation to insure against such liability, *Official Journal of the European Union*, L263, p.11-31.
11. Dorsey, C. (2008). CILA Anti-Fraud Special Interest Group Members: Counter Fraud Measures, Practical Steps for Loss Adjusters. Retrived 31.03.2016 from www.cila.co.uk/.../2%20CILA%20Counter%20Fraud...
12. Ella, J. V. (2006). Commom Law Fraud Claims: A Critical Tool for Litigators, *Bench&Bar of Minnesota*, 2006 (vol.63, no.8). Retrived 10.05.2016 from <http://www.mnbar.org/benchandbar/2006/sept06/fraud.htm>.
13. European Motor Insurance Markets (2015). Insurance Europe. Retrived 22.02.2016 from <http://www.insuranceeurope.eu/sites/default/files/attachments/European%20motor%20insurance%20markets.pdf>.
14. Insurance Europe: European Insurance – Key Facts, August 2015, p.9 (retrived 22.2.2016 <http://www.insuranceeurope.eu/sites/default/files/attachments/European%20Insurance%20-%20Key%20Facts%20-%20August%202015.pdf>)
15. Insurance Fraud. (2016). Retrived 10.02.2016 from <https://www.fbi.gov/stats-services/publications/insurance-fraud>.
16. International Risk Management Institute: Insurance Fraud: Red Flags for Property/Liability Insurance Content (2012), USA, p.7.
17. European Insurance – Key Facts. (2015). Insurance Europe: European Insurance – Key Facts, 2015. Retrived 22.02.2016 from <http://www.insuranceeurope.eu/sites/default/files/attachments/European%20Insurance%20-%20Key%20Facts%20-%20August%202015.pdf>
18. Matijević, B. (2004). Prijevar u osiguranju, *Osiguranje*, 2004 (no.12), p.17-18.
19. Macdonald Eggers, P. (2008). Utmost Good Faith and the Presentation and Handling of Claim. In B. Soyer, *Reforming Marine and Commercial Insurance Law* (p.234, 237). Informa: London.
20. Macdonald Eggers, P, Picken, S, Foss, P. (2010). *Good Faith and Insurance Contract*, Lloyd's List: London.
21. McGrath, R. A. (2016). How Insurance Companies Help the Economy. Retrived 27.04.2016. from <http://mcgrathinsurance.com/how-insurance-companies-help-the-economy>.
22. Mendoza, R. (2012). They cheat, You pay. In G. Dionne; C. Laberge-Nadeau, *Automobile Insurance: Road safety, New Drivers, Risks, Insurance Fraud and Regulation* (p.191, 192). Springer Science & Business Media.
23. Merkin, R., Gürses, Ö. (2015). The Insurance Act 2015: Rebalancing the Interests of Insurer and Assured. *The Modern Law Review*, vol.78, no.6, p.1023.

24. Nebraska Department of Insurance, Fraud Prevention Department: Insurance Fraud Detection Hints (2013), USA, p.9-10.
25. Njegomir, V. (2015). Prevaranti aktivni u svim zemljama, *Svijet osiguranja*, 2015 (no.10), p.56.
26. No Hiding place, Insurance Fraud Exposed (2012). Association of British Insurers. Retrived 15.03.2016 from https://www.abi.org.uk/~/_media/Files/Documents/Publications/Public/Migrated/Fraud/ABI%20no%20hiding%20place%20-%20insurance%20fraud%20exposed.pdf
27. Radionov Radenković, N. (2008). Zaštita prava putnika u cestovnom prometu i uloga osiguranja. *Zbornik Pravnog fakulteta u Zagrebu*, no.1.-2., p. 408.
28. Report from the President of the Council of Bureaux on International Motor Insurance System (2015). ECE/TRANS/SC.1/2015/1. Retrived 10.05.2016 from <https://www.unece.org/fileadmin/DAM/trans/doc/2015/sc1/ECE-TRANS-SC1-2015-1e.pdf>.
29. Research brief: General insurance claims fraud (2009). Association of British Insurers. Retrived 28.04.2016 from https://www.google.hr/search?q=Association+of+British+Insurers:+Research+brief,+july+2009+&ie=utf-8&oe=utf-8&gws_rd=cr&ei=gVnEVpykBOOe6ASEwqjgBA
30. Šubelj, L, Furlan, Š, Bajec, M. (2011). An expert system for detecting automobile insurance fraud using social network avalysis, *Expert Systems with Applications*, 2011 (no.3), 1039.
31. Templeman, M. (2008). Insurable Interest: A suitable Case for Treatment? In B. Soyer, *Reforming Marine and Commercial Insurance Law* (p.217). Informa: London.
32. Tenneyson, S, Salas-Forn, P. (2002). Claims Auditing in Automobile Insurance: Fraud Detection and Deterrence Objectives. *The Journal of Risk and Insurance*, 2002 (vol.69, no.3), p.289.
33. The impact of insurance fraud (2013). Insurance Europe. Retrived 15.02.2016 from <http://www.insuranceeurope.eu/sites/default/files/attachments/The%20impact%20of%20insurance%20fraud.pdf>.
34. Tomurad, M. (2014). Prijevare i zlouporabe u osiguranju i kako ih prevenirati. Retrived 15.03.2016 from uhms.hr/~/_MTomurad_Prijevare_i_zlouporabe_u_osiguranju_i_kako_i...
35. Viaene, S.; Ayuso, M.; Guillen, M.; Van Gheel, D.; Dedenne, G. (2007). Strategies for detecting fraudulent claims in the automobile insurance industry. *European Journal of Operational Research*, no.176., p.566.
36. Vidaković Mukić, M. (2006). Opći pravni rječnik. Narodne novine. Zagreb.
37. Whitepaper Insurance Fraud in the Digital Age (2013). Retrived 31.03.2016 from www.the-digital-insurer.com/wp-content/uploads/2014/01/94-NT-Insurance-Whitepaper1.pdf
38. You could not make it up, but they did. Savings for honest customers as insurers expose £3.6 million worth of insurance frauds every day. (2015). Retrived 10.02.2016 from <https://www.abi.org.uk/News/News-releases/2015/07/You-could-no...>
39. Zitouni, S.; Kallay, T. (2015). Sve više prijevera u osiguranju. *Osiguranje*, 2014 (no.4-5), p.27.
40. Žižmond, V. (2015). Insurance Fraud, a Worldwide Issue. Retrived 11.05.2016 from <http://www.admiralondemand.com/insurance-fraud-a-worldwide-issue/>.

LEGAL EFFECTS OF THE APPLICATION OF EU DIRECTIVE 2015/2302 ON PACKAGE TRAVEL AND LINKED TRAVEL ARRANGEMENTS

Mara Barun

*Faculty of Law in Split, Croatia
mbarun@pravst.hr*

ABSTRACT

This paper is dedicated to the analysis of significant provisions of Directive (EU) 2015/2302 of the European Parliament and Council of 25 November 2015 on travel in package travel and linked travel arrangements on the amendments to Regulation (EZ) no. 2006/2004 and Directive 2011/83/EU of the European Parliament and Council and the revoking of Council Directive 90/314/EEZ, the application of which regulating the contract on organised travel will be harmonised with contemporary development of the market of organised travel. With the growing trend of online sale of tourist package arrangements and other tourist services, the way travellers organise their travel has changed. In the tourist market together with classic in advanced prepared, package-arrangements, travellers are offered untraditional forms (combined package arrangements, linked travel arrangements). As the mentioned forms are not included in the existing regulation of organised travel, the intervention of the European Legislature was necessary, with the aim of their legal regulation and establishing the balance in the interests of protection of the public interests and mutual competition of business subjects by establishing equitable conditions for all operators determining which are the forms of tourist services protected by EU rules on organised travel. The author in particular dedicates special attention to the relation of the new Directive with other EU rules regulating certain aspects of travel services with the conceptual organisation of package travel and linked travel arrangements, with the characteristics related to the law, obligations and subject liability of the business relationship. She concludes that the new Directive as a modern legal instrument also represents the official entry of tourism into the digital age with the introduction of the online system for the sale and untraditional package arrangements with significant legal effects after its transposition into national legislations.

Keywords: *package-arrangements, linked travel arrangements, Directive (EU) 2015/2302.*

1. INTRODUCTION

Directive (EU) 2015/2302 of the European Parliament and Council of 25 November 2015 on travel in package travel and linked travel arrangements on the amendments to Regulation (EZ) no. 2006/2004 and Directive 2011/83/EU of the European Parliament and Council and the revoking of Council Directive 90/314/EEZ (Directive EU 2015/2302) is long awaited revision and modernization of the Directive 90/314 which has been present for more than 20 years in package arrangements on the European market of travel services. Although it met the standards of the time in which it was created, Directive 90/314 could no longer respond to the increasingly demanding challenges of the modern forms of tourism and organized travels particularly owing to the use of the Internet which significantly changes the way that travellers use travel services. In order to contribute to the proper functioning of the internal market and to assure a high level of protection of the travellers by adopting the Directive (EU) 2015/2302 European Legislator took into account the new forms of travel in package arrangements which are created according to the preferences and at the request of the travellers themselves, which were not included in the application of the Directive 90/314 or were included but in an unclear manner. All these factors have resulted in a legal uncertainty. In addition, Directive 90/314, as a minimum harmonization Directive, allowed EU Member States to regulate many issues of application of

the Directive with national regulations, which largely created disparities in national legislations regarding to the level of traveller protection in contracts of the organized travels. Considering the above, taking into an account the extent of the amendments in the Directive 90/314, instead of further altering, a new Directive on package arrangements and related travel arrangements was published on 11 December, 2015 in the Official Journal of the European Union (OJ L 326, 2015). The Directive was introduced on 30 December, 2015 provided that the Member States harmonize their national regulations with the provisions of the Directive respectively by 1 January 2018.

2. SCOPE OF THE DIRECTIVE APPLICATION AND CONTRACTS COVERED BY THE RULES OF THE DIRECTIVE

The scope of Directive application (EU) 2015/2302 is determined by the two criteria: the criteria of the person concerning the rules of the Directive (*ratione personae*) and the criteria of the contract (services) that are covered by the rules of the Directive (*ratione materiae*). In addition, there is a third territorial criterion (*ratione territorii*), but in this segment there is no change in relation to Directive 90/314.

Regarding the criteria of persons, Directive (EU) 2015/2302 in the Art. 3 par. 6 provides a clear definition of the term traveller thus solving doubts about the definition of the Directive 90/314. Unlike the Directive 90/314, which is about the consumer the new Directive defines the traveller as a person who concludes a contract or is authorized to travel on the basis of a contract that falls within the application of this Directive, including the travellers who travel for business reasons, provided they do not travel on the basis of a framework contract with a dealer specialized for organizing business travels. This decision resolved the complaints that the term consumer of Directive 90/314 does not correspond to the usual notion of a consumer in the European law. Namely, the more narrow meaning of a consumer covers only natural persons who enter the market outside their business or professional activities while the Directive 90/314 in the Art. 2. par. 4 deviates from such a narrow concept and the consumer is defined as a person who takes or agrees to take tourist package arrangement (main contractor) or the person on whose behalf the main contractor agrees to take the package arrangement (other users) or any other person to whom the main contractor or any another user transfers a package arrangement (receiver). (Nebbia and Askham, 2004., p. 36-41, Petrić, 2014, p. 250-251).

Considering the changed circumstances on the market of organized travels, the emergence of new forms of organized travels that are not covered by the existing legislation as well as the fact that current rules are becoming outdated and understated so very often a number of travels remain in the gray zone, Directive (EU) 2015/2302 introduces the so-called graded range of application with modernization of some of the rules Directive 90/314. Consequently, the new Directive distinguishes two types of travel contracts which, to varying extent, are related to its regulations: package arrangement and linked travel arrangement. In order to define these forms of travel previously we need to define a concept of travel services, which is an integral element of any travel covered by the provisions of the Directive (EU) 2015/2302. Thus Art.3 par. 1 of the Directive, with certain amendments, retains the essential elements of the definition of travel (tourist) services from Directive 90/314. Travel services in terms of Directive (EU) 2015/2302 are: transportation services; accommodation services, provided that it is not a permanent residence; rent a car, motorcycle or any other tourist services, which is not secondary in relation to the aforementioned services. The Directive introduces major changes in terms of the concept of package arrangements. According to the provision of Art. 3 par. 2 of the Directive, a package arrangement is a combination of at least two kinds of travel services for the purposes of the same travel or vacation, if such a combination of services fulfills one out of two conditions stated in the specified regulation:

a) That the combination of travel services has been prepared by a single trader before concluding the contract on all travel services, including the ones at the request of a traveller or in accordance with the choice of a particular traveller. Thus, specifically along with the classic package arrangements, which correspond to the package arrangements of the Directive 90/314, also included are package arrangements that tour operator prepared upon request and at the option of travellers where the traveller adjusts the contents of a package arrangement to his needs (one-trader dynamic package arrangement). New definition covers the multi-trader package arrangements as well whose preparation involves more traders. This Directive also resolves a doubt whether the concept of package arrangements refers only to contracts concluded in the agency or the contracts concluded online, but also to those concluded by phone. Namely, in t. 8 of the preamble of the Directive it is expressly stated that the identical principles should be applied regardless whether the reservation has been made in travel agency or online, and from the provision Art. 5 par.2 it is clear that travel contracts in package arrangements can be concluded by phone or

b) Regardless of whether the individual providers of travel services concluded individual contracts, if the services are:

i. bought at a single selling place in the framework of the same reservation procedure and if they are selected before the traveller agreed to pay; in t. 10 of the preamble of the Directive (EU) 2015/2302 it is stated that the travel services are purchased within the same reservation process if they are selected before the traveller agreed to pay additional cost for them ; we should consider tourist agency and web site as places where the traveller can reserve travel services, or

ii. offered or charged by total or lump sum (single price) , or

iii. advertised or sold as a package arrangement or under similar title, or

iv. combined after the conclusion of the contract by which the trader authorizes a traveller to choose travel services from a variety of travel services, or

v. bought from various traders through related procedures of the *online* reservation process in which the traveller's name or information necessary to complete the reservation are transferred between traders, and the contract with other trader or traders is concluded no later than 24 hours after reservation confirmation of the first service. Information needed to complete the reservation are considered to be an e-mail address, credit card information or other information related to service charging. Unlike the Directive 90/314, which defined only the concept of the tour operator and (retailer) intermediary, the new Directive in Art. 3 par. 7 defines also the term trader. In determining the concept of a " trader " Directive (EU) 2015/2302 accepts a common notion of the EU consumer Directives, and " trader " is defined as a person who works for purposes relating to his occupation, business, craft or profession, whether being an organizer, a retailer or a trader who provides a linked travel arrangement or as a travel service provider. Defining the concept of a tour operator and a retailer the Directive regulates that they must be trader s, which eliminates existing ambiguities. Furthermore, in the Art. 3 par. 8 tour operator is defined as a trader who combines and sells or offers for sale package arrangements, either directly or through another trader, or together with other trader s. In case of combined package arrangements if more than one trader meet any of the criteria mentioned in the definition of that form of travel (Art. 3 par 2, p. b), all the traders are considered to be the tour operators, unless one of them is defined as the tour operator, and the traveller is informed of this fact. A retailer is under the provisions of the Directive (EU) 2015/2302 a trader who is not a tour operator, but who sells or offers package arrangements combined by the tour operator.

In order to review the application of the Directive rules completely we will indicate the travels which are not applied by the Directive: package arrangements and related travel arrangements

that include a period of less than 24 hours unless the combination of services of the package arrangement include services of overnight accommodation which is an important novelty in relation to Directive 90/314. We consider such a solution as a positive step forward because we believe that the duration of the travel should not be a cause for distinction due to the fact that the travel services provided with combined services lasting less than twenty-four hours by its content is identical to the travel services provided in combination of services with the duration for more than twenty-four hours; package arrangements and linked travel arrangements that are provided occasionally and on a nonprofit basis, and only to a limited group of travellers; package arrangements and linked travel arrangements purchased on the basis of the general agreement for organizing business travels between the trader and other natural or legal persons working for purposes related to his trade, business, craft or professional activity. (Art. 2 of Directive (EU) 2015/2302).

It is important to point out one of the essential differences of Directive 90/314 / EEZ and the new Directive, which refers to the obligations of Member States regarding the manner and intensity of transposition of the Directive into national law. While Directive 90/314 / EEZ is a Directive of minimum harmonization, which stems from the Art. 8 of the Directive according to which Member States may for the protection of consumers in are covered by the Directive adopt or maintain more stringent regulations, the provisions of the new Directive are based on the method of maximum harmonization, except for provisions of Art. 14 par. 5 which relates to minimum statute of limitation period and the regulations of Art. 17 and 18 which regulate the protection in case of the insolvency, which represent the minimum harmonization clauses that allow the Member States to prescribe more stringent solutions by the national law. The directive contains an explicit regulation according to which the Member States are not authorized to retain either to adopt regulations in the national law which would depart from the provisions of the Directive, regardless of whether such regulations of national law are more lenient or more severe, which would result in different levels of traveller protection (Art 4). (Gorenc and Pešutić, 2006, p. 17-44, Tot, 2015., p. 492-493, Schuster-Wolf and Karsten, 2014, p. 172)

3. RELATION WITH OTHER REGULATIONS

In order to achieve additional protection of the rights of travellers different sources of tourism law can be used. Also, travellers from the contract on transport may have such protection when they are at the same time customers in such contracts of tourism law, then they can also be consumers and enjoy the protection provided by the laws on consumer protection. Similarly, the transport operator, which is defined as such in the applicable regulations of transport law, at the same time can be a tour operator as defined by regulations of tourism law. The Directive takes into account the relation of its regulations with the relevant EU regulations governing certain aspects of travel services. On the one hand, there are the EU regulations on transport and international conventions that bind the EU and relate to the individual transport sectors. (air transport, bus transport, rail transport, sea and inland waterways). From the Regulation significant are: Regulation (EU) No 181/2011 of the European Parliament and of the Council of 16 February 2011 concerning the rights of passengers in bus and coach transport and amending Regulation (EC) No 2006/2004, Regulation (EC) No 392/2009 of the European Parliament and of the Council of 23. April 2009. on the liability of carriers of passengers by sea in the event of accidents, Regulation (EC) No. 889/2002 of the European Parliament and of the Council of 13 May 2002 amending Council Regulation (EC) No 2027/97 on Air Carrier Liability in the Event of Accidents, Regulation (EC) No 785/2004 of the European Parliament and of the Council of 21. April 2004 on insurance requirements for air carriers and aircraft operators Regulation (EC) No 1371/2007 of The European Parliament and of The Council of 23 October 2007 on rail passengers rights and obligations, Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on

compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights, Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning business-to consumer commercial practices in the Internal market, Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and of the Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council Directive, Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce). From the international conventions in the field of transport should be mentioned Protocol of 2002 to The Athens Convention relating to The Carriage of Passengers and their Luggage by Sea, 1974, Convention for the Unification of Certain Rules for International Carriage by Air, Montreal 28 May 1999 and Protocol of 3 June 1999 (Protocol of Vilnius) for the Modification of the Convention concerning International Carriage by Rail (COTIF) of 9 May 1980 (1999 Protocol). Please note that the regulations of these international conventions are fully incorporated into the relevant regulations of EU transport law. The Directive, in terms of the relation between its and the other relevant EU regulations in Article 14 t. 5., determines that Member States may provide that the liability of the tour operator and/or intermediary for damages for breach of contract can be limited in compliance with the Regulations of the EU and the international conventions governing the transport explicitly stating that the rights of travellers to compensation or price reduction does not affect on their rights which they have according to the regulations for certain types of transport.

Accordingly, travellers may exercise their rights either by the Directive or one of the Regulations, but cannot cumulate requirements, in order to avoid excessive compensation. Also, the Directive in Art. 14. t. 4. provides that the limitations on the amount of damages which provider of services owes covered by the organized travel, and under international conventions binding the EU, refer to the tour operators. In the case of international conventions that do not bind the EU, Member States can limit the compensation in an appropriate manner which must be paid by the tour operator. In addition to these regulations, another group of EU regulations relevant for the field of travelling consist of standard European consumer rights. The travellers as customers in travel contract can be also the consumers and will enjoy the protection provided by the laws on consumer protection. These are the provisions of the Directive on Unfair Terms in Consumer Contracts, the Directive on Unfair Commercial Practice, the Directive on Consumer Rights, the Directive on Services in the Internal Market, and the Directive on Electronic Commerce. It is important to emphasize that these regulations are applied to contracts covered by the scope of the Directive only if the traveller in the contract has the status of consumer within the meaning of certain consumer directives and only if there are no specific rules of the Directive (EU) 2015/2302 as *lex specialis*. The adoption of the new Directive means modification of the Directive on Consumer Rights and its regulations will apply not only to contracts of package travels, but also to contracts related to linked travel arrangements. We can conclude that the new Directive is fully compatible with existing EU legislation and international conventions in the field of transport and horizontal consumer directives. Also, this assumption is valid for the provisions of Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law Applicable to Contractual obligations (Rome I) and Regulation 44/2001 on Jurisdiction and Recognition and Enforcement of Judgments in Civil and Commercial Matters. (Petrić, 2014, p. 246-247)

4. LIABILITY OF TOUR OPERATORS

According to Art. 13. t. 1. of the Directive, a tour operator as a counterparty is responsible for the proper performance of obligations under the package travel contract regardless if it executes obligations by itself or has entrusted its execution to other service providers. During the term of the contract it may result in its failure to fulfill or disorderly fulfillment. In the case that the commitments are not fulfilled in the agreed manner, the tour operator is obliged to give the traveller compensation which is regulated by national or international law. The tour operator may be released from liability if it can prove: a) that the damage has resulted from causes that cannot be imputed to the tour operator or service provider; b) that the damage due to the behavior of traveller; c) that the damage has been caused by the omission of the third person who has not participated in the execution of the travel contract on a package travel, and the behavior was unpredictable and unavoidable; d) that the damage has been caused by extraordinary circumstances which could not be avoided, an event that means the situation outside the control of the party invoking it and whose consequences could not have been avoided even if all reasonable measures had been taken. For all forms of damage caused by failure to execute or irregular execution of the contract by the service provider, the tour operator is responsible to a traveller. This Directive has left to the traveller the possibility of placing a direct request to the tour operator for any damages which provided the traveller better protection, which would be missed if the traveller had to require compensation from all service providers. This solution is much more efficient because the service provider is often located in another country, whose language and the right traveller does not know, before whose courts traveller has no time to keep the dispute, nor the means or the knowledge to do so. However, the tour operator and/or the retailer can realize the right of recourse to the responsible service providers, for which it needs the cooperation of the traveller that can be accomplished by providing documents and information useful for this task. According to the Directive, the traveller is obliged to immediately inform the tour provider about any perceived failure in the execution of the contract in writing or in any other appropriate manner. This obligation must be expressly stated in the contract. It is the duty of the person who has received the complaint to accommodate the traveller, to explore reasons for dissatisfaction to the possible extent, and to propose possible solutions. The tour operator and/or retailer are required to provide the traveller assistance in obtaining evidence of significant complaints which could not be satisfied and friendly eliminated. In this case, they are required to provide sufficient evidence of security of return of money paid and the traveller's return to home or country in the case of insolvency. The Directive eases strict liability of the tour operator with its restrictions. So for the amount of damage caused by failure to execute or irregular execution of the contract there are the limitations provided by the regulations governing each individual service. Counterparties may agree on greater liability of the tour operator, but under penalty of nullity are the clauses which the parties could determine the limits of liability under the current legislation. Where there is no legal limitation of liability, except for personal injury or damage caused intentionally or by negligence and if compensation is not less than three times the total price of the package travel, counterparties can limit liability in the travel contract, but this limitation cannot be unreasonable. It must be emphasized that when it comes to personal injury of the traveller, EU regulations and international conventions relating to the individual transport sectors will be applied. The liability of the transport operator (the tour operator) for such damages is very strict, based on causality (objective liability). Liability regulations containing the legal instruments are of cogent nature which means that the transport operator cannot be exempted from liability except with generally known exculpation reasons (force majeure, fault of travellers, and the behavior of a third party which is outside the contractual relation). The Directive provides the optional conclusion of an insurance contract to cover the costs incurred by the traveller's cancellation of the contract, the cost of providing help when the unexpected

event that happened in countries outside the EU arises the need of forcible return of the traveller, as well as to cover the costs of repatriation of the traveller in the case of illness or accident. (Marin, 2014, p. 53-54)

5. ESSENTIAL CHARACTERISTICS OF DIRECTIVE 2015/2302

Summarizing the above, Directive 2015/2302, along with the traditional, includes other non-traditional forms of package arrangements, combined package arrangements and linked travel arrangements, extends to ten key rights that currently apply to already concluded package arrangements. Travellers are provided with new benefits while the new responsibilities for tour operators are established, among others: a) The traveller must get clear and concise information on the main rights and obligations before signing a contract, b) predictable prices: the upper limit of 8% in terms of increase in prices associated with the fuel costs, taxes, and changes in foreign exchange rates but with the explicit contractual regulation that supports the specified right (Art. 10.), c) a greater possibility of a refund in case of a damage: the possibility of a compensation for any damage that is caused to the traveller, including compensation for non-pecuniary damages, such as compensation for inability to enjoy the trip or vacation due to problems in providing appropriate travel services, while reducing the final price in the case of poor service, d) clear information on whether the service offers package arrangements and information on provide level of protection, e) clear liability of the tour operator in providing travel services covered by travel contract of the package arrangement, regardless of whether these services are provided by the tour operator or any other provider of travel services. Member States can transfer further liability to the retailer. Consequently, the provisions of article 7 of the Directive 2015/2302 concerning the content of the travel contract on package arrangement and documents to be submitted before the start of the package arrangement, Chapter III. (changes to the travel contract on a package arrangement before the beginning of package arrangement, IV. (realization of the package arrangements) and V. (protection in the event of insolvency), applicable to the tour operator, in this case, *mutatis mutandis* is applicable to the retailer as well, f) greater rights of cancellation: free cancellation in the event of "extraordinary and unavoidable circumstances" relating to the situation outside the control of the party calling for such situation and the consequences of which could not have been avoided even if all reasonable measures had been taken, greater flexibility in cancelling the contract by paying a reasonable cancellation cost to the tour operator that can be justified and explained at the request of traveller. Reasonable standard charges for the breach of contract can be established in the travel contract of a package arrangement that are based on the time of the breach before the start of the package arrangement as well as expected cost savings and revenue from the provision of travel services to another user. Due to insufficiency of a cancellation cost for the breach of contract, the amount of compensation for breach of contract corresponds to the reduced price of the package arrangement due to cost savings and revenue from the provision of travel services to another user, g) the right to repatriation: if the travel contract of a package arrangement includes transport of the travellers the liability of the tour operator is to provide the assurance for the repatriation of travellers and obligation of a refund of all advances that are paid in the event of bankruptcy (" insolvency protection program") taking into account the length of time between advances and final payment and completion of package arrangements. (Art. 17 and 19), h) creating a network of central contact points in the Member States, which will facilitate cross-border cooperation in the event of insolvency of the trader and the control of the tour operators working in different countries, the tour operators are obliged to provide assurance which must be effective and is able to cover reasonably foreseeable costs in accordance with legislation of the Member Country. Along with protection from insolvency adequate protection in all circumstances should be provided, which should reflect the level of financial risk that trader takes on. For an effective protection in the event of insolvency very low risks

should not be taken into account. In defining the rules for protection from insolvency provided by traders (organizers) in connection with the package arrangements, and related travel arrangements the Member States should take into account the protection of small and medium companies i) a single contract clause: the trader is required to assume liability for all complaints and claims, to the local authorities and consular assistance, by helping the traveller in establishing remote communication and arranging alternative travel plans, j) more effective help: the tour operator is required to provide assistance to travellers with no unnecessary delay, among other things: information about health care.

6. LINKED TRAVE ARRANGEMENTS

The provisions of the new Directive have also been applied to the linked travel arrangements, although on a much smaller scale than to the package travels. For linked travel arrangements will be applied only the provisions of the Directive of the insurance of insolvency (Art. 17. and 18.), informing the traveller about the exclusive liability of the service provider for the correct execution of contracted services (Art. 19.), the liability for mistakes in booking (Art. 21.), the right of recourse against a third party (Art. 22.) and introductory, general and final regulations. The term linked travel arrangement has been defined by section in Art. 3. t. 5. in the Directive. The definition of linked travel arrangements has further developed in such a way that it states that the traveller separately chooses different travel services purchased for the needs of the same travel or vacation and they are paid separately. In addition, it is clear that a trader should in a targeted way allow the purchase of additional travel services from another trader, and the contract with other traders should be made no later than 24 hours after booking confirmation of the first travel service. In this case the traveller buys a variety of travel services for the same travel or vacation in separate transactions, but under condition that none of the criteria indicates that it is a package travel. The aim is to ensure the protection of the traveller while purchasing linked travel arrangement in the case of insolvency of the trader who provides the linked travel arrangement. Accordingly, the traveller will be entitled to repatriation. Furthermore, before making the contract which leads to a linked travel arrangement the trader who provides the linked travel arrangement has to inform the traveller, using standard forms of notification, that the traveller will not be able to use the rights that are guaranteed by the Directive, except in the case of insolvency protection when *mutatis mutandis* provisions of Art. 17. par. 1. sub-par. 2. and Art. 17. par. 2 to 5. and Art. 18. in the Directive will be applied. As linked travel arrangement has no characteristics of classic package travel, position of the trader that provides linked travel arrangement in such transactions is not identical to the position of the tour operator. Therefore, such intermediary (trader) will not be responsible for the execution of the services of other service providers, which is the most important aspect of the position of the tour operator (intermediary) in the package travel. (Tot, 215, p. 505-506, Petrić, 2014, 255-256)

7. CONCLUSION

By analyzing the provisions of Directive 2015/2302 we have concluded that it follows highly dynamic development of tourist business practice and delivers solutions that ensure a satisfactory level of protection in different, generally conflicting interests, on the one hand the interests of the traveller, and on the other hand the interests of business subjects engaged in organizing the travels. The Directive has extended the protection of classic package travels which includes the package arrangements combined according to personal preference of the travellers who have the same rights as customers who buy ready-made travels. With the introduction of the so-called graded approach, distinguishing between the legal regime of the package travel and much more lenient regime of the linked travel arrangement that includes the use of only certain obligations under the Directive, it allows business subjects to select a

business model that suits them. Also, a new wider determination of the package travel, much more favorable for the traveller, includes situations that were previously in a gray area of regulation or totally outside the scope of the provisions of the Directive 90/314, which has introduced the necessary legal clarity and certainty for the participants of the business relationship. Since the new Directive is a directive of maximum harmonization, its application will establish predictable, balanced protection in the area of organized travels with clearly defined rights, obligations and responsibilities of the parties. We can conclude that the Directive as a modern legal instrument represents the official entry of tourism in the digital age by introducing online sales system and non-traditional package travels with significant legal effects after its transposition into national legislations.

LITERATURE:

1. Directive (EU) 2015/2302 of the European Parliament and Council of 25 November 2015 on travel in package travel and linked travel arrangements on the amendments to Regulation (EZ) no. 2006/2004 and Directive 2011/83/EU of the European Parliament and Council and the revoking of Council Directive 90/314/EEZ. Official Journal of the European Union, vol. 58, L 326, 11. 12. 2015., p.1-33.
2. Convention for the Unification of Certain Rules for International Carriage by Air (Montreal 28 May 1999). NN-MU, br. 9/2007
2. Council Directive 90/314/EEC of June 1990 on package travel, package holidays and package tours, OJ L 158, 23. 6. 1990.
3. Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ L, 095, 21. 4. 1993, p. 0029-0034.
4. Council Regulation (EC) No 44/2001 of 22. December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ EU, L 12, 16. 1. 2001.
5. Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning business-to consumer commercial practices in the Internal market, OJ L 149, 11. 6. 2005. p. 22-39.
6. Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and of the Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council Directive, OJ L 304, 22. 11. 2011., p. 64-88.
7. Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, OJ L 376, 27. 12. 2006., p. 36-68.
8. Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (Directive on electronic commerce), OJ L 178, 17. 7. 2000., p. 01-16.
9. European Parliament legislative resolution of 12 March 2014 on the proposal for a directive of the European Parliament and of the Council on package travel and assisted travel arrangements, amending Regulation (EC) No 2006/2004, Directive 2011/83/EU and repealing Council Directive 90/314/EEC, COM (2013)0512–C7-0215/2013–2013/0246 (COD), 12. 3.2014.,
<http://www.europarl.europa.eu/sides/getDoc.do?sessionId=536B30ED9D8D09384833E8F91F6DF1BD.model?pubRef=-//EP//TEXT%20TA%20P7-TA-2014-222%2000%20DOC%20XML%20v0//en>
10. Gorenc, V. & Pešutić, A. (2006). Razgraničenje organizatora i posrednika putovanja, Zbornik Pravnog fakulteta u Zagrebu, vol. 56., Poseban broj/2006, str. 17-44.

11. Marin, J. (2014). Osiguranje u funkciji zaštite prava putnika i poslovanja putničkih prijevoznika, Zbornik radova: Dani hrvatskog osiguranja 2014. p. 43-55.
12. Vijeće EU, Nacrt directive o putovanjima u paket aranžmanima i potpomognutim putnim aranžmanima – 2013/0246, <http://www.consilium.europa.eu/hr/policies/package-travel>, 25. 4. 2016.
13. Nebbia, P. & Askham, T. (2004) EU Consumer Law, Oxford University Press, 2004, p. 36-41.
14. Petrić, S. (2014). Reforma pravnog uređenja ugovora o turističkim paket aranžmanima, Zbornik radova „In memoriam prof. dr. sc. Vjekoslav Šmid“, No. 3. p. 234-262.
15. Petrić, S. (2013). Ugovor o organiziranju putovanja: (6.-8. lipanj 2013.) p. 55-84.
16. Position (EU) No 13/2015 of the Council at first with a view to the adoption of a Directive of the European Parliament and of the Council on package travel and linked travel arrangements, amending Regulation (EC) No 2006/2004 and Directive 2011/83/EU of the European Parliament and of the Council and repealing Council Directive 90/314/EEC, OJ L 360, 30. 10. 2015., p. 37-40.
17. Proposal for a Directive of the European Parliament and of the Council on package travel and assisted travel arrangements, amending Regulation (EC), No. 2006/2004, Directive 2011/83/EU and repealing Council Directive 90/314 (EEC), COM (2013) 512 final – 2013/0246 (COD), 9. 7. 2013., http://ec.europa.eu/justice/consumer-marketing/files/com-2013_512_en.pdf, 25. 4. 2016.
18. Protocol of 2002 to the Athens Convention Relating to the Carriage of Passengers and Their Luggage by Sea, 1974., NN-MU, br. 2/2013.
19. Protocol of 3 june 1999 (Protocol of Vilnius) for the Modification of the Convention concerning International Carriage by Rail (COTIF) of 9 May 1980 (1999 Protocol), NN-MU, br. 12/2000.
20. Regulation (EC) No. 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (Rome I), OJ L 177, 4. 7. 2008, p. 6-16.
21. Regulation (EC) No 392/2009 of the European Parliament and of the Council of 23. April 2009. on the liability of carriers of passengers by sea in the event of accidents, OJ EU, L 131/24, 28. 5. 2009.
22. Regulation (EC) No. 889/2002 of the European Parliament and of the Council of 13 May 2002 amending Council Regulation (EC) No. 2027/97 on Air Carrier Liability in the Event of Accidents, OJ EU, L 138, 13. 5. 2002.
23. Regulation (EC) No 785/2004 of the European Parliament and of the Council of 21. April 2004 on insurance requirements for air carriers and aircraft operators, OJ EU, L 138; 30. April 2004.
24. Regulation (EU) No 181/2011 of the European Parliament and of the Council of 16 February 2011 concerning the rights of passengers in bus and coach transport and amending Regulation (EC) No 2006/2004, OJ EU, L 55, 28. 2. 2011.
25. Regulation (EC) No 1371/2007 of The European Parliament and of The Council of 23 October 2007 on rail passengers rights and obligations, OJ L 315/14 , 3. 12. 2007.
26. Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing common rules on compensation and assistance to passengers in the event of denied boarding and of cancellation or long delay of flights, OJ L 46, 17. 2. 2004.
27. Schuster-Wolf, C. & Karsten, J. (2014) Entwicklungen im EU-Passagierrecht 2013-2014, Verbraucher und Recht, No 5, p. 167-175.
28. Tot, I. (2015). Paket-aranžman i potpomognuti putni aranžman, Zbornik Pravnog fakulteta Sveučilišta u Rijeci (1991), vol. 36, No 1, p. 489-5

CROSS – BORDER PRACTICE OF LAW

Dinka Sago

*Faculty of Law, University of Split, Domovinskog rata 8, Split,
Croatia dsago@pravst.hr*

ABSTRACT

This paper analyzes the profession of lawyers which are experts in their own legal systems, but do not necessarily have knowledge of other legal systems. Lawyers take up a unique position when it comes to the legal regime for free movement applicable to them in the EU. Their profession is covered by a separate system of Directives: the Lawyers' Services Directive and the Lawyers' Establishment Directive. Both Directives have largely been implemented correctly in the Member States. As far as irregularities are concerned, these are most notably encountered with regard to the administrative requirements for registration under the home title and to a lesser extent to the introduction of limitations on professional activity. Both Directives offer some discretionary room to the Member States in the implementation in national law, such as whether or not to use requirements of working in conjunction with local lawyers, and introduction to the court and Bar president. The requirement to work in conjunction with a local lawyer in court proceedings is implemented in almost all Member States including Croatia. The main problems encountered in cross - border practice of law in the EU seem to be more associated with the exercise of the right to establishment, which gives it a character of permanency. Paper analyzes some problems, first of all two legal systems existing within the territory of the EU, the continental civil law and the common law. Also, lawyers wishing to practice law in a Member State outside their language speaking area are facing potential language barriers. The third problem could lie in insufficiently good knowledge of the national law of the host Member State in which one plans to set up an establishment.

Keywords: *establishment, lawyer, Member State, professional title.*

1. INTRODUCTION

Over the fifty years since the foundation of the European Community, the EC Treaties have set out all the political, institutional, legal and economic conditions necessary for its smooth functioning. These conditions refer to creation of an autonomous Community legal system, its character and impact on national laws of member states and their citizens, on application and interpretation of such law by the European Court of Justice, and establishment of an internal market with fundamental economic freedoms. In the conditions of today's economic zone of the European Union, its citizens freely participate in cross-border movement of people and trading of goods, services and capital, and have freedom of establishment without the fear that any prohibitions or restrictions will be imposed by legally unjustifiable regulations of national laws of member states. In practice, the result of operation of the Community's internal market and autonomous legal system leads to economically determined migrations of EU citizens aimed at cross-border business activities. For professionals such as lawyers this means a possibility of business operation outside one's own jurisdiction, either for provision of services or establishment. In this sense, the effects of the internal EU market are comparable to those of the global market, and there is no doubt that the increasing market globalization and technological developments in the international economic context have contributed to the development of the EU market. Such circumstances inevitably required the European lawyers to quickly adapt to the new forms and methods of practicing law. Therefore, in such market conditions, the reasons for the expansion of cross-border movement of European lawyers within the EU's legal market should be sought in their economic interests. At the same time, this fact determined the transition of the law profession from an exclusively national to a transnational

category, with the scope of its activity expanding outside strictly national boundaries, thereby lending the law profession in the European Union a cross-border character (Altić, 2007. p. 229.). However, due to strict national regulations of EU member states, lawyers were directly or indirectly banned from or restricted in cross-border activities. Such regulations were immanent to all legal systems, both at the level of EU member states and the global level, law being a profession that is governed by special regulations and professional rules within the framework of national legal systems of Member States (Misita, 2007, p. 338). This is why any interference with such regulatory rules through legalization of the principle of freedom of provision of services or establishment aimed at cross-border law practice within the jurisdiction area of another member country tended to encounter resistance. In the legal practice of member states, this means that such principles were not accepted or construed in an equal manner, moreover they were suspended by restrictive measures through imposition of national bans or limitation of their application. The main problems faced by foreign lawyers were those regarding unequal diplomas acquired from different law schools within the European Union, i.e. a lack of appropriate knowledge about the law of the country of establishment and non-recognition of qualifications. By invoking such reasons, member states introduced special national regulations and professional rules trying to limit or altogether ban the freedom of movement in their territory and prohibit foreign lawyers from temporary or permanent setting up of business. In most cases this was achieved through imposition of different forms of discrimination or non-discrimination measures, which, under the provisions of the Community law, were not among measures considered legally justifiable. In order to achieve complete implementation of this principle in practice, it was necessary to meet the imperative of simultaneous recognition of equal rights and conditions for the pursuit of law to foreign lawyers and the lawyers of the host country, which implied recognition of obtained qualifications and recognition of the right to the use of title.

2. DEVELOPMENT OF LEGISLATION AFFECTING THE FREE MOVEMENT OF LAWYERS

A further progress was made in regulating the basic principles and freedoms within the framework of secondary EU legislation, leading to liberalization of the law profession. Through introduction of appropriate guidelines in the area of university diplomas and qualifications relevant for specific sectors of professional activity, such as the law profession, and through adoption of a package of the so-called "lawyer" guidelines and their implementation into national legislation of the member countries, this issue was resolved at the level of the Community law and Member State laws. This resulted in regulation of all the required preconditions for the performance of the law profession across frontiers. The first guideline adopted in connection with the principle of freedom to provide services was the Lawyer Guideline on Services (77 /249/EEC) which regulates cross-border pursuit of the law profession by foreign lawyers through the freedom to provide services on a temporary basis. Following this directive was the Diploma Directive (89/48/EEC) which regulates the requirement for mutual recognition of university diplomas allowing for recognition of previous professional qualifications acquired by lawyers (Schneider, Claessens, 2005, p.129.). Finally, through adoption of the Lawyer Directive on Establishment (98/5/EC), European lawyers originally established in one Member State were granted the right to practice their profession across frontiers in any other EU Member State on a permanent basis by setting up a secondary practice, and were thus put on an equal footing with local lawyers in regard to their rights, obligations and responsibilities. The system applicable to lawyers specifically employs a unique mechanism of mutual recognition, without (immediate) integration into the profession of the receiving Member State (Sheldon, 1996, p. 75). Besides the Lawyers' Directives, lawyers can also make use of the general system of Directive 2005/36, which leads to full

integration in the profession of the receiving Member State. Under this regime, to proceed to full integration, a lawyer must first successfully complete an aptitude test. The Lawyers' Establishment Directive also offers a possibility to integrate fully in the legal profession, without the need to do an aptitude test, but only after the lawyer has practised for three years in the receiving country under the system of the Lawyers' Establishment Directive. Directive 89/48/EEC was a step forward for the developments of the free movement of lawyers. Now for the first time candidates from other Member States were guaranteed a possibility to enter into the legal profession of the host Member State. This option was open to them if they themselves were qualified to exercise the corresponding regulated profession in their home Member State. This meant that lawyers who integrated into the legal profession of another Member State became dually qualified. In 2005, Directive 89/48/EEC was replaced by Directive 2005/36/EC, the transposition period of which ended on 20 October 2007. It was also established that the new Directive did not change anything with regard to the system of diploma recognition that was observed under Directive 89/48/EEC, in spite of earlier attempts in the decision-making process to abolish the aptitude test for lawyers and replace it with the method of integration provided in Directive 98/5/EC. The principle underlying Directive 98/5/EC, similar to Directives 77/249/EEC and 89/48/EEC, is the principle of mutual recognition. Unlike the Diploma Directive, it is not based on the mutual recognition of professional qualifications but is rather more akin to the Services Directive, in which there is a mutual recognition of the profession itself. The Establishment Directive allows lawyers who qualify for the legal profession in one of the Member States to exercise professional activities in any other Member State under their home country professional title. While established in the host Member State, the lawyer established under his home country title may exercise all professional activities that a lawyer established under the professional title of the host Member State may exercise, except for situations which involve the representation of clients in court, where, similar to the Services Directive, obligatory cooperation with a host country lawyer may be imposed. While established in the host State, the lawyer concerned is subject to the professional conduct rules of that State. In essence, (except for representation) the lawyer established under his home country title does not therefore exercise his home country profession in another Member State, but he exercises the profession of the host country under his home country professional title (Johannes Claessens, 2008., p. 18-19.). After a lawyer who is established under his home country title has been active in the law of the host Member State he may integrate into the legal profession of the host Member State without any further testing of his capabilities. This means that a lawyer in such a situation can integrate into the legal profession of the host Member State without having to take an aptitude test. Together with the right to be established under home country title, this is the most important feature of the Directive. Another important feature was the effort to liberalise rules on practice in association, and, to a lesser extent, multi-disciplinary partnerships. The articles in the Directive pertaining to practice in association do not entail a direct application of the host country rules but only provide for the application of host country rules after it has been established that home and host country rules are incompatible and application of the host country rules can be objectively justified. The European Court of Justice decided that Articles 3 and 5 of the Directive lead to complete harmonisation in the scope of the application of those articles.

3. ESTABLISHMENT OF LAWYERS UNDER THEIR HOME COUNTRY PROFESSIONAL TITLE

Since the practice of the profession of lawyer in Europe is today governed by primary and secondary Community law, as superior law, and national regulations of Member States, as subordinate law, the required level of harmonisation of national regulations of Member States with the Community law is achieved through application of the *lex superior derogat legi*

inferiori principle. It allows the lawyers from one Member State the freedom of cross-border professional mobility outside the country of their primary establishment for the purpose of providing lawyer services on an occasional or permanent basis by setting up secondary establishment in any other Member State. Assuming the established legal and economic conditions for cross-border provision of lawyer services, we may conclude that the application of the principle of freedom of establishment has for this purpose brought about better results for European lawyers compared to the principle of freedom to provide services. Namely, the lawyers initially started exercising their right to cross-border practice of law exclusively on a temporary basis, pursuant to the provisions of Directive 77/249/EEC on lawyer services. Nevertheless, with the further strengthening of the European legal system and the developing European legal market, the interest of lawyers for cross-border activities increasingly became focused on permanent instead of temporary practice of the law profession, because the latter did not suit the interests of lawyers and their clients in terms of content and functioning. The biggest reason for this is primarily found in the true nature of the category of service, that is the occasional character of such form of cross-border practice of law, and the circumstance that provision of services does not require the change of primary headquarters. This is the reason why it was not possible to achieve permanent presence of lawyers from one Member State in the territory of another Member State. At the same time, foreign lawyers were not able to formally register, their qualifications were not recognized, nor were they allowed to use their professional title, which means that they were not entitled to rights pertaining to host country lawyers. The said shortcomings of cross-country practice of law have finally led to legal regulation of the right of foreign lawyers to set up secondary establishment, as set out in the European Community Directive 98/5/EC on establishment of lawyers. In this connection we may say that the full effect of application of the principle of freedom of establishment was most strongly reflected on cross-border mobility of European lawyers, which principle has today gained precedence over the principle of freedom to provide services. The reason for this lies in the fact that time-limited cross-border mobility of lawyers always requires previous setting up of secondary establishment in another member country, provided that necessary, cumulatively stipulated requirements have been met. By setting up secondary establishment, foreign lawyers acquire the right to practice the law profession in another Member State with recognized qualifications and the right to use the professional title obtained in the Member State of origin under equal conditions as lawyers of the host country. Furthermore, they acquire the right to listing in the lawyer directory and many other rights. This allows the foreign lawyers to fulfil all the requirements of today's legal market of the European Union, as well as their own business interests and needs of their clients. This is substantiated by the fact that the Directive 98/5/EC on establishment of lawyers has already been implemented in all of the 25 member states of the European Union, including the three EFTA Members States, or a total of 28 states, indicating that with its solutions this directive has completely pushed back the previously adopted Directive 77/249/EEC on provision of lawyer services. In this connection we may conclude that by practising law across frontiers on a permanent basis, foreign lawyers have made it possible to achieve full integration into the legal system of the host member country and to meet their professional and business interests and interests of their clients. The importance of the transformation of the lawyer profession within the context of the European Community law should be viewed in the light of the fact that law is a profession that has until recently been very traditional and exclusively reserved for the citizens of an individual Member State and has been under strict jurisdiction of the national law of the respective country and its professional structure. It is therefore interesting that despite adoption of secondary legislation the issue of the exercise of the freedom to provide lawyer services across borders on an occasional or permanent basis has become a legal matter before the European Court of Justice. The reason for this should primarily be sought in the need of member countries to protect their

own territory of jurisdiction and legal system against the influence of foreign lawyers, to protect the interests of local lawyers from the coming competition and to protect the interests of their own citizens as potential clients. Consequently, this resulted in adoption of numerous restrictive measures of discriminatory or non-discriminatory character citing reasons justified by the public interest. As a reaction to such resistance by Member States, a series of court rulings were enacted by the European Court of Justice in cases such as Gebhard, Reyners, Klopp, Thieffry (Mattera, 1991, p. 191), Vlassopoulou etc (Knežić – Popović, 2007, p. 19) which acknowledged and adopted the standardized principles of the freedom of cross-border practice of law and protection of acquired rights (Touret, 1998, p. 220). The clearest indication of a broader approach in regards of establishment can be found in Gebhard, where the Court made it clear that non-discriminatory measures which hinder access to the market fall within the scope of Article 43 unless justified. The Gebhard case is milestone in the development of EU free movement law and made clear that the possibility of non-discrimination restrictions to movement is evident. Additionally, the case clarified many of the underlying confusions with cross-border legal practices and the application of the Treaty provisions on establishments and services to lawyers.

3.1. RECOGNITION OF DIPLOMAS

The Professional Qualification Directive provides the same derogation for lawyers as the previous Diploma Directive 89/48, i.e. the host Member State may stipulate either an adaptation period or an aptitude test (Claessens, 2008, p. 247). The choice is left to the Member State, not to the applicant. This is justified by the specificity of the profession of lawyer which requires precise knowledge of national law and the fact that different legal systems apply in the various Member States. The term 'diploma' as used by the Directive has a particular meaning, embracing all certificates on the successful completion of a higher education lasting three or more years without regard to their official name. Additionally, the term is defined to include certificates of required periods of practical education or experience whether assessed by an examination or not, which are compulsory for the candidate to fully qualify as a member of the profession. Further, the Directive prescribes certain rules which govern the acceptance of additional certificates issued by authorities of Member States: the host state must accept confirmations of another Member State concerning the mental health, the good character, the absence of a declaration of bankruptcy, or the non-conviction of a criminal offence. These rules are designed to prevent disguised discriminatory measures or practices by authorities of a Member State which could contravene the aim of the Directive (Le Dain, Wehlau, 1992, p. 39). Almost all the Member States have opted for the aptitude test. Lawyers who want to establish and to be entitled to use the host Member State professional title usually integrate through the regime of Directive 98/5 EC rather than aptitude test. Pursuant to Council Directive 89/48/EEC of 21 December 1988 on a general system for the recognition of higher-education diplomas awarded on completion of professional education and training of at least three years' duration, a lawyer who is fully qualified in one Member State may already ask to have his diploma recognised with a view to establishing himself in another Member State in order to practise the profession of lawyer there under the professional title used in that State; whereas the objective of Directive 89/48/EEC is to ensure that a lawyer is integrated into the profession in the host Member State, and the Directive seeks neither to modify the rules regulating the profession in that State nor to remove such a lawyer from the ambit of those rules (Deckret, 1998, p. 122). While some lawyers may become quickly integrated into the profession in the host Member State, inter alia by passing an aptitude test as provided for in Directive 89/48/EEC, other fully qualified lawyers should be able to achieve such integration after a certain period of professional practice in the host Member State under their home-country professional titles or else continue to practise under their home-country professional titles.

3.2. RIGHT TO PRACTISE UNDER THE HOME-COUNTRY PROFESSIONAL TITLE

Any lawyer shall be entitled to pursue on a permanent basis, in any other Member State under his home-country professional title. A lawyer practising under his home-country professional title who has effectively and regularly pursued for a period of at least three years an activity in the host Member State in the law of that State including Community law shall, with a view to gaining admission to the profession of lawyer in the host Member State, be exempted from the conditions set out in Article 4(1)(b) of Directive 89/48/EEC. Effective and regular pursuit means actual exercise of the activity without any interruption other than that resulting from the events of everyday life. A lawyer practising under his home-country professional title in a host Member State may, at any time, apply to have his diploma recognised in accordance with Directive 89/48/EEC with a view to gaining admission to the profession of lawyer in the host Member State and practising it under the professional title corresponding to the profession in that Member State. A lawyer who has effectively and regularly pursued a professional activity in the host Member State for a period of at least three years but for a lesser period in the law of that Member State may obtain from the competent authority of that State admission to the profession of lawyer in the host Member State and the right to practise it under the professional title corresponding to the profession in that Member State, without having to meet the conditions referred to in Article 4(1)(b) of Directive 89/48/EEC, under the conditions and in accordance with the procedures. The competent authority of the host Member State shall take into account the effective and regular professional activity pursued during the above mentioned period and any knowledge and professional experience of the law of the host Member State, and any attendance at lectures or seminars on the law of the host Member State, including the rules regulating professional practice and conduct. The lawyer shall provide the competent authority of the host Member State with any relevant information and documentation, in particular on the matters he has dealt with. Assessment of the lawyer's effective and regular activity in the host Member State and assessment of his capacity to continue the activity he has pursued there shall be carried out by means of an interview with the competent authority of the host Member State in order to verify the regular and effective nature of the activity pursued (Claessens, 2008, p. 140). Reasons shall be given for a decision by the competent authority in the host Member State not to grant authorisation where proof is not provided that the requirements laid down in the first subparagraph have been fulfilled, and the decision shall be subject to appeal under domestic law (Mijatović, 2004, p. 61). The competent authority of the host Member State may, by reasoned decision subject to appeal under domestic law, refuse to allow the lawyer the benefit if it considers that this would be against public policy, in a particular because of disciplinary proceedings, complaints or incidents of any kind. The representatives of the competent authority entrusted with consideration of the application shall preserve the confidentiality of any information received. A lawyer who gains admission to the profession of lawyer in the host Member State shall be entitled to use his home-country professional title, expressed in the official language or one of the official languages of his home Member State, alongside the professional title corresponding to the profession of lawyer in the host Member State. The profession of lawyer takes up a unique position among the professions in Europe. First, lawyers have an important function in the administration of justice and in safeguarding the rule of law. Also the profession of lawyer is specifically targeted to and based on the national legal systems in which prospective lawyers train and fully qualified lawyers practise. In general, that means that lawyers are trained and, therefore, are experts in their own respective legal systems, but do not necessarily have knowledge of other legal systems (Šago, 2011., p. 885-902.). Since the consolidation of the directives applicable to the medical professions and architects in Directive 2005/36/EC, the profession of lawyer is the only profession that is covered by a separate system of Directives: the Lawyers' Services Directive

and the Lawyers' Establishment Directive (Šago, 2013, p. 117.). The system applicable to lawyers specifically employs a unique mechanism of mutual recognition, without integration into the profession of the receiving Member State. To proceed to full integration, a lawyer must first successfully complete an aptitude test. The Lawyers' Establishment Directive also offers a possibility to integrate fully in the legal profession, without the need to do an aptitude test, but only after the lawyer in question has practised for three years in the receiving country under the system of the Lawyers' Establishment Directive. The traditional coupling between the Member State and the content of the knowledge and activities of lawyers along with the role of the lawyers in the national justice system has led to strict controls on access to and exercise of the legal professions (Claessens, 2008, p. 18-19.). The qualification criteria and the extent of activities that can only be carried out by lawyers differ largely between the Member States, which is a complication in the realization of free movement of lawyers in the EU. In general, both Lawyers' Directives have largely been implemented correctly in the Member States. As far as irregularities are concerned, these are most notably encountered with regard to the administrative requirements for registration under the home title and to a lesser extent to the introduction of limitations on professional activity. Both Lawyers' Directives offer some discretionary room to the Member States in the implementation in national law, such as whether or not to use requirements of working in conjunction with local lawyers, and introduction to the court and Bar president. The requirement to work in conjunction with a local lawyer in court proceedings is implemented in almost all Member States including Croatia.

4. THE LEGAL PROFESSION IN CROATIA

Significant for the Republic of Croatia is the Stabilization and Association Agreement concluded with the European Communities and their Member States. This agreement is important because it specially regulates the issue of freedom of establishment of entities from member countries to the Agreement. From this follows the importance of fundamental economic freedoms and application of the general principle of the freedom of movement and freedom of establishment in the Community law. The contents of the said Agreement clearly indicate the obligation for harmonization of national legislation of the Republic of Croatia with the Community law, its implementation into the Croatian legal system. Considering the normative solutions in the Republic of Croatia regarding this issue and obligations assumed under the Stabilization and Association Agreement, it is evident that contentwise they fall under the set goals of harmonization of the Croatian national legislation with Community legislation. On 3 October 2005, accession negotiations started with the screening of Croatia's legislation to identify where modifications were needed to ensure compliance with EU norms and rules. After finalising the screening process in October 2006, negotiations process about 35 chapters began, but some problems came up which slowed down the negotiation process. Finally, after closing all 35 chapters, out of which the chapter 25 on Science and research was first open and the chapters 8 on Competition policy, chapter 23 on Judiciary and Fundamental Rights and chapter 33 Financial and Budgetary Provisions were last closed on 30 June 2011. On 12 October 2011, the European Commission adopted its favourable opinion on Croatia's accession to the European Union and on 01 December 2011. The European Parliament gives its consent to the accession of Croatia. Finally, on 9 December 2011 Croatia and twenty-seven Member States of the EU signed the Accession Treaty. Croatia become the EU's twenty eighth Member State on the 01 July 2013. (Lazowski, 2012., p. 1- 39). The decision of the Council of the European Union on adoption of a framework for negotiations with the Republic of Croatia at the beginning of 2005, marked the formal begin of the process of harmonisation of the Croatian legal system with the Community law. This process also included amendments to the Act on the Legal Profession (Official Gazette No. 9/94), because its provisions were discriminatory to foreign lawyers on account of citizenship, acquired qualifications and professional title, and

they ban foreign lawyers from practicing law in the territory of the Republic of Croatia, making this Act contrary to the Community law (Sevšek, 2001, p. 37-39). The changes to this Act resulted in opening of the Croatian legal market to foreign lawyers in accordance with the legal system of the Community and the provisions of the Directive 98/5/EC on establishment of lawyers (Vidan, 2005, p. 6 - 15).

5. CONCLUSION

The main goal of cross-border practice of law is improving and facilitating judicial cooperation between the Member States in all fields; improving the effective and practical application of Union instruments and promoting effective access to justice for the general public. All Directives represents a true advancement in the integration process, the goals of which are to simplify, speed up, reduce the costs of cross-border litigation and reduce language obstacles because in cross-border litigation, language differences are one of the main obstacles preventing parties from taking action and defending their rights. The lawyers' Directives are the pillars of free movement of lawyers in Europe and should be preserved. Opening the Lawyers' Directives to possible changes creates a risk of weakening the existing well balance framework. Practical problems that may occur where lawyers from different jurisdictions handle cases within a team cannot be tackled by a conflict rule in favour of home country rules, but by application of the strictest home country rules. The assumption that the complexity of complying with two different and sometimes conflicting sets of deontological rules at the same time might preclude lawyers from providing temporary cross border services lacks a factual basis. We may say that the issue of motivation of European lawyers for cross- border practice of law and their transformation from a national into a transnational category is defined, on the one hand, by legal, and, on the other hand, by economic criteria (Claessens et al., 2012, p. 226). Legal, in the sense of legal permission of cross-border business activity at the level of Community law and national laws of Member States. Economic, in the sense of economic efficiency of activities, its orientation towards generating profit. To be added to the latter criterion is the element of time of cross-border activity of lawyers, which, depending on the duration of activity, may be either temporary or permanent in character. Nevertheless, the problem cannot be merely put down to the above mentioned criteria. As opposed to cross-border provision of services on a temporary basis, the main problems encountered in cross-border practice of law in the European Union seem to be. more associated with the exercise of the right to establishment, which gives it a character of permanency. Firstly, problems are posed by two legal systems existing within the territory of the European Union - the continental civil law on the one hand, and the common law on the other. Secondly, lawyers wishing to practice law in a Member State outside their language- speaking area are facing language barriers and insufficiently good knowledge of the national law of the host Member State in which one plans to set up an establishment. These circumstances can objectively restrict cross-border practice of the law profession by lawyers coming from different legal systems. It is therefore to be believed that practice in the area of national law of Member States will be left to home or local lawyers, whereas foreign lawyers will mostly concentrate on international law and Community law, and only to some extent to the law of the Member State of origin. This is why the request of Member States for restrictions to be applied to foreign lawyers for representation before national courts seems justified to a certain degree. We may conclude that the cross-border character of lawyer activities is the direct consequence of the request imposed by the autonomous law of the Community, European integration processes, and globalisation of the legal market, leading to introduction into national legislation of solutions different from the earlier traditional understanding of the lawyer profession. Consequences of general globalization are also felt in the legal market, the service sector, including lawyer services. They are reflected in the fact that lawyers who are not registered in any of the EU Member States, for instance lawyers and lawyer offices from USA,

have started economically motivated migrations in search of new markets. This is a fact that apart from imparting a cross-border identity to today's lawyer's practice, also gives it a multi-jurisdiction character, and in interaction with accounting and auditing companies additionally imparts it a multidisciplinary character. In this way, the clients whose business interests are globally oriented are provided the widest range of different services in the area of law, finance and accounting by a single service provider, also organized on a global level. However, such practice of the profession of law may make the average lawyer less competitive before clients because of the possibility of unlimited use of marketing for winning and representing customers, as allowed by the legal system in which lawyers have their primary establishment. The future will show how prepared European, and Croatian, lawyers are to face the challenges of the competition from the USA. Croatia has also been taking extensive reform steps in the past decade, basically motivated by outside pressures that arise out of the process of accession to the EU. To facilitate the establishment of lawyers, the process of registration should be simplified and made more uniform across Member States. This can be done in a number of ways, such as by including detailed requirements for registration in the Directive or by creating the possibility to use an identity card, such as the European Professional Card in the process of registration. Intensified contact between bars could be helpful when bars need to assess the professional indemnity insurance policies of lawyers from other Member States. The Lawyers' Establishment Directive provides the opportunity to achieve integration into the profession of another country after three years of professional practice, without the need to take an aptitude test. Only a limited number of lawyers have made use of this provision since the implementation of the Directive. Thousands of lawyers have achieved integration into the profession by making use of the Professional Qualifications Directive. The limited use of the route of the Establishment Directive is likely due to a number of difficulties (Graf Von Westphalen, 2006, p. 33). First, the provision is not very well-known compared to other possibilities that the legal framework offers. Second, the practical implementation is surrounded by a great deal of uncertainty among the Bar Associations and lawyers about the requirements. Third, insurers in general seem to be hesitant to accept a lawyer that has gained admission to the profession of another country via the route of the Lawyers' Establishment Directive. They are more inclined to accept a lawyer who has proven his abilities by taking a test. Possible solutions to the difficulties are manifold, they should at least be aimed at taking away uncertainties by clarifying the criteria to become eligible for admission to the profession after three years of establishment.

LITERATURE:

1. Accession Treaty, Council of the European Union, Brussels, 7 November 2011.
2. Act on the Legal Profession, Official Gazette No. 9/94, 117/08, 50/09, 75/09, 18/11
3. Altić, E. (2007). *Sloboda osnivanja poslovnog nastana odvjetnika u pravu europske zajednice i usporednom pravu*, Rijeka: Faculty of Law University of Rijeka, master's thesis
4. Claessens, S.J.F.J. (2008). *Free Movement of Lawyers in the European Union*, Maastricht, p. 18-19.
5. Claessens, S.J.F.J. et al. (2012). *Evaluation of the Legal Framework for the Free Movement of Lawyers - Final Report*, Zoetermeer, Retrived 16.07.2016. from http://ec.europa.eu/internal_market/qualifications/docs/studies/2013-lawyers/report_en.pdf
6. Council Directive of 22. March 1977. to facilitate the effective exercise by lawyers of freedom to provide services (77/249/EEC), Official Journal L 078.
7. Council and Commission Decision of 13 December 2004 concerning the conclusion of the Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Croatia, of the other part; OJ L26 of 28/01/2005, p.1

8. Deckert, R. M. (1998). EG – Binnenmarkt für rechtsberatende Beruf. Internationales Steuerrecht, n. 4, p. 122.
9. Directive 98/5/EC of the European Parliament and of the Council of 16. February 1998. to facilitate practice of the profession of lawyer on a permanent basis in a Member State other than that in which the qualification was obtained, Official Journal L 077.
10. Graf von Westphalen, F. (2006). *Strani odvjetnici u Njemačkoj – sadašnje stanje i izgledi*, Zagreb: Odvjetnik, n. 5-6, p. 33.
11. Knežić – Popović, D. (2007). *Slučaj Vlassopoulou – putokaz u pravu nastanjivanja advokata*, Beograd: Strani pravni život, Institut za uporedno pravo, n. 3., p. 19.
12. Lazowski, A. (2012). *European Union do not worry, Croatia is behind you: a commentary on the seventh Accession Treaty*, Zagreb: Croatian Yearbook of European Law and Policy, Vol. 8, No. 8, p. 1-39.
13. Le Dain, A., Wehlau, A. (1992). *Free movement of lawyers in the EEC - opportunities for law students in euro-degree courses*, Bracton Law Journal, Vol. 24, pp. 35-44.
14. Mattera, A. (1991) *Les principes de proportionnalité et la „reconnaissance mutuelle“ dans la jurisprudence de la Cour en matière de la libre circulation des personnes et des services: de l'arrêt Thieffry aux arrêts Vlassopoulou, Mediawet et Dennemeyer*, RMUE, n. 4, p. 191.
15. Mijatović, N. (2004). *Odvjetništvo u Njemačkoj s posebnim osvrtom na djelovanje tzv. europskih odvjetnika*, Zagreb: Odvjetnik, n. 9-10, p. 61.
16. Misita, N. (2007). *Osnovi prava Evropske unije*, Sarajevo: Law Faculty University of Sarajevo
17. Schneider, H., Claessens, S. (2005). *The Recognition of Diplomas and the Free Movement of Professionals in the European Union*, from SCHNEIDER, H., „Migration, Integration and Citizenship“, A Challenge for Europe's Future, Volume I., Forum Maastricht, Maastricht: p. 129.
18. Sevšek, V. (2001). *Strani odvjetnici u RH*, Zagreb: Odvjetnik, n. 3-4, p. 37-39.
19. Sheldon, M. (1996). *Kako raditi u inozemstvu*, Zagreb: Odvjetnik, n. 7-8, p. 75.
20. Šago, D. (2011). *Prekogranično pružanje odvjetničkih usluga*, Beograd: Pravni život. 549 III, p. 885-902.
21. Šago, D. (2013). *Some aspects of Croatian accession to the European Union and cross-border litigation // SEE-LAW NET: Networking of Lawyers in Advanced Teaching and Research of EU Law post - Lisbon, Outcome of the SEE Graduates EU Law Teaching & Research Academy 2013 Collection of Papers / Giegerich, Thomas et. al (ur.). (ur.).* Skopje, Saarbrücken: Deutscher Akademischer Austausch Dienst (DAAD),. p. 115-126.
22. Touret, C. (1998). *La jurisprudence de la Cour de justice Vlassopoulou et Gebhard*, La reconnaissance des qualifications dans un espace Européen des formations et des professions , sous la direction de J. Pertek, Bruxelles: p. 220.
23. Vidan, H. (2005). *Strani odvjetnici u Hrvatskoj – da ili ne*, Zagreb: Hrvatska pravna revija, n. 2, p. 6 – 15.

THE MEASURES OF INTELLECTUAL PROPERTY RIGHTS PROTECTION

Dominika Bochanczyk - Kupka

University of Economics in Katowice, Poland
dominika.bochanczyk-kupka@ue.katowice.pl

ABSTRACT

Intellectual property rights (IPRs) are nowadays one of the principal means through which companies, creators and inventors can generate returns on their investment in knowledge, innovation and creativity. Intellectual property creates incentives to search, develop, produce and distribute new and authentic products. From protection of these goods and services all citizens benefit and therefore national economies and global economy. There is no doubt that solid and predictable IPRs frameworks create environment conducive to innovation and sustainable development. Nowadays proper protection of intellectual property rights is particularly important for strengthening and accelerating economic growth and development. The increase of global attention connected with intellectual property rights) protection has caused the readiness and necessity of international comparison between countries. The most serious problem in conducting such research has been the creation of common and accurate measure (index) of IPRs protection. The specific features of intellectual property (inter alia such as its open and diversified character) have caused many problems. The paper shows the current state of knowledge connected with attempts to build such a measure of IPRs protection and describes the most well-known and popular IPRs protection measures used nowadays in international comparisons. It also tries to discuss the advantages and disadvantages of these measures.

It also tries to analyze the roots of measurement problems and tries to find solutions needed in creation of globally accepted measure (index) of intellectual property rights protection.

Keywords: *intellectual property, intellectual property protection, measures of intellectual property protection.*

1. INTRODUCTION

World Intellectual Property Organization (WIPO) describes intellectual property (IP) as such creations of the human mind as inventions, literary and artistic works, and symbols, names, images, and designs used in commerce. IP is divided into two main categories: industrial property and copyright and has three customary legal domains: copyright (author's rights), patent, and trademark. Intellectual property rights (IPRs) are usually defined in economic terms as the rights to sell and use these creation of human mind. They are treated as the important part of intangible assets together with customer goodwill, specific skills of employees, knowledge imbedded in the organization or good management practices. IPRs are considered as policy tool to align the private returns to innovative activity. [United Nations Economic Commission for Europe. (2011), p.7].

All over the world various legal regimes have evolved over time, each of which, to different degrees, recognizes rights of ownership in a particular form of intellectual subject-matter under specific conditions for designated periods of time. There are many nationally-based regulations strictly connected with the intellectual property rights protection. But just only internationally-based legislation can help to clarify cross-border issues, as well as develop global IPR standards. Over the years, there has been a long tradition of international IPR harmonization in

order to ensure that right protected by IPR is respected globally¹. To compare international standards of IPR protection and the effectiveness of this protection it is necessary to construct a common measure of IPR protection. Nowadays the most fundamental task is to measure the IPRs existence and strenght on a consistent international basis. IPRs are not readily measurable and do not have obvious price-based equivalents like those used to asses restrictiveness of quotas. IPRs also interact with many policies in reaching their full effectiveness. Identical law may have different effect in countries which implement other economic systems (other market structues, distinc customer preferences, etc.). The paper describes the previous efforts to create measures of intellectual property protections from the historical point of view and then describes and comments measures which are currently used.

2. THE MEASURES OF IPRS PROTECTION IN THE PAST

The most straightforward way to asses the nation's legislation connected with IPRs was to list membership in the international conventions promoting IPRs. There was no doubt that the most important agreement was the TRIPs agreement (the core component of the WTO). But also there were many other mostly regional convention on intellectual property, mainly maintained under auspices of WIPO. Such measure of IPRs protection based on membership in international and regional conventions was described in 2000 by K.Markus [Markus, K. (2000), pp.88-91]. The participation in international or regional conventions on intellectual property was not the sufficient factor to determine the quality of intellectual property protection in particular country but could give the general overview of national systems of IPRs protection and could clearly describe the states priorities in that case. The variables based on membership could be at best only the crude indicator of strength of nation IPRs. But it was interesting to track changes in IPRs over time to observe the national climate and direction of changes. To did it, it was possible to use the annual National Trade Estimate Reports of the United States Trade Representative (USTR) [National Trade Estimate Report. (2016)]. Such qualitative but not quantitative descriptions (USTR divides countries into four groups which describe the level of protection as: good, week, moderate and strong) could be informative but of limited use for comparisons of large number of countries and insufficient for statistical analysis. This attempt was limited in their ability to capture IPR protection, focusing more on the laws with limited attention paid to how nations enforce those law. But nowadays in many modern indexes the membership in regional and international conventions is one of the factors influencing the final assessment of IPRs protection. The other way of eveluation of IPRs protection in the past, was an analysis of the components of the legal structure in order to develop numerical indices of IPRs strength. The best well-known indexes based on IP law were created by: R.T. Rapp and R.P. Rozek (1990), J.C. Ginarte and W.G. Park (1997) with updates to 2005, W.G. Park and S. Wagh (2001) updated annually to 2006. The first cross-country measure (index) was developed in 1990 by R.T. Rapp and R.P. Rozek. Their aggregated patent law indicator was known as Rapp and Rozek Index (RRI). The RRI indicator focused on the standards proposed by the United States Chamber of Commerce (1987). These standards included the guidelines for patent examination procedures, the term of protection, compulsory licensing coverage of inventions, transferability of patent rights and effective enforcement against infringement. The RRI measured patent rights protection on a zero to five scale (where zero represented a country with

¹ The importance of intellectual property was first recognized in the Paris Convention for the protection of industrial property (1883) and then in the Berne Convention for the protection of Literary and Artistic Works (1886) administered by the World Intellectual Property Organization (WIPO). Among other important international agreements there are: the Universal Copyright Convention (UCC) and the TRIPS Agreement under the patronage of the World Trade Organization. TRIPS has established homogeneous minimum standards of protection among all WTO members, introducing two basic

no patent rights protection laws, one was equal to seriously flawed laws, three was equal to flaws in laws, some enforcement laws, four was equal to generally good laws, and five represented a country with protection and enforcement laws fully consistent with minimum standards proposed by the U.S Chamber Commerce) [Kyrkilis D., Koboti-Alafostergiou S. (2008), p.7 and Rapp R.T, Rozek R.P. (1990)]. Also in the literature existed the comparison between the value of Rapp and Rozek Index with income per capita². It showed the direct relationship between these two measures. [Richards D.G. (2004), p.64]. The main Rapp and Rozek Index disadvantage was that it did not take into consideration the nation's abilities to enforce the law and the law actual effectiveness. Much more popular attempt to quantify IPRs was undertaken by J.C. Ginarte and W.G. Park in 1997. They examined the patent laws of a comprehensive number of countries from 1960 to 1990. This index (called GP Index - GPI) went beyond the RRI approach by studying in greater detail the aspects of the law (including: duration of protection, extent of coverage, membership in international patent agreements, provisions for loss of protection and enforcement measures). Each component was further broken down into important characteristics determining its effective strength (for example, patent coverage referred to patentability of some groups of products, and the existence of utility models; enforcement measures included the availability of preliminary injunctions, contributory infringement actions, reversals of the burden of proof in process patent cases). Each of these subcomponents was assigned a value of one if present and zero if absent, with the component score being the sum of these values as a percentage of the maximum value. Thus the minimum possible national score was 0.0 and the maximum was 5.0. Although each subcomponent was binary, the aggregate score was more. Also the GPI in comparison to the RRI was more finely defined so that the measuring of patent rights exhibited greater variability across countries. [Maskus K., 2000, p.96]. Ginarte and Park Index (GPI) was perceived as more nuanced to reflect variations in patent laws. Moreover its computation for different years permitted analysis of the index over time [Ginarte J. (1997), p.283-301]. Then W.G. Park and S.Wagh calculated index values in five-year increments from 1970-2000 and annually through 2006. Their system was based on five categories: coverage (patentable subject matter), duration of protection, enforcement mechanisms, membership in international patent treaties, and limitations like compulsory licenses on patent rights). Each category had a maximum value of one, so the index ranged from zero to five while sub-categories contained from one (duration of protection) to seven components (patentable subject matter). In 2000 sixty three countries were ranked, and then in 2006 this number increased to 140 countries [Park, G.W, Wagh, S. (2011) and Lesser, W. (2011)]. Except measures connected with analysis of the components of the legal structure there were other measures (indexes) of IPRs which included incorporating implementation (enforcement factors). The best well-know indexes were created by: E.Mansfield (1995), R.M. Sherwood (1997), and such indexes as: Taylor Wessing Global Intellectual Property Index (2009), World Economic Forum Global Competitiveness Index (2009), Property Rights Alliance International Property Rights Index (2010) and Economic Freedom of the World: Annual Report (2009). Some of them are nowadays still in use so will be described in next section. From the historical point of view it is worth to mention indexes created by E. Mansfield in 1995 and R.M. Sherwood in 1997. E. Mansfield surveyed 180 executives and patent attorneys in the three countries: the US, Japan and Germany and focused on the chemical and drugs, machinery, and electrical equipment industries because he believed that they are particularly sensitive to IP protection. [Mansfield, E. (1994)]. The index developed by R.M. Sherwood in 1997 was a measure with subjective assessment of several components of IPRs, including patents, trademarks, trade secrets, protection of new life forms, copyrights,

² High-income countries (above US\$7,000 for 1985) had an average value on the index of 4.14, middle-income countries (US\$2,500-\$7,000) had an average of 2.62, and low-income countries (below US\$2,500) had an average of 2.46. [Richards D.G. (2004), p.64]

treaty adherence, and enforcement and administration in 18 developing countries (most in Latin America) in mid-1990s [Sherwood, M. (1997), p.491-544]. Each country was ranked on a 100-point scale for nine components including: enforceability (twenty-five points), administration (ten points), and patents (seventeen points). The scales were thoroughly researched with interviews in each country. A verbal justification was given for deducting points in each component, but the overall allocation of points to each component was not discussed. Using a similar procedure R.M. Sherwood scaled the TRIPS requirements. All indexes which have been mentioned are not in use nowadays and they are interesting just only from historical point of view. But they built the background for modern indexes and started the international discussion over measuring IPRs protection strength.

3. MODERN MEASURES OF IPRS PROTECTION

Nowadays still doesn't exist one, common measure which enables the evaluation of the strength of intellectual property protection national systems and allows international comparisons. It is mainly because intellectual property is a very special type of asset. It describes the ideas, inventions, technologies, artworks, music and literature, that are intangible when first created, but become valuable in tangible form as products. Lack of understanding and awareness about IP is partly understandable because, in the past, it was an very limited field of law, that preserved just only for technical specialists and corporate lawyers. However, times have changed. Nowadays because of information technology revolution, and the increasing pace, impact, and importance of invention and innovation, linked to rapid globalization, protection of IP is crucial for economic growth and development. From being a backwater issue, it is now a key factor in government policy-making and in corporate strategic planning. [Idris, K. (2003), p.4]. The problem of adequate measurement still exists but some important and interesting measuring attempts have appeared recently. Among them are: Taylor Wessing Global Intellectual Property Index, International Property Rights Index founded by Property Rights Alliance and Americans for Tax Reform Foundations and measure created by the Global Intellectual Property Center (GIPC). Protection of intellectual property rights is also the component of many famous indexes dealing with wider economic issues such as economic freedom or world competitiveness. Among them are: Index of Property Rights created as a part of Index of Economic Freedom by Heritage Foundations and Legal System and Property Rights Index used by Fraser Institute in Economic Freedom of the World. The importance and strength of national system of IPRs protection is also investigated by World Economic Forum in creation of Global Competitiveness Index (GCI). Taylor Wessing Global Intellectual Property Index was first launched in May 2008 and in 2016 the 5th report was published, comparing 43 jurisdictions around the world. It was a first private firm effort to create the index measuring IPRs protection. At the beginning it ranked only twenty-four countries, both developed and developing [Taylor Wessing Global Intellectual Property Index. (2008), p.4]. Due to the restricted number of countries included in this index, it was of limited use in the other analysis. It is worth to notice that it was the first index which focused not only on patents but also trademarks and copyright protection. The overall index was a compilation of scores for trademark, patent and copyright protection. It was based on a combination of two distinct components, referred to as jurisdictional assessments and instrumental factors. Nowadays it is not very popular and very seldom is mentioned in literature. Main disadvantage of this index is lack of international comparisons because of limited number of countries which are investigated. Nowadays the most popular measure of IPRs protection which is used in global comparison is the International Property Rights Index (IPRI) created by Americans for Tax Reform's Property Rights Alliance. The 2015 IPRI ranks a total of 129 countries from around the world, up from 97 countries in 2014. Since 2007, the Property Rights Alliance (PRA) has been dedicated to the protection of property rights all around the world and it has instituted the

Hernando de Soto fellowship to produce a yearly edition of the International Property Rights Index. IPRI is widely recognized as probably the most accurate and comprehensive comparative study of property rights protection nowadays. It was developed to serve as a barometer for the status of property rights across the world. The authors of IPRI reviewed the literature on property rights in order to conceptualize a comprehensive characterization of this issue. They assume that the strong property rights regime strengthens the confidence of people in its effectiveness to protect private property rights and provides for trouble-free transactions related to registering property and allows access to credit necessary to convert property into capital. The final index consists of three core elements: Legal and Political Environment (LP), Physical Property Rights (PPR) and Intellectual Property Rights (IPR). The Legal and Political Environment (LP) component provides an insight into the impact of political stability and the rule of law in a given country. Consequently, the measures used for the LP are broad in scope. The authors of this index treat this component as significant to the right development and protection of physical and intellectual property rights. The other two components of the index are Physical Property Rights and Intellectual Property Rights (PPR and IPR). They reflect two forms of property rights which are crucial to the economic development of a country. The items included in these two categories account for both de jure rights and de facto outcomes of the analyzed countries. Intellectual Property Rights (IPR) component evaluates the protection of intellectual property. It assesses protection of two major forms of intellectual property rights (patents and copyrights) from de jure and de facto perspectives, respectively. Protection of

Intellectual Property Rights Index contains opinion survey outcomes reflecting a nation's protection of intellectual property. It is a crucial aspect of the IPR component [The International Property Rights Index. (2015).]

The other well-know organization deals with IPRs protection is the Global Intellectual Property Center (GIPC) which is the principal institution of the United States Chamber of Commerce handling all issues relating to intellectual property. The GIPC recognizes intellectual property (IP) rights as vital to creating jobs, saving lives, and advancing global economic growth. The

U.S. Chamber's International IP Index provides economies with a comprehensive roadmap to harnessing the benefits that robust IP systems. The Index maps the IP environment in 38 economies around the world, collectively accounting for nearly 85% of global gross domestic product (GDP). Each economy's score is based upon 30 indicators spread across six categories – patents, copyrights, trademarks, trade secrets, enforcement, and international treaties. The 4th edition of the Index which has been published in 2016 also includes an updated measure on physical counterfeiting to provide a more accurate estimate of the level of counterfeiting in the economies benchmarked in the Index³. An overall score approaching 30 is indicative of a highly robust IP system. [Infinite Possibilities. U.S. Chamber International IP Index. (2016).]

The institutional environment of a country depends on the efficiency and the behavior of both public and private stakeholders. Intellectual property protection appears two times in the whole ranking which is yearly created by World Economic Forum in publication Global Competitiveness Report but in fact it is ranked once. In the first pillar of competitiveness dedicated to public institution property protection and intellectual property protection are ranked as first indicators which influence the level of country's competitiveness and then intellectual property appears again in twelfth pillar dedicated to innovation. This same indicator enters the GCI in two different pillars. In order to avoid double counting, the WEF assign a half-weight to each instance. [Schwab, K. (2016)]. The GCI includes statistical data from

3

The relationship between the IPRs protection and problem of counterfeit and pirated good is describe also in OECD and WIPO publications. These organizations jointly measure and analyze the scale of counterfeit and pirated trade in order to provide policymakers with robust empirical evidence about this threat. [Trade in Counterfeit and Pirated Goods: Mapping the Economic Impact. (2016).] Some researchers find measures connected with counterfeit and pirated good as alternative measure for IPRs protection.

internationally recognized agencies and it also includes data from the World Economic Forum's annual Executive Opinion Survey to capture concepts that require a more qualitative assessment, or for which comprehensive and internationally comparable statistical data are not available. The intellectual property protection is measured by Executive Opinion Survey, because of lack of well-know and globally accepted measure of IPRs protection. In 2016 year the Report covers 140 economies. There are also some famous indexes which deal with IPRs protection but final indexes present the protection of property protection in general and do not create the separate indexes for IPRs only. One of the best well-know indicator, the Index of Economic Freedom focuses on four main aspects of the economic environment over which governments usually exercise policy control: the rule of law, government size, regulatory efficiency and market openness. The part dedicated to property rights is a part of the rule of law and it is a qualitative assessment of the extent to which a country's legal framework allows individuals to freely accumulate private property, which is secured by clear laws that are enforced effectively by the government. It measures the degree to which a country's law is able to protect private property rights and the extent to which those laws are respected. It also assesses the possibility that private property will be expropriated by the state and analyzes the independence of the judiciary, the existence of corruption within the judiciary, and the ability of individuals and businesses to enforce contracts. More effective legal protection of property means higher country's score [Miller T, Kim A.B., Holmes K.R. (2014)]. In 2015 index covers

10 freedoms – from property rights to entrepreneurship – in 186 countries. Economic Freedom of the World is the index published yearly in Economic Freedom of the World by the Fraser Institute. It measures the degree to which the national policies and institutions are supportive of economic freedom. Forty-two data points are used to construct a summary index and measure the degree of economic freedom in five broad areas: size of government (expenditures, taxes, and enterprises), legal structure and security of property rights access to sound money, freedom to trade internationally and regulation of credit, labor, and business. According to the Report's authors the protection of persons and their rightfully acquired property is a central element of economic freedom and a civil society. Indeed, it is the most important function of contemporary government. The key elements of a legal system consistent with economic freedom are: rule of law, security of property rights, an independent and unbiased judiciary, impartial and effective enforcement of the law. Security of property rights (also intellectual property rights), protected by the rule of law, provides the foundation for both economic freedom and the efficient operation of markets and consequently for economic growth and development. Freedom to exchange, for example, is meaningless if individuals do not have secure rights to property, especially the results of their labor. When individuals and businesses lack confidence that contracts will be enforced and the results of their productive efforts will be protected, their incentive to engage in productive activity is destroyed. This area is essential for the efficient allocation of resources. Countries with major deficiencies in this area are unlikely to prosper regardless of their policies in the other four areas [Gwartney, J. Lawson, R. Hall J. (2014)]. In 2012 Economic Freedom of the World measured economic freedom in 157 nations.

4. CONCLUSION

The creation of globally accepted measure of intellectual property rights protection in national and global dimensions is an important issue for international business, scholars and practitioners. Without it, conducting future research and comparison between countries seems to be worthless. For scholars, the measure can offer insightful perspectives into micro-level questions about the nature of incentives, and at the macro-level such index can also help answer questions about the relationship between IPRs and trade, foreign investment flows, economic freedom, global competitiveness and economic growth and development. Practitioners in international business may find such index as a valuable tool in assessing intellectual property

investment risk in countries, particularly in industries that are sensitive to the protection of IPRs. [Ostergard, R.,L. (2000), p.357.]

This paper has attempted to accomplish three main goals. The first was to call attention to the need for additional quantitative research in the area of IPRs protection. The second was to underline the necessity of creation globally accepted measure of IPRs protection. The third goal was to present, shortly describe and compare existed measures. The importance of an enforcement component in assessing the strength of IPR protection in countries should not be overlooked. Measures that do not take enforcement into account may unintentionally overestimate the protection.

LITERATURE:

1. Ginarte, J. (1997). Determinants of Patent Rights: A Cross-national Study. *Research Policy*, vol.26
2. Gwartney, J, Lawson, R, Hall, J. (2014). *Economic Freedom of the World: 2014 Annual Report*. Fraser Institute. Retrieved 12.06.2016 from http://www.freetheworld.com/datasets_efw.html.
3. Idris, K. (2003). *Intellectual Property. A Power Tool for Economic Growth*. Geneva: WIPO.
4. *Infinite Possibilities. U.S. Chamber International IP Index. Fourth Edition*. (2016). Global International Property Centre. US Chamber of Commerce. Retrieved 10.07.2016 from <http://www.theglobalipcenter.com/gipcindex>.
5. *Intellectual Property Commercialization. Policy Options and Practical Instruments*. (2011). New York: United Nations Economic Commission for Europe.
6. Lesser, W. (2011). Measuring Intellectual Property 'Strength' and Effects: An Assessment of Patent Scoring Systems and Causality. *The Journal of Business, Entrepreneurship & the Law*. Volume 4, Issue 2,
7. Mansfield, E. (1994). Intellectual Property Protection, Foreign Direct Investment and Technology Transfer. *International Finance Corporation Discussion Paper*. No. 19.
8. Markus, K. (2000). *Intellectual Property Rights in Global Economy*. Institute for International Economics.
9. Miller, T, Kim, A,B, Holmes, K,R. (2014). *2014 Index of Economic Freedom. Promoting Economic Opportunity and Prosperity*. Washington DC: The Heritage Foundation. Retrieved 10.06.2016 from www.heritage.org
10. Ostergard, R, L. (2000). The Measurement of Intellectual Property Rights Protection. *Journal of International Business Studies*. No. 31/2.
11. Park, G,W, Wagh, S. (2001). *Intellectual Property and Patent Regimes, in Economic Freedom of The World: Annual Report 2001*. Retrieved 1.06.2016 from <http://www.cato.org/pubs/efw/efw2001/efw01-ch4.pdf>.
12. Rapp, R,T, Rozek, R,P (1990). Benefits and costs of intellectual property protection in developing countries. *Journal of World Trade*. Vol. 24, pp. 75-102.
13. Richards, D,G. (2004). *Intellectual Property Rights and Global Capitalism. The Political Economy of the TRIPS Agreement*. New York: M&E Sharpe.
14. Schwab, K.(2016). *The Global Competitiveness Report 2015-2016*. Geneva: World Economic Forum.
15. Sherwood, R, M. (1997). The TRIPS Agreement: Implication for Developing Countries, *IDEA: The Journal of Law and Technology*. Vol. 37.
16. *Taylor Wessing Global Intellectual Property Index*. (2008). Berlin, Brussels, Cambridge: Taylor Wessing. Retrieved 1.06.2016 from <https://netherlands.taylorwessing.com>
17. *The International Property Rights Index*. (2015). Retrieved 2.07.2016 from <http://internationalpropertyrightsindex.org/>.
18. *Trade in Counterfeit and Pirated Goods: Mapping the Economic Impact*. (2016), Paris: OECD, EUIPO.

EUROPEAN AIMS AND CROATIAN LEGAL SOLUTIONS FOR THE PROTECTION OF THE ADRIATIC SEA FROM POLLUTION

Biljana Cincurak Erceg

Josip Juraj Strossmayer University of Osijek

Faculty of Law Osijek, Croatia

biljana.cincurak@pravos.hr

ABSTRACT

Within the European Union, there is a significant area of marine waters which are under the sovereignty and jurisdiction of the Member States. Sea and marine environment are an invaluable natural resource that must be protected and preserved from the harmful impact of human activities. The Member States of the European Union are parties to the most important conventions aimed to protect the marine environment, and the European Union has adopted a number of important directives aimed at protecting the environment. The European Union has recognised the importance of protecting the marine environment and has therefore adopted Directive 2008/56/EC of the European Parliament and of the Council establishing a framework for community action in the field of marine environmental policy (Marine Strategy Framework Directive) in 2008, establishing a framework within which Member States take the measures necessary to achieve or maintain good environmental status in the marine environment by 2020. As a Member State, the Republic of Croatia should develop a marine strategy for the Adriatic Sea and for that purpose it has to cooperate with both other Member States and third countries. The paper analyses the activities related to the implementation of the Marine Strategy Framework Directive which Croatia has carried out, legal solutions made for that purpose, the problems they faced as well as measures to be taken and the plans to be executed.

It also gives a brief overview of the implementation of the Directive in the European Union, the existing situation and the goals of the neighbouring countries as well as a critical review of the adopted solutions.

Keywords: *Adriatic Sea, Good Environmental Status, Marine Strategy Framework Directive, Protection of the Marine Environment.*

1. INTRODUCTION

Sea and marine environment are an invaluable natural resource subject to pollution from several sources (e.g., land-based activities, vessel pollution, pollution from platforms, pollution from air, dumping, off-shore activities), hence the marine environment must be protected and preserved from the harmful impact of human activities. Marine waters under the sovereignty and jurisdiction of Member States of the European Union (hereinafter referred to as 'the EU') include waters in the Mediterranean Sea, the Baltic Sea, the Black Sea and the North-east Atlantic Ocean, including the waters surrounding the Azores, Madeira and the Canary Islands. Member States have recognised the importance of protecting the marine environment, and therefore the European Parliament and the Council of the European Union adopted Directive 2008/56 /EC of the European Parliament and of the Council establishing a framework for community action in the field of marine environmental policy (Marine Strategy Framework Directive - hereinafter referred to as 'MSFD') in 2008.

The Republic of Croatia has a large part of the Adriatic coast and is responsible for its protection and preservation. In accordance with existing regulations and commitments, the Republic of Croatia has undertaken a number of activities in order to achieve the goals planned. In addition to taking specific measures, in the case of the Adriatic Sea, cooperation with not only EU Member States but also third countries will be necessary.

2. THE ADRIATIC SEA AS A PART OF THE MEDITERRANEAN SEA REGION – A GEOGRAPHICAL AND LEGAL OVERVIEW

2.1. Geographical overview

The Adriatic Sea is a part of the Mediterranean Sea positioned between the Italian and Balkan peninsulas. There are six countries sharing its coast, i.e., Albania, Bosnia and Herzegovina, Croatia, Italy, Montenegro and Slovenia. The length of the Adriatic Sea is 783 km, the average width is 248.3 km, and its average depth is 173 m. Its surface area amounts to 138,595 km². The length of the entire mainland Adriatic coast is 3,690 km, of which Croatia's Adriatic Sea mainland coast is 1,777 km long, Italy's is 1249 km, Albania's 396 km, Montenegro's 200 km, Slovenia's 47 km and finally, Bosnia and Herzegovina's is 21 km. (<http://www.enciklopedija.hr/natuknica.aspx?id=28478>) EU Member States' share of surface area is 87.7% (State of Europe's seas, 2015, p. 14).

The Croatian Adriatic Sea coastline (both the mainland and islands) accounts for 75.8% of the total Adriatic shoreline (Ćorić, Debeljak – Rukavina, 2008, p. 959). Therefore, the Republic of Croatia plays an important role in the preservation and protection of the Adriatic Sea. Namely, the Mediterranean Sea is one of the most ecologically endangered seas thanks to its specific geographical location (according to Art. 122 of the United Nations Convention on the Law of the Sea (hereinafter referred to as 'UNCLOS'), it belongs to the group of enclosed or semi-enclosed seas), but also to heavy traffic occurring there, as well as industrial and municipal waste that reaches the Mediterranean Sea through rivers.

2.2. Legal instruments relevant for the protection of the sea environment

The Republic of Croatia as well as other Member States of the EU are parties to the most important conventions aiming to protect the marine environment. Legal sources relevant for the protection of the sea environment can be divided into the following three groups: international conventions, European legislation and national sources of law.

2.1.1 International conventions

The MSFD recalls that both the EU and Member States should take into account the obligations under UNCLOS (Preamble, Art. 17), the implementation of the Convention on Biological Diversity (Preamble, Art. 18) and the fulfilment of duties and obligations under the Convention for the Protection of the Marine Environment and the Coastal Region of the Mediterranean, as well as its Protocol for the Protection of the Mediterranean Sea against Pollution from Land-Based Sources.

The United Nations Convention on the Law of the Sea (UNCLOS), concluded in 1982, came into force in 1994 is the most important international treaty regulating the law of the sea in general, but also the protection and preservation of the marine environment. The Convention lays down the fundamental obligation of all States to protect and preserve the marine environment (Art. 192 of UNCLOS) and urges all States to cooperate on a global and regional basis in formulating rules and standards and otherwise take measures for the same purpose. Its provisions lay down only general principles and rules, establishing a global framework of obligations, responsibilities and powers of states in all matters of marine environment protection. Therefore, UNCLOS needs to be complemented with a further treaty law structure.

“From the EU perspective, UNCLOS served as a catalyst for the member states to come up with more expansive ocean policies, as the Convention did not explicitly obligate parties to promote ecosystem-based integrated ocean governance.” (Koivurova, 2009, p. 172)

The Convention on Biological Diversity was concluded in 1992 and it came into force in 1993. Biological diversity means the variability among living organisms from all sources including, inter alia, terrestrial, marine and other aquatic ecosystems and the ecological complexes of which they are part; this includes diversity within species, between species and of ecosystems. The objectives of the Convention, as defined in Art. 1, are the conservation of biological diversity, the sustainable use of its components and the fair and equitable sharing of the benefits arising out of the utilisation of genetic resources, including by appropriate access to genetic resources and by appropriate transfer of relevant technologies, taking into account all rights over those resources and to technologies, and by appropriate funding.

According to the MSFD, the Adriatic Sea is a subregion of the Mediterranean Sea region, hence all conventions regulating the Mediterranean Sea region are also relevant. First of all, it is the Convention for the Protection of the Mediterranean Sea against Pollution (Barcelona Convention) which was adopted in 1976 and amended in 1995 when it changed its name into the Convention for the Protection of the Marine Environment and the Coastal Region of the Mediterranean with its 7 protocols. The Barcelona convention is a result of the Mediterranean Action Plan, a plan adopted as a Regional Seas Programme which is one of UNEP's most significant achievements. For the purpose of this paper, it should be pointed out that the Republic of Croatia assumed the obligations stemming from the Protocol on Integrated Coastal Zone Management in the Mediterranean on the development of the National Strategy for Integrated Coastal Zone Management.

In the context of this paper, the International Convention for the Prevention of Pollution from Ships (MARPOL) has to be mentioned as well. It was concluded in 1973, and it came into force in 1983 together with the 1978 Protocol. MARPOL regulates and prevents marine pollution by ships, and covers accidental and operational oil pollution as well as pollution by chemicals, goods in packaged form, sewage, garbage and air pollution. "It should be noted that in accordance with Annexes I and V to the MARPOL Convention, the Mediterranean Sea area, and thus the Adriatic Sea area as part thereof, are defined as special areas. This includes more stringent controls, i.e., prohibition of discharge of oil and garbage from ships." (Ćorić, Debeljak – Rukavina, 2008, p. 964)

2.1.2 European legislation

The main act regulating marine environmental policy within the EU has already been mentioned, i.e., the Marine Strategy Framework Directive (see *infra* Chapter 3). The MSFD is not an unrelated legislative act as it complements a number of other European, regional and international instruments. According to Art. 13(2) of the MSFD, it is connected to Council Directive 91/271/EEC of 21 May 1991 concerning urban waste-water treatment (OJ L 135, 30. 5. 1991, pp. 40–52), Directive 2006/7/EC of the European Parliament and of the Council of 15 February 2006 concerning the management of bathing water quality and repealing Directive 76/160/EEC (OJ L 64, 4. 3. 2006, pp. 37–51), as well as, according to Art. 13(4) of the MSFD, Council Directive 92/43/EEC of 21 May 1992 on the conservation of natural habitats and of wild fauna and flora (OJ L 206, 22. 7. 1992, pp. 7–50) and Directive 2009/147/EC of the European Parliament and of the Council of 30 November 2009 on the conservation of wild birds (OJ L 20, 26. 1. 2010, pp. 7–25). It should be noted that the achievement of the objectives outlined in the MSFD is also closely related to the fulfilment of obligations under Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for Community action in the field of water policy (the Water Framework Directive) since the primary method of marine pollution is pollution from land-based sources, i.e., rivers.

The Marine Strategy Framework Directive is intended to provide a regulatory platform for implementing the environmental objectives of the European Integrated Maritime Policy (IMP).

The MSFD it is the “environmental pillar” of the IMP (Juda 2010, p. 44). “The Directive also highlights the need for cross-cutting coordination of the present effort to protect the marine environment with a host of other EU-wide policies such as the Common Fisheries Policy, the Common Agricultural Policy, and the Directive on Water Policy as well as with relevant requirements of international agreements. In this sense, the MSFD is seen as a corrective reaction to the failures associated with earlier sectoral policies taken on a compartmentalized basis that have addressed particular marine uses at all levels of governance from local to international” (Juda, 2010, p. 38).

2.1.3 Croatian legal sources

There is a great number of Croatian rules and regulations which directly or indirectly regulate the protection of the marine environment. Most of these rules and regulations are the result of relevant international conventions adopted under the auspices of the International Maritime Organisation, as well as the implementation of EU legislation. (Ćorić, Debeljak – Rukavina, 2008, p. 960).

In order to achieve the objectives provided for by the MSFD, the Republic of Croatia has amended a few important acts such as the Environmental Protection Act (OG, No. 80/2013, 78/2015) and the Maritime Code (OG, No. 181/04, 76/07, 146/08, 61/11, 56/13), that were harmonised with UNCLOS, and has adopted several new ones, e.g., the Regulation on the preparation and implementation of documents under the Coastal and Marine Management Strategy (OG, No. 112/2014), the Decision on the adoption of the Coastal and Marine Management Strategy Action Programme: Monitoring and observation system for a continuous assessment of the state of the Adriatic Sea (OG, No. 153/2014), and the Maritime Development and Integrated Maritime Policy Strategy of the Republic of Croatia for the period from 2014 to 2020 (OG, No. 93/2014).

The dynamics of human activities at sea and along the coast is continually growing which in turn increases the pressure on the marine environment. In addition to traditional forms of pollution, there are also some new forms - marine invasive species spread via ballast water. Therefore the Republic of Croatia adopted the Ballast Water Control and Management Ordinance (OG, No. 128/2012), which makes a significant contribution to improving the protection of the marine environment.

Continuous efforts are put into drafting a proposal for the designation of the Adriatic Sea a Particularly Sensitive Sea Area, which includes a proposal for additional protective measures relating to ballast water. “The Republic of Croatia considers this institute of the MARPOL Convention a priority tool for effective protection of the marine environment of the Adriatic Sea in all coastal states of the Adriatic.” (Maritime Development and Integrated Maritime Policy Strategy of the Republic of Croatia for the period from 2014 to 2020, OG, No. 93/2014) There are significant activities focused on the prevention of the marine environment against pollution, in particular in the context of safety of navigation, and safety of human life and property. A major threat to the Adriatic Sea is also possible pollution that could arise as a result of maritime accidents. In relation to this, Croatia, Italy and Slovenia adopted the Sub-regional Contingency Plan for the prevention of, preparedness for and response to major marine pollution incidents in the Adriatic sea and there also exists a national Contingency Plan for Accidental Marine Pollution (OG, No. 92/2008).

Since the Republic of Croatia is a party to all international conventions mentioned above (see *supra* Chapter 2.1.1) and since as an EU Member State it is obliged to respect and implement EU regulations, we can say that the legislative framework relating to the protection of the marine environment from pollution is satisfactory.

3. MARINE STRATEGY FRAMEWORK DIRECTIVE

The European Parliament and the Council of the European Union adopted Directive 2008/56/EC of the European Parliament and of the Council of 17 June 2008 establishing a framework for community action in the field of marine environmental policy (the Marine Strategy Framework Directive - MSFD). This Directive establishes a framework within which Member States shall take the necessary measures to achieve or maintain good environmental status in the marine environment by the year 2020 at the latest (Art.1).

For that purpose, marine strategies shall be developed and implemented in order to:

- a) protect and preserve the marine environment, prevent its deterioration or, where practicable, restore marine ecosystems in areas where they have been adversely affected;
- b) prevent and reduce inputs in the marine environment, with a view to phasing out pollution, so as to ensure that there are no significant impacts on or risks to marine biodiversity, marine ecosystems, human health or legitimate uses of the sea (Art. 2).

The MSFD prescribes that good environmental status (hereinafter referred to as 'GES') “means the environmental status of marine waters where these provide ecologically diverse and dynamic oceans and seas which are clean, healthy and productive within their intrinsic conditions, and the use of the marine environment is at a level that is sustainable, thus safeguarding the potential for uses and activities by current and future generations” (Art. 3(5)).

In order to reach GES, the MSFD wants to apply an ecosystem-based approach to the management of human activities.

To help Member States understand what GES means in practice, in Annex I, the MSFD sets out 11 qualitative descriptors (biological diversity, non-indigenous species, commercial fish and shellfish, food webs, eutrophication, sea-floor integrity, hydrographical conditions, contaminants, contaminants in seafood, marine litter, energy including underwater noise) which describe what the environment will look like when GES has been achieved. Further, the European Commission adopted 2010/477/EU: Commission Decision of 1 September 2010 on criteria and methodological standards on good environmental status of marine waters (notified under document C (2010) 5956) Text with EEA relevance, OJ L 232, 2.9.2010, pp. 14–24). It contains a number of criteria and associated indicators for assessing good environmental status in relation to the 11 descriptors of good environmental status laid down in Annex I of the MSFD.

The scope of the MSFD are all marine waters, i.e., a) waters, the seabed and subsoil on the seaward side of the baseline from which the extent of territorial waters is measured extending to the outmost reach of the area where a Member State has and/or exercises jurisdictional rights, in accordance with the UNCLOS, and b) coastal waters as defined by Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for Community action in the field of water policy, their seabed and their subsoil.

In order to achieve good environmental status by 2020, each Member State is required to develop a strategy for its marine waters. “Term ‘marine strategy’ is best understood as an action plan for applying an ecosystem-based approach to the management of human activities in the marine environment” (Long, 2011, p. 28).

Marine strategies should culminate in the execution of programmes of measures designed to achieve or maintain good environmental status. Programmes of measures will be preceded by a preparatory process of the states, which consists of the following: 1. an analysis of the features or characteristics of, and pressures and impacts on marine waters, identifying the predominant pressures and impacts on those waters; 2. determination for their marine waters a set of characteristics for good environmental status; 3. establishment of environmental targets and monitoring programmes for ongoing assessment; 4. establishment and implementation of programmes of measures designed to achieve or maintain good environmental status in the waters concerned (see Articles 8–11 of the MSFD). The programme of the measures should start by 2016 at the latest.

3.1. Implementation of the Marine Strategy Framework Directive

First of all, all Member States have transposed the MSFD into their national legislation. Member States have reported under the MSFD on the state of the environment in their marine waters, and on what they consider to be GES. In its report “The first phase of implementation of the Marine Strategy Framework Directive (2008/56/EC) The European Commission’s assessment and guidance (COM/2014/097 final)”, the European Commission stated that “Member States’ definition of good environmental status and the path they set out to achieve it shows overall limited ambition, often fails to take into account existing obligations and standards and lacks coherence across the Union, even between neighbouring countries within the same marine region.” (Report, 2014, p. 2) Further, most Member States have reported on most articles and most descriptors but the quality of reporting varies widely from country to country, and within individual Member States, from one descriptor to another. (Report, 2014, p. 5) The presence of data gaps in Member States’ reports is also significant. Another problem is that initial assessment reports often give only a fragmented overview of the state of the marine environment. Therefore “comparability of the reporting of Member States is low and makes coordinated action and analysis difficult.” (Report, 2014, p. 7)

The Commission concluded that regional cooperation amongst Member States and other relevant countries by the Regional Sea Conventions is well developed in all four regions. “However, the role and the use of the results of this regional cooperation in the MSFD reporting varied considerably.” (SWD (2014) 49 final, p. 72). Since the implementation of the MSFD is complex and requires cooperation within and between the marine regions, the Commission and the EU Member States agreed to establish informal cooperation under a Common Implementation Strategy (CIS) since 2008.

4. CROATIAN ACTIVITIES REGARDING THE IMPLEMENTATION OF THE MARINE STRATEGY FRAMEWORK DIRECTIVE

The implementation of the Marine Strategy Framework Directive in Croatia consists of harmonisation of national legislation with the provisions of the MSFD (see supra 2.1.3), preparing a marine strategy for Croatian coastal waters, and the realisation/continuation of sub-regional cooperation with neighbouring countries surrounding the Adriatic area as well as regional cooperation in the context of the Barcelona Convention.

As for the development of the Croatian Marine Strategy, it was decided that a unified strategy for marine environment and coastal zone management should be developed for achieving the objectives of the MSFD and the Protocol to the Barcelona Convention on Integrated Coastal Zone Management in the Mediterranean. The Strategy is still pending (the draft strategy of September 2015 is available at: http://mio-strategija-hr.pap-thecoastcentre.org/docs/strategija_prvi_nacrt.pdf).

As part of the implementation of the MSFD and in accordance with the MSFD, the Republic of Croatia prepared the documents “Initial assessment of the state and load of the marine environment of the Croatian part of the Adriatic”, “Good environmental status of the marine environment and a Set of environmental goals and related indicators” and “An economic and social analysis of the use and the cost of degradation of the coastal and marine environment”. The “Action Programme of the Marine Strategy: The monitoring and observation system for ongoing assessment of the Adriatic Sea” (OG, No. 153/2014) was adopted, and according to available data, the adoption of the Programme of measures for marine environment and coastal zone protection and management is in progress (noting that the said Programme of measures should have been adopted by the end of 2015).

4.1. Problems that may affect the implementation of the MSFD in Croatia

The Initial assessment of the state and load of the marine environment of the Croatian part of the Adriatic encompasses several important problems: excessive construction in the coastal area (probably the most important influence on the biological and landscape diversity of the Adriatic Sea); pollution of the sea through ballast water (although the Ballast Water Control and Management Ordinance were adopted, due to lack of funds, they are not applied regularly, and the number of comprehensive analyses of ballast water in Croatia is rather low); marine pollution most commonly comes from land-based activities or vessels. On the other hand, it is pointed out that the quality of sea water at beaches along the Croatian coast is very high (Initial assessment of the state and load of the marine environment of the Croatian part of the Adriatic, 2012, p. 341).

There are also some other significant problems like an insufficient number of studies (systematic investigations of the effect of fisheries on ecosystems have not been made, only few comprehensive analyses of ballast water have been conducted), for some pollutants there are no data at all (e.g. the introduction of pathogenic microorganisms in the marine environment), and there is generally no systematic monitoring of certain pollutants. The problem of a lack of data has come to the fore in the document “Good environmental status of the marine environment and a Set of environmental goals and related indicators” since because of that it was not possible to assess GES for some components.

4.2. Cooperation with other Member States

In the Preamble, Art. 13, the MSDF states that Member States should cooperate to ensure the coordinated development of marine strategies for each marine region or subregion. “Since marine regions or subregions are shared both with other Member States and with third countries, Member States should make every effort to ensure close coordination with all Member States and third countries concerned. Where practical and appropriate, existing institutional structures established in marine regions or subregions, in particular Regional Sea Conventions, should be used to ensure such coordination.” In our situation, this implies cooperation with Greece, Italy and Slovenia as other Member States, and Albania, Bosnia and Herzegovina and Montenegro as third countries (see map:

http://ec.europa.eu/environment/marine/eu-coast-and-marine-policy/implementation/index_en.htm).

Italy and Slovenia made initial assessments of their marine waters, determined GES and established a comprehensive set of environmental targets and associated indicators (a monitoring programme). Greece has not made a monitoring programme. Neither of three countries has prepared the programme of measures (http://ec.europa.eu/environment/marine/eu-coast-and-marine-policy/implementation/scoreboard_en.htm).

Under Art. 12 of the MSFD, the Commission was assigned to review the progress and provide to the Member States “guidance on any modifications it considers necessary”, so the Commission has published the detailed technical assessment reports for each country and each marine region (see: http://ec.europa.eu/environment/marine/eu-coast-and-marine-policy/implementation/reports_en.htm). In the Commission Staff Working Document (SWD(2014) 49 final), which is an Annex to the Commission Report COM(2014) 97 final, summary findings and recommendations for each Member State are available, with strong and weak points of national assessments (Greece, pp. 129-132, Italy, pp. 136-139, Slovenia, pp. 159-162. Croatia did not provide its national report on time, hence the Commission did not report about Croatia).

5. THE STATE OF SEAS IN EUROPE

In 2015, the European Environment Agency (EEA) published a report which gives an assessment of Europe’s seas. According to the State of Europe’s seas report, although Europe’s seas are productive, they cannot be considered to be healthy, clean and undisturbed (State of Europe’s seas, 2015, p. 188) and are unlikely to become so in the future (p. 189). Namely, 80% of the species and habitats assessments under the MSFD are categorised as 'unknown', and only 4% have achieved the 2020 target of 'good' status. (p. 54). Similarly, most of the assessed commercial stocks (58%) in Europe’s seas are not in good environmental status, whilst the status of 40% of commercial fish stocks is not assessed due to lack of data. (p. 54). There is an “evidence of significant marine biodiversity/ecosystem degradation and, in addition, of a substantial lack of knowledge on the state of marine biodiversity/ecosystems. This lack of knowledge prevents the effective management of all human activities that can damage marine ecosystem/biodiversity overall.” (p. 153). Further, the report states that it is unlikely that many improvements in the condition of marine ecosystems/biodiversity can be seen by the MSFD 2020 deadline to achieve good environmental status (p. 154).

Several human-induced pressures affect the state of marine ecosystems directly: physical loss and damage to the seafloor, the capture of fish and shellfish, the introduction of non-indigenous species, pollution that comes from land and the atmosphere, marine litter and underwater noise.

“Analysis performed in the Mediterranean and Black Seas shows that 20% of both regions and 60–99% of the territorial waters of EU Member States in these regions are subject to high impact from human activities, while less than 20% are classed as low impact. Very few areas — less than 1% — remain relatively unaffected by human activities“ (State of Europe’s seas, 2015, p. 94).

6. CONCLUSION

The European seas are seriously endangered by land-based pollution, oil and hazardous substance discharges and spills, introduction of alien species, overfishing, port and other coastal development, eutrophication, etc. In order to protect the marine environment, in 2008, the European Parliament and the Council of the European Union adopted Directive 2008/56/EC establishing a framework for community action in the field of marine environmental policy (Marine Strategy Framework Directive - MSFD). The MSFD establishes a framework within which Member States shall take the necessary measures to achieve or maintain good environmental status in the marine environment by the year 2020.

The MSFD is the first framework instrument which is aimed particularly at protecting and preserving the marine environment, preventing its deterioration or, where practicable, restoring marine ecosystems in areas where they have been adversely affected. In order to reach GES, the MSFD applies an ecosystem-based approach to the management of human activities.

Additionally, sustainable use of Europe's seas and avoiding further marine ecosystem degradation and loss cannot be achieved by marine policy alone.

To be effective, the MSFD is dependent on reliable scientific data and analysis. In its report, the Commission stated that a number of states have shown gaps while reporting on the state of the environment in their marine waters, and on what they consider to be GES. Lack of information prevents effective management (potential pressures on marine ecosystems and their biodiversity may not be appropriately managed, or may not be managed at all) of all activities that can harm the marine environment. Insufficient and poor quality data will be a problem and could also influence the objectives of the MSFD not to be achieved by 2020.

The Republic of Croatia and other EU Member States, which are also Adriatic coastal states, have so far fulfilled their obligations relatively well (except for delays in making documents), by which they should achieve the objectives of the MSFD. What they all have in common are the disadvantages of certain data that will be needed in order to carry out MSDF implementing activities with the best quality possible. All of them also participate in the framework of the Barcelona Convention. However, they should participate more actively in the adoption of measures for the prevention and protection of the marine environment, and strengthen cooperation with other Adriatic coastal states in the protection of the seas and the marine environment.

Reports indicate that the current state of Europe's seas is not good. Since there isn't much time left by 2020, i.e. by when GES should be achieved, it is impossible not to wonder whether the European Union has set too high a goal to be achieved by Member States and whether they will manage (despite the will and a good legislative framework, but also many problems) to accomplish it.

LITERATURE:

1. *Article 12 Technical Assessment of the MSFD 2012 obligations*, 7 February 2014, *Final version* (Greece, Italy, Slovenia). (2014). Retrieved 25.07.2016 from http://ec.europa.eu/environment/marine/eu-coast-and-marine-policy/implementation/reports_en.htm.
2. Commission Staff Working Document, Annex, Accompanying the document Commission Report to the Council and the European Parliament: The first phase of implementation of the Marine Strategy Framework Directive (2008/56/EC) - The European Commission's assessment and guidance COM (2014) 97 final, SWD (2014) 49 final. (2014). Retrieved 25.07.2016 from <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52014SC0049>.
3. Convention on Biological Diversity. (1992). *United Nations Treaty Series*, Vol. 1760, No. 30619, pp. 79–307.
4. Ćorić, D, Debeljak - Rukavina, S. (2008). Zaštita morskog okoliša u zaštićenom ekološko-ribolovnom pojasu Republike Hrvatske, In *Zbornik Pravnog fakulteta Sveučilišta u Rijeci*, Vol. 29, No. 2, pp. 959–974. Rijeka: Pravni fakultet Sveučilišta u Rijeci.
5. Decision on the adoption of the Coastal and Marine Management Strategy Action Programme: Monitoring and observation system for continuous assessment of the state of the Adriatic Sea. (2014). *Official Gazette*, No. 153/2014.

6. Directive 2000/60/EC of the European Parliament and of the Council of 23 October 2000 establishing a framework for Community action in the field of water policy. (2000). *Official Journal of the European Union*, L 327, 22.12.2000., pp. 1–73.
7. Directive 2008/56/EC of the European Parliament and of the Council of 17 June 2008 establishing a framework for community action in the field of marine environmental policy (Marine Strategy Framework Directive). (2008). *Official Journal of the European Union*, L 164, 25.6.2008., pp. 19–40.
8. Good environmental status of the marine environment and a Set of environmental goals and related indicators. Retrieved 10.07.2016 from http://www.mzoip.hr/doc/skup_znacajki_dobrog_stanja_okolisa_za_morske_vode_pod_suverenitetom_republike_hrvatske_i_skup_ciljeva_u_zastiti_morskog_okolisa_i_s_nji_ma_povezanih_pokazatelja.pdf.
9. European Environment Agency (2015), *State of Europe's seas*, (EEA Report No. 2/2015) Luxembourg: Publications Office of the European Union. Retrieved 20.07.2016 from <http://www.eea.europa.eu/publications/state-of-europes-seas>.
10. An economic and social analysis of the use and the cost of degradation of the coastal and marine environment. Retrieved 10.07.2016 from http://www.mzoip.hr/doc/skup_znacajki_dobrog_stanja_okolisa_za_morske_vode_pod_suverenitetom_republike_hrvatske_i_skup_ciljeva_u_zastiti_morskog_okolisa_i_s_nji_ma_povezanih_pokazatelja.pdf.
11. Hrvatska enciklopedija, digital edition. (2016). Leksikografski zavod Miroslav Krleža, *Jadransko more*. Retrieved 13.07.2016 from <http://www.enciklopedija.hr/natuknica.aspx?id=28478>.
12. International Convention for the Prevention of Pollution from Ships (MARPOL). (1973 and Protocol 1978). *United Nations Treaty Series*, Vol. 1340, No. 22484, pp. 6–265.
13. Juda, L. (2010). The European Union and the Marine Strategy Framework Directive: Continuing the Development of European Ocean Use Management. *Ocean Development & International Law*, 41:1, pp. 34–54. Retrieved 02.06.2016 from <http://dx.doi.org/10.1080/00908320903285463>.
14. Juda, L. (2007) The European Union and Ocean Use Management: The Marine Strategy and the Maritime Policy. *Ocean Development & International Law*, 38:3, pp. 259–282. Retrieved 02.06.2016 from <http://dx.doi.org/10.1080/00908320701530466>.
15. Koivurova, T. (2009). A Note on the European Union's Integrated Maritime Policy. *Ocean Development & International Law*, Vol. 40, No. 2, pp. 171–183. Retrieved 02.06.2016 from <http://dx.doi.org/10.1080/00908320902864904>.
16. Long, R. (2011). The Marine Strategy Framework Directive: A New European Approach to the Regulation of the Marine Environment, Marine Natural Resources and Marine Ecological Services. *Journal of Energy & Natural Resources Law*, 29:1, pp. 1–44. Retrieved 02.06.2016 from <http://dx.doi.org/10.1080/02646811.2011.11435256>.
17. Draft of Marine environment and coastal zone management strategy. Retrieved 23.07.2016 from http://mio-strategija-hr.pap-thecoastcentre.org/docs/strategija_prvi_nacrt.pdf.
18. Initial assessment of the state and load of the marine environment of the Croatian part of the Adriatic. (2012). Retrieved 10.07.2016 from

- http://www.mzoip.hr/doc/pocetna_procjena_stanja_i_pritisaka_na_morski_okolis_hrvat_skog_dijela_jadrana.pdf.
19. Regulation on the preparation and implementation of documents under the Coastal and Marine Management Strategy. (2014). *Official Gazette*, No. 112/2014.
 20. Report from the Commission to the Council and the European Parliament: The first phase of implementation of the Marine Strategy Framework Directive (2008/56/EC) The European Commission's assessment and guidance (COM/2014/097 final).
 21. Seršić, M. (2003). *Međunarodnopravna zaštita morskog okoliša*, Zagreb: Pravni fakultet Sveučilišta u Zagrebu.
 22. Maritime Development and Integrated Maritime Policy Strategy of the Republic of Croatia for the period from 2014 to 2020. (2014). *Official Gazette*, No. 93/2014.
 23. *The Marine Strategy Framework Directive Scoreboard*, Retrieved 21.07.2016. from <https://translate.google.hr/?hl=hr#en/hr/The%20Marine%20Strategy%20Framework%20Directive%20Scoreboard>.
 24. United Nations Convention on the Law of the Sea (UNCLOS). (1982). *United Nations Treaty Series*, Vol. 1834, No. 31363, pp. 396–581.

CROATIAN LEGISLATION AND PRACTICE - THE EFFECTS ON INVESTMENT PROCESSES

Blanka Ivancic - Kacer

*Faculty of Law University of Split
Domovinskog rata 8, 21 000 Split,
Croatia blanka.ivancic-kacer@pravst.hr*

ABSTRACT

Investments are conditio sine qua non of economic development, and consequently the development in general. For every investor, when making final decision to invest or not, it is extremely important whether it is an environment that is characterized by legal certainty. In other words, in an environment of legal uncertainty there are no or few investments. Legal certainty primarily means that it is clear when and under what conditions something is legal or illegal. Unfortunately, in Croatia, according to the information given by the author, there are legal environment and practice that, instead of going in favorem investment, do the opposite. As a typical example, we analyzed paying property taxes in millions to the international trading corporation for the non-existing facility whose construction never started, but was only issued construction permit, later reduced. The construction was performed according to such reduced permit, but the taxes were charged as if it were several times bigger object. The examples of numerous laws abolished by the Croatian Constitutional Court are also given, of which some in full and before the entry into force (Criminal Code), some had their implementation indefinitely postponed and until then were ordered to implement the law abrogated by the legislator (Family Law), with a range of less drastic examples. In such environment it doesn't surprise the fact that the constitution has been amended several times in the short term (the offenses of transition and privatization). In recent Croatian Parliament convene more laws were passed by urgent, than the regular procedure. Each of these phenomena, separately and all together, give us reason to admit with a great regret that both, the legal framework and practice in its essence, reject investments and investors.

Keywords: *investments, legal certainty, legal practice, legal norm.*

1. INTRODUCTION

Croatian legislation and practice together, in their essence, make the Croatian legal framework and the topic of this article is the effect of the legal framework on investment processes. This effect may have various signs, it can either be positive or negative depending on the elements that prevail. Of course, although the legal framework is the *conditio sine qua non* of many processes, including those of investment, there are no investments and there can not be any if there is only a legal framework, and all or some of the other conditions are left out (eg. attractive business project, available capital and skilled labor force, the absence of war, terrorism and similar environments ...). The things that have been done so far in Croatia regarding the legal framework is a past we cannot change, but can and must learn from it, so that mistakes or negligence would not be repeated. Although it is correct that, for now, there is no precise research that would answer how many probable investments have been lost, delayed or formally implemented so far, we can with great certainty say that Croatian legal framework cannot be described as stimulating for investments. At the same time that framework can and must be significantly improved without high costs. Thereby, in this introductory part we want to emphasize that we do not consider the legal framework as good, just the opposite, if it enables and / or encourages various abuses, primarily those that come down to disabling creditors to collect their claims. The abuses also include the slow conduct of court and other processes, with or without the infinite abolition of lower courts's decisions, as well as the absence of any

individual consequences for sometimes even catastrophic decisions at any level of government – from the executive over the legislative to judicial authority. In this study we mentioned a few very clear and concrete examples of practice and norms, all with clear and very negative signs. In doing so, the various national and international classifications of more or less questionable criteria were not crucial- by using the criterion of attractiveness to investors we as a country are classified as absolutely low-class country. We started from the fact that this unattractiveness is notorious and this study confirmed it. The key part of the text (entitled Analysis) is divided into two main parts, one relating to the activity of the legislator, the other to legal practice.

2. ANALYSIS

2.1. General

No matter how much we discuss certain legal acts or legal system as a whole, there will always be one and the same constant - money, capital, investments - all these are the fruits that grow **where there is legal certainty, but fail when there is none**. That is why legal security must be defined. There are many definitions, but it all comes down to the fact that legal security is a feature of a certain situation, a system in which it is completely clear what that the legal effects of certain decisions and actions are, regardless of who makes them. Within separate units entitled Croatian laws and Croatian legal practice we will exemplify a few which we consider the most problematic due to the topic of this text.

2.2. Croatian laws

The fact is that from 01 July 2013 Croatian laws are also European laws, and vice versa. However, European and Croatian legal practice, unfortunately, have little in common. At this point a really big number of laws, passed by the mandate of one convened by the legislature, is not put in the forefront (nor completely unacceptable practice in which the legislation by urgent procedure, instead of being a rare exception becomes the rule that applies in 90% of cases, and nobody sees anything disputable about it, but to the vast majority is enough of an "argument" to seek alignment with the *acquis communautaire*), but their quality which is evident at whether and how often they change and how often the Croatian Constitutional court in its intervention acts as a "back legislator" because there was a violation of the Croatian Constitution.¹ Below we single out examples of the most important laws for the following: the illegal conduct (Criminal Code)², which was repealed as a whole before the entry into force; a law on property relations (Law on Ownership and other real Property Rights)³, which was changed more than

¹ The Constitution of the Republic of Croatia („Narodne Novine“ 56/90,135/97,8/98- consolidated text, 113/2000, 124/2000-consolidated text,28 /2001, 41/2001 - consolidated text, 55/2001- amendment) and The Change of the Constitution of the Republic of Croatia, published in „Narodne Novine“ 76/2010, 85/10-consolidated text).

² Criminal Law („Narodne Novine“ 110/97, 27/98 - amendement, 50/00, 129/00, 51/01, 111/03, 190/03, 105/04, 84/05, 71/06, 110/07, 152/08 and 57/11- hereinafter CL 97 or Criminal Law 97).

³ Law on Ownership and other Real Property Rights („Narodne Novine“ 91/96), Law on Amendments to the Law on Sale of Apartments with Tenancy Right („Narodne Novine“ 68/98), Decision of the Constitutional Court of the Republic of Croatia no. U-I-58/97, U-I-235/97, U-I-1053/9 and U-I- 1054/97 from November 17 1999. („Narodne Novine“ 137/99), Decision of the Constitutional Court of the Republic of Croatia no. U-I-1094/99 from February 9 2000. („Narodne Novine“, no. 22/00), Law on Amendments to the Law on Ownership and other Real Property Rights („Narodne Novine“ 37/00), Law on Amendments to the Law on Ownership and other Real Property Rights („Narodne Novine“ 114/01), Law on Amendments to the Law on Ownership and other Real Property Rights („Narodne Novine“ 141/06), Law on Amendments to the Law on Ownership and other Real Property Rights („Narodne Novine“ 146/08), Law on Amendments to the Law on Ownership and other Real Property Rights („Narodne Novine“ 38/09), Law on Amendments to the Law on Ownership and other Real Property Rights („Narodne Novine“ 153/09), Law on Amendments to the Law on Ownership and other Real Property Rights („Narodne Novine“ 143/12) and Law on Amendments to the Law on Ownership and other Real Property Rights („Narodne Novine“ 152/14), 81/15-consolidated text: hereinafter Law on Ownership or Law of Property).

10 times (and as such is no exception, rather a rule), and only then an official consolidated text was passed; a law of Debtor-Creditor relations (Law of Obligations)⁴ which was changed by other laws and the information about the change is not visible when we "surf" the website of the official gazette "Narodne Novine". We also give an example of a crucial law in case of death (Investors are people who will eventually pass away, and Croatian law for real estate on the Croatian territory imposes jurisdiction of Croatian courts, and respectively notaries as court Commissioners) which had been changed even before it began to apply (Inheritance Act)⁵; then, an example of a law in the area of enforcement (Enforcement Act)⁶ which has been changed so many times as a whole, amendment and appendix that it has become impossible for anyone to understand it (and enforcements last for years !!!). Finally, although it is not closely related to the investments, we should at least mention a law whose application has been indefinitely postponed by the Constitutional Court and until then ordered the application of the law that the legislator previously repealed (Family Law).⁷

2.2.1. Criminal law

It is common not only for every investment but also for every part of the investment process (making business decisions, raising funds if you don't have or don't want to use your own, obtaining registration and building permits if the construction is a part of the project, starting business) to take actions which under certain conditions (must be prescribed by law) can obtain their criminal justice aspect – the list of such cases only in recent Croatian history is too long. Since that is the case and every entrepreneur must necessarily take care of that and spend much of his time while doing so, the minimum a state should ensure is that the investor knows what the criminal rules that apply to these processes are, what can and cannot be done and what are the sanctions if he makes a mistake. The look at the history of changes to the Criminal Code 97 shows that it has been changed almost once a year (regardless of the fact that all the changes are not of the same intensity, type or meaning) which itself is disastrous to legal certainty. However, the amendment from 2003. (Narodne Novine 111/03) has 156 articles which is almost 50% of the legal text and as such the meaning of almost completely new comprehensive legal text. Although it entered into force on 15 July 2003. (On the date of its publication in the official gazette, as specified in the transitional and final regulations) it could not be applied because the application was determined by 01 December 2003, and before that, the Constitutional Court (Narodne Novine 190/03) with the validity of the decision (27 November 2003) had abolished the complete amendment. The writing of an amendment was a long process and many criminal law experts took part in it. By entering the legislative procedure many legal experts were also involved. It lasted for more than a year. After the entry into force in the period of more than four months all the addressees prepared themselves for the new legislation (it is not without significance that by using the criterion of mandatory application of a more lenient law, many people were eager to start its application, so that the proceedings against them would be suspended, dismissed or continued but with less severe punishment) and in the end it was all in vain. Since it was abolished, because the Constitutional Court ruled that there weren't enough votes during the voting (more than half of the total number of members of parliament, not present members), which could and had to be evident already during the vote, **in terms of**

⁴ Law of Obligations („Narodne Novine“ 35/05, 41/08 and 125/11, 78/15).

⁵ Law on Inheritance („Narodne Novine“ 48/03, 163/03, 35/05 and 127/13, 152/14, 33/15) - hereinafter: Inheritance Act or Law on Inheritance.

⁶ Enforcement Act („Narodne Novine“ 57/96, 29/99, 42/00, 173/03, 194/03, 151/04, 88/05, 121/05 and 67/08), Enforcement Act („Narodne Novine“ 139/10, 150/11, 154/11, 12/12, 70/12, 80/12 Enforcement Act („Narodne Novine“ 112/12 and 25/13, 93/14).

⁷ Family Law („Narodne Novine“ 103/15 is in effect since November 1 2015).

legal certainty this is an example of what should not be happening. Although the Constitutional Court has not addressed the formulation according to which the law comes into force on the date of publication and shall apply on December 1, 2003 it also should be noted that such a structure in the Constitution DOES NOT EXIST, as demonstrated in the art. 90, which reads:

Before coming into force, laws and other regulations of government bodies shall be published in "Narodne Novine", the official journal of the Republic of Croatia.

Regulations of the bodies that have public authority before the entry into force must be published in an accessible manner in accordance with the law.

The law comes into force at the earliest on the eighth day after its publication, unless it is for exceptionally justified reasons otherwise specified by law.

The laws and regulations of government bodies or bodies with public authority shall not have retroactive effect.

For exceptionally justified reasons only certain regulations of the law may have a retroactive effect.

2.2.2. Law of Property

Law of Property is certainly very important law, a law which, among other things, means a break with social ownership. It is something that has been long and carefully worked on and therefore it is very difficult to apprehend that it took more than 10 interventions in the text of the law to get the revised text, much less that from 1 January 1997 to present the full implementation of the principle of confidence in the Land Registry has been delayed by series of amendments of the law. By the end of this year another delay will have been expected and that is nothing but the acknowledgement of their own incompetence and another generator of legal uncertainty. If after 20 years of passing Law of Property we still support the negligence and incompetence of individuals and institutions, we can only conclude that we don't need external enemies, because we are the worst enemies to ourselves. Many investors want to ensure themselves and others the purchase of high-quality home and / or office space in the building with a lot of similar units. This represents an easy solution to the problem of neighbours who make life impossible to the others. Law of property has a good solution for such situations in the art. 97- 99, but has "forgotten" to decreed that the person is allowed to return into the building only after a certain period of time (eg. 10 or 20 years). The consequence is that, to our knowledge, there is only one verdict of this kind, but only because the defendant "didn't find the way out". If he manages to "find a way out of the situation", we all have to endlessly suffer the chaos in the building which we are living and / or working in , and that is unacceptable.

2.2.3. Law of obligations

When making decisions each investor will analyze the Law of Obligations because it is a crucial law for obligatory relations. In it you can find which and how individual contracts are administred, liability for damages and the basic principles (to name just a few ,in our opinion the most important parts). Every reasonable person expects that by pressing the search button on the website of the official gazette will get all relevant changes of this and all other laws. Unfortunately, the search is only effective if the changes are implemented in a way that the amendment of the low has just been passed, but if it has been done in the form of passing a new

law it can not be obtained via search engine, which, unfortunately, happens very often. Sadly, the same applies to the Constitutional Court decision, which represent intervention in individual legal text.

2.2.4. Law on inheritance

Law on Inheritance in is an example of legislation that (as well as the amendment to Criminal Code of 2003) applied the formulation by which it entered into force, but does not apply. In our opinion this is not *a vacatio legis* as the general well-known term in civil law of all legal systems with meaning of a period in which the legal norm is published (*promulgation of law*) but still with no legal effect (*the time when the law takes legal effect*). If the law came into force but does not apply, in our opinion it is *contradictio in adiecto* and thus another potential generator of legal uncertainty.

2.2.5. Enforcement act

Although, objectively speaking, there is quite big competition among the laws for the title of the one who was most damaging to the legal security and consequently the investment climate, it is almost certain that the Enforcement Act is at the top or near the top. To emphasize, this is the law, without which any decision (besides rare exceptions such as constituent ones) practically does not mean anything, but also the law that proves the effectiveness of the legal system when it finally comes to the enforcement. What to say about the law that from 1996. (20 years) had as much intervention in its text, and during that time three completely new legal text were passed? With all the wandering and coming back to previous solutions, enforcement (except those on accounts that are not blocked) still remains the bottleneck of Croatian judiciary. Unfortunately, the cases in which enforcement takes longer than lawsuit are often, and at least part of the blame is on the complex and often unenforceable legal text. What is, for example, the purpose of imprisonment for debt institution, when it is well known that it hasn't been used not even once?

2.3. Croatian practice

2.3.1. General

Sometimes, we dare to say even quite often, the key problem is not in the legal norms. Although, it could be better, clearer and more active, there are still no legal barriers in it. However, it "gets stuck" in the interpretation and any reference to eg. the legal principles of the *acquis communautaire* (especially legitimate expectation, proportionality, equality before the law), is seen as an obstruction of the proceedings, not to mention the target or teleological interpretation, even unfairness to the head of the process or a lack of seriousness. Everything mentioned is certainly in the alphabet of law and should not be questionable. Everybody knows how long it took for the multinational company IKEA to open its facility near Zagreb. *Ab ovo* was clear that everybody would benefit and that there are no obstacles. However, several governments had been changed before it was realized that, for example, is logical, legitimate and cheap (compared to benefits) to move the tollbooth a few kilometers away and the like. Great French trading company gave up on investments in Zagreb because no one was willing to apply the institute of urban Land Management and thus prevent the owner of a small plot in the center of the project, to disable project with his requirements. In Split, for a few tens of square **centimeters** a fee was required at a rate per unit area more expensive than the most expensive places in the world (eg. St. Moritz, the Champs Elysees, the center of Tokyo or New York). However, we decided to mention an example that is topical, already presented in the media and still possible to get a positive solution from. We could have chosen the case of marina in Zaton near Dubrovnik which , although completely finished, misses its first season; marina in Zadar

in which the averse institution system (possibly with a dose of concessionaire's inertia) led to the fact that the claim submitted 20 years ago is still being processed and nothing is not clear except the fact that those who are the most responsible (institution system) eventually won't bear any damage, unlike all others; Institute of Immunology; hotel in Dubrovnik that was purchased and paid in bankruptcy a few years ago, but the buyer still doesn't own it...

2.3.2. Municipal contribution for non built-up area

Utilities Act⁸ is the most important law on payment in the construction and nothing should be questionable about it. The legislator has predicted the existence of the so-called local "sheriffs" and set limits or maximums. However, analyzed examples show that is not enough, practically almost everything should already be prepared to the last detail, and if /until we don't do so, all the investors will leave.

Facts:

When big foreign investor opts for the so-called *green field* investment he builds a large shopping center on the deserted area (which means high utility bills calculated at a cubage for which the surface is very important). The idea of purchase and purchase date from the time before the crisis, and basic projects were made according to that. Permits were granted, payment in installments accepted and insurance agents given. Before the beginning of construction the investor had realized that it was not profitable to build such a big facility, so he changed the project, got permits, built and began to work in a much smaller facility. After a while local governments decided to make use of insurance funds- the amount for the first construction which had never started (tens of millions of kunas and hundreds of employees, whose salaries fill the budget of the local government). The investor refuses to pay, makes appeals to ministry that accepts the appeal, but the local government institutes legal actions at the Constitutional Court, so the process lingers.

Legal situation:

Utilities Act has been modified 17 times (without writing the revised text after 2003, which should have been done after the third change, nevertheless, 8 changes were made after that year) and that says a lot. However, in terms of accepting to pay public utilities statutory formulation of Article 31. is very clear as follows:

(1) Public utility income is the profit of the local government. Funds from public utilities are intended to finance the construction of facilities and equipment of communal infrastructure referred to in Article 30, paragraph 1 of this Act.

*(2) Public utilities are paid by the owner of the building plot **on which he builds**⁹ or the investor.*

Even without any target interpretation it should be clear to every benevolent person that we don't talk about the future time or future plans, but the present, so it is about the project whose construction HAS ALREADY BEGUN. When we add target interpretation to the language interpretation (which otherwise could change the language, but in this case there is no need for it) things are the same in the outcome of the interpretation, but even more clear. Only those who

⁸ Utilities Act („Narodne Novine“ 36/95, 70/97, 128/99, 57/00, 129/00, 59/01, 26/03 – consolidated text, 82/04, 18/04, 38/09, 9/09, 153/09, 49/11, 84/11, 90/11, 144/12, 94/13, 153/13, 147/14).

⁹ Emphasized by the author.

see the enemy in the investors (and in that case they clearly set against all declared attitudes of the Croatian state to attract investments and investors) can be charged and attempt to charge for what has not even begun to be built. In the imaginary neat situation everyone would worry not to send the wrong message to the world, local government -relationship would be friendly, not the opposite. Maybe this would be possible to understand, not to support, if it was the case of the first investment in the particular environment. However, this is about Zagreb, which should be good example to others.

3. CONCLUSION

Choosing between the decision to start the conclusion with positive or negative part, we opted for a positive. As much as all the above examples are bad, even catastrophic, it is notorious that they can be changed without the need to invest a large amount of money. This is about changing norms and the way of thinking so as to react quickly to the identification of legal obstacles for investors and to remove those obstacles as much as possible – so called removal with a legislator's "stroke of the pen", but it mustn't be hasty and cause other unnecessary problems, rather carefully planned. However, it is all in vain if the bureaucracy's attitude towards investors remains hostile. It is a lasting process, but we have to work on this part about changing the way of thinking, so that actions that are not *in favorem* investments (this does not mean that the investor is always right, but means that in the interpretation we must assume that the legislator wants to encourage investments) and which are illegal (it can also be an obstruction of proceedings) must be brought to justice. The fact that we have already lost a lot in terms of investments is bad. Investors communicate with each other and it is impossible to avoid the exchange of bad experiences, but the one who's deciding where to invest easily makes negative decision. Therefore, by accepting what we have already lost, we must do all that we can to lose as little as possible in the future, at least for reasons of legal framework on which we can and must act and for which don't have common excuse or explanation WE WOULD HAVE DONE IT, BUT WE CANNOT AFFORD IT.

LITERATURE:

1. Bienenfeld J., Gagro B., Kontrec D., Kosović Marković M., Sarvan D. (2016). Construction, Urban Development and Municipal Economy. Zagreb: Novi informator.
2. Ćesić Z., Gorenc V., Kačer H., Momčinović H., Pavić D., Perkušić A., Pešutić A., Slakoper Z., Vidović A., Vukmir B. (2005). Commentary on the Civil Obligations Act. Zagreb: RRiF.
3. Gavella N., Josipović T., Gliha I., Belaj V., Stipković Z. (2007). Property Law. Zagreb: Narodne novine.
4. Gorenc V., Belanić L., Momčinović H., Perkušić A., Pešutić A., Slakoper Z., Vukelić M., Vukmir B. (2014). Civil Obligations Act with Commentary. Zagreb: Narodne novine.
5. Gorenc V., Kačer H., Momčinović H., Slakoper Z., Vukmir B., Belanić L. (2012). Law of Obligations - Special part 1. , Individual agreements. Zagreb: Novi informator.
6. Kačer H., Radolović A., Slakoper, Z., (2006). Civil Obligations Act with Commentary. Zagreb: Poslovni zbornik.
7. Milotić I., Peranić D. (2015). Nomotehnics - drafting general acts with practical examples; Zagreb: RRiF.
8. Schafer H-B., Ott C. (2004). The economic analysis of Civil Law. Cheltenham, UK, Northampton, MA, USA: Edward Elgar Publishing Inc.
9. Slakoper Z., Gorenc V., (2009). Law of Obligations – General part – Entering into, alteration and expiration of contracts. Zagreb: Novi informator.
10. Žuvela M. (2014). Law of Real Property. Zagreb: Organizator.

IMPLEMENTATION OF THE RAILWAY SYSTEM OF THE REPUBLIC OF CROATIA IN THE EU RAILWAY SYSTEM

Aleksandra Vasilj

Josip Juraj Strossmayer University of Osijek

Faculty of Law Osijek, Croatia

avasilj@pravos.hr

ABSTRACT

The efficiency of the railway system is a very important issue around the world, primarily for the ministers responsible for transport, and railway infrastructure managers in countries burdened by fiscal constraints. In this paper, we show the basic guidelines for the development of railway transport in the Republic of Croatia, as well as the results of negotiations between the Republic of Croatia and the EU in the accession process related to the field of rail transport and inclusion of Pan-European corridors in the Republic of Croatia in the Trans-European Transport Network. The main problems of rail transport are related to the existing rail networks, inadequate rail and rolling stock, as well as the outdated railway signalling and electronic communication systems. On the one hand, the railways are under constant pressure to maintain low operating costs, often because of pressure from the market or due to the unavailability of public funds as a result of predetermined national economic, social and transport priorities. On the other hand, an increase in the demand for transport by rail, of both passengers and cargo, is taking place after decades of its continuous decline, which requires immediate additional investments in rail infrastructure and accompanying rolling stock, under pressure to simultaneously reduce operating costs.

Keywords: *Rail transport, EU transport policy, the Croatian railway system.*

1. INTRODUCTION

In the 1990s, several EU guidelines were adopted with a view to gradually opening up national rail service markets and abolishing formerly invariable monopolies of railway transport companies in the provision of rail transport services within these countries. (Radionov1, 2003, p. 846). The Republic of Croatia (hereinafter referred to as 'Croatia') became a member of the European Union (hereinafter referred to as 'the EU') on 1 July 2013. With its accession to the EU, Croatia started using financial resources from structural funds and the Cohesion Fund (Cohesion Fund, <http://www.europski-fondovi.eu/program/kohezijski-fond>). The National Strategic Framework covered the period from 1 July to 31 December 2013 when the then EU financial perspective ended. The Strategic Framework refers to 4 key sectors for development, i.e., transport, environment, regional competitiveness and human resources development (the National Strategic Reference Framework, <http://www.hzinfra.hr/fondovieu>).

The business success of rail transport as a complex system depends on the quality of information obtained through the fundamentals of the railway system. The construction of the rail transport information system is an imperative of its modern development and the urgent need to further develop the Croatian railway system towards integration flows with the relevant environment (Grbavac et al., 2008, p. 477). The priority is to improve the railway system in the Republic of Croatia and it which promotes the restoration and development of the railway network in Croatia to make it compliant with the technical standards of the EU. Investments are focused on the Pan-European Corridor X. The projects are of public interest and, broadly speaking, the user is the Croatian public in general. As from 2000, Croatia benefited from pre-accession assistance programmes EU CARDS, PHARE, ISPA and SAPARD, which were replaced in 2007 by the Instrument for Pre-Accession Assistance. (Croatian Railways Infrastructure and the EU funds, <http://www.hzinfra.hr/fondovieu>)

In this paper, we show the basic guidelines for the development of railway transport in the Republic of Croatia, as well as the results of negotiations between the Republic of Croatia and the EU in the accession process related to the field of rail transport and inclusion of Pan-European corridors in the Republic of Croatia in the Trans-European Transport Network (TEN-T). The main problems of rail transport are related to the existing rail networks, inadequate rail and rolling stock, as well as the outdated railway signalling and electronic communication systems. There is an obvious need for high-quality passenger railway lines since stable growth in this segment of transport provides a great opportunity for the development of the sector, but it also makes it easier to identify congestion hot spots in urban environments and peripheral areas, and contributes to labour mobility.

Transport policy is based on the Transport Development Strategy of the Republic of Croatia (at its session held on 30 October 2014, the Government of the Republic of Croatia adopted the Transport Development Strategy of the Republic of Croatia for the period from 2014 to 2030) and the Croatian Railways' Modernisation and Restructuring Strategy adopted in 2000, the documents and recommendations (the White Paper), as well as the documents relating to the Pan-European corridors specified in Helsinki in 1998.

2. THE TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY AND THE DEVELOPMENT OF A EUROPEAN TRANSPORT POLICY

2. 1. The provisions of the Treaty relating to transport

The Treaty Establishing the European Economic Community, i.e., the Treaty of Rome (1957), is a fundamental treaty on today's European integration. The Treaty on European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU) are in effect today. Articles 90-100 TFEU and Articles 170-172 TFEU (in relation to Trans-European Transport Networks (TEN-T)) are articles of the Treaty Establishing the European Economic Community based upon which EU transport policy is governed.

The provisions of Article 100 TFEU stipulate that the provisions of Title VI shall apply to transport by rail, road and inland waterway. The Treaty failed to establish a common transport policy but provided for the authority to establish such a policy at European level (Radionov, N. et al., 2011, p. 11). At that time, the European Commission and the Council of Ministers were responsible for establishing transport policy.

By the judgment of the Court of Justice of the European Union on the Common Transport Policy the Council was committed to adopt a common transport policy (at least in respect of land transport). The White Paper from the Commission on Completing the Internal Market and the Single European Act proposed the adoption of a large number of measures in the field of transport and this period was marked by the creation of a real European transport policy.

2. 2. The development of rail transport policy

Networking the national territory by the railway enabled transport of people from isolated places and a strong connection of the population with the cities. Investments in railway infrastructure were a burden on a country, but due to that reason, the country got an important political trump card, i.e., better territorial connectivity, and hence political control and economic growth. The attitude of these countries in the 19th century that favoured the construction of railway networks pursuing at the same time their own interests exclusively has led to large technical differences between rail systems in different countries.

The pressure from the Commission and the Parliament on the Council resulted in the adoption of an important document known as Directive 91/440/EEC on the development of the Community's railways (Council Directive 91/440/EEC of 29 July 1991 on the development of the Community's railways, OJ L 237, 24.8.1991). The aim of this Directive is to facilitate the transition and the adaptation of entrepreneurship relating to railroad systems in the EU to the needs of the Single Market and to increase its efficiency and competitiveness (Radionov1, 2003, p. 856). Many countries have reformed their railway sectors in ways that were not mutually harmonised, and a need has arisen to have such level of development stipulated by EU acts. Countries that believed in the railway monopoly tried to delay that process and cooperated to a minimum. The White Paper was adopted, which also contains "A Strategy for Revitalizing the Community's Railways" (a greater role of the market was proposed, which would reduce costs and improve the quality of services, as well as separation of the state from the railways).

There are three main objectives to be achieved in the development of the common transport policy:

1. A healthy financial environment for the operation of railways.
2. Transportation activity is based on market principles and open to competition.
3. The development of public service contracts to ensure continuous passenger transport services by rail on unprofitable lines. (Radionov, N. et al., 2011, p. 63)

A new White Paper entitled "European transport policy for 2010: time to decide" was released in 2001. The measures aimed at the development of the transport system that would be able to strike a balance between different modes of transport. Rail transport was promoted as the most sustainable transport system.

"In the 2006 document on mobile Europe, the European Commission referred to the White Paper of 2001, and gave up on promoting the railway and the idea of treating transport and economic development separately. Instead, throughout the document it only deals with the increasing need for mobility separately from its negative effects. The European Commission then predicted that by 2020, freight traffic in the EU as a whole will rise by 50%, and experts expected a further decline in the share of railway transport. This is true. A drastic reduction in the number of employees has been recorded. Most positive effects that were announced have not been achieved. Many people call the White Paper of 2001 the Black Paper." (Radionov, N. et al., 2011, p. 68).

3. REPUBLIC OF CROATIA AND RELEVANT DOCUMENTS

Croatia is a signatory to the successors of international agreements AGC of 1985 and AGTC of 1991. These agreements cover railway lines in the said corridors and branches, as well as some railway lines in Croatia. The Republic of Croatia is one of the 16 members of the UNECE TER (Trans-European Railway) project, which includes the countries in Central, Eastern and Southeastern Europe, that was founded in 1993 with the aim of improving the quality and efficiency of the transport sector, assisting the integration process of European transport infrastructure systems, and developing a coherent and efficient international railway system in the region (for more information about the Trans-European Railway (TER) Project, see: <http://www.unece.org/trans/main/ter/ter.html>). The project encompasses a network of AGC and AGTC railway lines and largely coincides with the Pan-European transport corridors.

Relevant EU documents relating to the transport sector of the Republic of Croatia are the multilateral Memorandum of Understanding on the Development of the South East Europe Core Regional Transport Network (Luxembourg, 2004) and Protocol 6 on Land Transport,

which is part of the Stabilisation and Association Agreement (SAA) between the European Union and the Republic of Croatia, which emphasises the measures of development of a multimodal transport infrastructure network, particularly on Pan-European corridors V, VII and X, and the Adriatic-Ionian Pan-European transport corridor connected to Corridor VIII.

In 2006, the Agreement on the Establishment of a High Performance Railway Network (OG 31/08) was signed within the framework of the South-East European Cooperation Process (SEEC) that also includes railway lines in Croatia, which are part of the corridors and their branches. The aim of this Agreement was to establish a high-performance railway network for passenger, freight and intermodal transport in South East Europe by 2020.

The “Regional Balkans Infrastructure Study (REBIS)” (Operational Programme “Transport 2007-2013”),

http://www.strukturnifondovi.hr/UserDocsImages/kako_do_fondova/korak1/uvjeti/operativni_program_pomet_2007-2013-hrvatskijezik-1383573060.pdf) was the last of the complementary studies relating to the development of transport in the region that was funded by the European Commission in 2002. This study, which was completed in July 2003, focuses on the development of a multimodal core transport network in the South-East European region. On the territory of the Republic of Croatia, this network includes multimodal Pan-European corridors that have already been specified, the seaports of Rijeka, Split, Ploče and Dubrovnik, the airports of Zagreb, Split and Dubrovnik, and the Danube and Sava waterways.

4. RESTRUCTURING AND DEVELOPMENT OF THE CROATIAN RAILWAY SYSTEM IN THE CONTEXT OF EUROPEAN LEGISLATION

“Within the PHARE National Programme 2006, the European Union pre-accession instrument intended for the acceding and candidate countries of Central and Eastern Europe helping the administrations of the candidate countries to prepare for EU membership, the programme PHARE 2006 “Restructuring and Development of the Croatian Railway System within the Framework of EU Legislation” was launched in 2008” (Restructuring and Development of the Croatian Railway System within the Framework of EU Legislation, <http://www.mppi.hr/default.aspx?id=8845>).

The main technical assistance contract worth 1,343,010 Euro, whose main purpose was to establish the regulatory and institutional framework in the rail sector in accordance with EU legislation, should monitor the implementation of the EU *acquis communautaire* in the Croatian national legislation, particularly EU railway directives, and assist the establishment and training of the staff of necessary bodies through drafting legislation, as well as through lectures and workshops.

4. 1. Investments in railway infrastructure

Investments in infrastructure for years after the war were directed to the reconstruction of lines, but only to the extent necessary to restore traffic in liberated areas, and then to the rehabilitation of critical points on existing lines. Investments amounted to 65 million HRK in 1995 and even 270 million HRK in 2002. After that, investment activities have increased and become focused on modernisation and reconstruction of dilapidated railway infrastructure.

For the purpose of infrastructure management, the Croatian Government set up a special company - the infrastructure manager, with which it enters into a contract on mutual rights and obligations (Radionov2, 2002, p. 321).

Investments are classified into the following programmes: programmes aimed at reconstruction and modernisation of railway lines of international importance, reconstruction and modernisation of railway lines of regional importance, reconstruction and modernisation of railway lines of local importance, the railway junction modernisation programme, activities in the function of infrastructure and traffic on the network in general, the upgrade and construction of new railway lines and tracks.

The strategic objectives for the period 2012-2016 are as follows:

1. to achieve a speed of 160 - 200 km/h on new and renewed lines proposed for TEN-T;
2. to achieve a speed on the lines of regional importance;
3. to reduce the number of employees after the restructuring by 20%;
4. to increase revenue from services outside the core business by 34%.

([http://www.mppi.hr/UserDocsImages/4.PREZENTACIJA%20-%20PROGRAM%20RESTRUKTURIRANJA\[1\]%20infrastruktura.pdf](http://www.mppi.hr/UserDocsImages/4.PREZENTACIJA%20-%20PROGRAM%20RESTRUKTURIRANJA[1]%20infrastruktura.pdf))

5. MARKET ACCESS

Directive 91/440 was the first step towards liberalisation of the market and thus it opened the door to the free provision of one segment of railway services for a large number of transport operators (Radionov, N. et al., 2011, p. 74). The policy of gradual liberalisation continued with Directive 2001/12 (Directive 2001/12/EC of the European Parliament and of the Council of 26 February 2001 amending Council Directive 91/440/EEC on the development of the Community's railways, OJ L 051/1), and it represents the second phase of liberalisation of the classic railway transport of goods. The formation of international groupings has remained to this day the only model of the entry of foreign operators into the market of passenger transport by rail in the EU.

The problem occurs when a foreign rail transport operator does not want to get into the grouping, which actually prevents the execution of international transportation. The efforts of the Commission to liberalise this segment of the market by 2010 have not been taken into account completely but rather formalised at the level of one of the proposals of the "Third railway package" of 2004 (Radionov, N. et al., 2011, p. 76). The goal of the Community legislation was to integrate the existing railway systems that will ensure fair competition between railway operators.

"The first railway package" was adopted in 1995, and it consists of Directive 95/18/EC of 19 June 1995 on the licensing of railway undertakings (OJ L 143 of 27.06.1995, pp. 70-74) and Directive 95/19/EC of 19 June on the allocation of railway infrastructure capacity and the charging of infrastructure fees (OJ L 143 of 27.06.1995, pp. 75-78). The aim of Directive 95/18/EC was to break the heterogeneity of national decisions on the licensing in the implementation of the objectives provided for in Directive 91/440/EEC and to ensure uniform conditions for market access in the whole EU (Radionov, N. et al., 2011, p. 78).

"The second railway package" was adopted in 2001, and it is composed of Directive 2001/13/EC of 26 February 2001 (OJ L 075, 15/03/2001, pp. 26-28) amending Directive 95/18/EC and Directive 2001/14/EC (OJ L 075, 15/03/2001, pp. 29-46) that fully replaces Directive 95/19/EC. Uniform conditions for operators in the domestic and international traffic were introduced, which means that as of 15 March 2003 the same requirements prescribed by both EU and national legislation must be met. The internal market for rail services was created in 2003 within solid boundaries, i.e., combined transport and freight transport on the Trans-European Network was liberalised, uniform conditions for access to the rail service market in

domestic and international transport were introduced and detailed rules on the allocation of railway infrastructure capacity, the charging of infrastructure fees and safety certificates were drawn up (Radionov, N. et al., 2011, p. 78). Other unresolved questions include liberalisation of passenger traffic in all segments as well as the issue of freight cabotage transport.

“The third railway package” was adopted in 2004 as the last phase in the development of the common transport policy. It is composed of Directive 2004/49/EC on safety on the Community’s railways and the licensing of railway undertakings (OJ L 164 of 30 April 2004), Directive 2004/50/EC on the interoperability (OJ L 164 of 30 April 2004, pp. 114-163) and Directive 2004/51/EC amending Directive 91/440/EEC on the development of the Community’s railways, which makes further steps towards market liberalisation (OJ L 164 of 30 April 2004, pp. 164-172).

The most significant consequence of the creation of the single market is shortening of the deadlines provided for by previous directives aimed at liberalisation of international freight transport on the entire rail network in the Community.

The issue relating to the conditions and procedure for awarding licenses is regulated today by Directive 95/18/EC. It was amended by Directive 2001/13/EC, and this is one of the examples of the application of the principles of subsidiarity and proportionality where the EU has assumed jurisdiction over the matter. Licenses are permanent, they are valid as long as transport operators meet the requirements for their issuance (Radionov, N. et al., 2011, p. 80). The body authorised to issue licenses checks, at least every five years, whether the transport operator still fulfils the necessary conditions.

The second most important prerequisite for performing the activities of railway transport is the right of access to railway infrastructure and the allocation of railway infrastructure capacity. The rules and the charges for the use of railway infrastructure and safety certification are contained in Directive 2001/14/EC. The term ‘infrastructure capacity’ means the potential to schedule train paths requested for an element of infrastructure for a certain period, and this capacity is allocated by an infrastructure manager on a fair and non-discriminatory basis to all transport operators seeking access to railway infrastructure (Radionov, N. et al., 2011, p. 82).

The rail transport market is supervised by a special regulatory authority that must be fully independent of any transport operator on the market. The state may entrust market regulation issues to the competent ministry or establish a separate body (Radionov, N. et al., 2011, p. 86).

6. CONCLUSION

The European Union has set the objectives and conditions which Croatia must meet in order to have its railway compliant with both its regulations and the conditions provided by the EU itself. Rail transport should be the most effective and safest form of transport with the lowest environmental impact providing at the same time a high level of service and safety. If no investments were made in the Croatian railway system, rolling stock maintenance costs would grow continuously, the number of railway vehicles would be reduced due to their age, the number of passengers would drop, freight transport would become totally uncompetitive within the framework of the implementation of EU directives, and Croatia would be affected by the rising costs of maintaining infrastructure for minimum transport capacity, isolation of Adriatic seaports without adequate rail support, loss of high-quality transport alternatives, large quantities of bulk cargo could be found on the roads, and many local governments would feel the negative effects due to the fall in the rail market.

Railways have to make major changes in the organisation of business and raising the level of service. Croatia's railways are incorporated in this process, and due to the fact that strategic commitment of the Republic of Croatia is its membership in the EU, they adapt their operation to business conditions and the system under which the EU operates. Such action requires large investments in railways. To achieve that what was anticipated and required by the EU, investments in the Croatian railway system will become even more intense, and Croatia must exploit its favourable geographical position as much as possible. On 30 October 2014, the Government of the Republic of Croatia adopted the Transport Development Strategy of the Republic of Croatia (2014-2030), which provided for all previous conditions for the National Railway Infrastructure Programme for the period from 2016 to 2020 to be adopted in accordance with the current strategy. The Transport Development Strategy of the Republic of Croatia is based on a specific methodological approach and a new concept of development of the overall transport sector of the Republic of Croatia, which results in the need for a new methodological approach and a new concept for the new National Railway Infrastructure Programme. Pursuant to Article 8(1) of the Railway Act (Official Gazette, 94/13 and 148/13), the Croatian Government adopts the National Railway Infrastructure Programme. The key criterion in the preparation of the National Railway Infrastructure Programme of the Republic of Croatia for the period 2016 to 2020 is maintenance or increasing the efficiency of the railway system in order to improve end-user satisfaction. It should be noted that the efficiency of the railway system is a very important issue around the world, primarily for the ministers responsible for transport, and railway infrastructure managers in countries burdened by fiscal constraints. On the one hand, the railways are under constant pressure to maintain low operating costs, often because of pressure from the market or due to the unavailability of public funds as a result of predetermined national economic, social and transport priorities. On the other hand, an increase in the demand for transport by rail, of both passengers and cargo, is taking place after decades of its continuous decline, which requires immediate additional investments in rail infrastructure and accompanying rolling stock. Under pressure to simultaneously reduce operating costs, improve the level of rail transport services and increase available railway capacity, railway administrations and governments are continuously taking steps and measures to improve the efficiency of the railway system. Efficient railway systems produce a high level of efficiency and transport capacity on the basis of secured financial resources for the management and supervision, as well as maintenance and renewal and their modernisation. In strategic terms, the concept of "central technological and logistics network operation" was selected as a good basis for the operational preparation for the implementation of a sustainable sector strategy in the subsystem railway transport. It is based on the use of collected and processed data on traffic and technological requirements relating to the subsystem railway transport, and networking of objectives and allocated resources, enabling in this way additional capacity and a higher level of efficiency in achieving the goals set. The National Railway Infrastructure Programme of the Republic of Croatia for the period 2016 to 2020 outlines plans for building a new and modernising and maintaining the existing rail network, defines priorities and determines the pace of implementation, as well as the amount and sources of necessary financial resources. Planned investments in modernisation and construction as well as railway infrastructure maintenance costs from 2016 to 2020 amount to roughly 17.2 billion HRK, of which 2.23 billion HRK (12.97%) refer to reconstruction and modernisation programmes, 10.2 billion HRK (59.32%) to the construction of new and expansion of existing lines and tracks, while maintenance costs (together with infrastructure management costs) are 4.77 billion HRK (27.71%). Funding sources for the implementation of the National Programme are planned with the following structure: 7.45 billion HRK (43.3%) from the state budget including term debt with the guarantee of the Republic of Croatia, 7.17 billion HRK (44.85%) from EU funds, 1.19 billion HRK (6.9%) from sales revenue, 674.3 million HRK (3.9%) from other operating

income and 174.4 million HRK (1%) from the World Bank. The planned investment dynamics is in line with the dynamics of the insurance provided for by financial sources, ranging from 2.46 billion HRK in 2016, 3.47 billion HRK in 2017, 3.45 billion HRK in 2018, 3.67 billion HRK in 2019 and 4.14 billion HRK in 2020. The plan is aligned with both productive and administrative capacities. In addition to railway investments, Croatia must increase its investments in other branches of transport as well, for the purpose of easier connection and intensification of traffic. Croatian seaports and rivers would play a significant role as they link the southern part, which would in turn make the Pan-European Corridor X best for connecting Central Europe with Turkey.

To achieve the set objectives, it is necessary to increase infrastructure investments and boost its capacity. It is expected that this will be achieved through multi-year plans. The funding source will largely come from the national budget, EU accession and cohesion funds, but the private sector should become involved as well.

LITERATURE:

1. *About the Trans-European Railway (TER) Project*. Retrieved 17.1.2016 from <http://www.unece.org/trans/main/ter/ter.html>
2. Act on Division of the Company HŽ - Croatian Railways Ltd. (2005). *Official Gazette*, 153/05, 57/12.
3. Act on Ownership and Other Real Rights. (1996). *Official Gazette*, 91/96, 68/98, 137/99, 22/00, 73/00, 129/00, 114/01, 79/06, 141/06, 146/08, 38/09, 153/09, 143/12, 152/14.
4. Act on Rail Market Regulatory Agency. (2007). *Official Gazette*, 79/07, 75/09, 61/11.
5. Act on the Regulation of the Rail Services Market. (2014). *Official Gazette*, 71/14.
6. Civil Obligations Act. (2005). *Official Gazette*, 35/05, 41/08, 125/11.
7. *Cohesion Fund*. Retrieved 24.2.2016. from <http://www.europski-fondovi.eu/program/kohezijski-fond>
8. *Croatian Railways Infrastructure and the EU funds*. Retrieved 23.2.2016 from <http://www.hzinfra.hr/fondovieu>
9. Directive of the European Parliament and of the Council 2012/34/EU of 21.11.2012. (2012). *OJ L 343*, 14.12.2012. Retrieved 18.2.2016 from http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2012.343.01.0032.01.ENG
10. *External costs of transport, Zurich 2000*. Retrieved 11.2.2016 from http://www.uic.org/cdrom/2005/external_costs_env/docs/externalcosts_previous_en.pdf
11. Grbavac, J, Plenković, M, Grbavac, V. (2008). *Važnost infoosnove u razvitku hrvatskog prometa*, In *Suvremeni promet*, Vol. 28, p. 373-508, Zagreb: Hrvatsko znanstveno društvo za promet.
12. *Harmonisation of laws*. Retrieved 18.1.2016 from <http://www.hzinfra.hr/uskladiivanje-zakona-s-pravnom-stecevinom-eu->
13. Kreč, S. (2012). *Razvojne mogućnosti željeznice u Hrvatskoj: Ocjena dosadašnjeg prometnog razvitka Hrvatske i osnovne smjernice daljnjeg razvoja*. Zagreb: Hrvatska akademija znanosti i umjetnosti, Znanstveno vijeće za promet.
14. National Railway Infrastructure Programme for the period from 2008 to 2012. (2008). *Official Gazette*, 31/2008. Retrieved 22.10.2015 from <http://www.propisi.hr/print.php?id=7830>
15. National Railway Infrastructure Programme for the period from 2016 to 2020. Retrieved 4.7.2016 from

- http://www.mppi.hr/UserDocsImages/Nacionalni%20program%20HZI%2024-9_15.pdf
16. *National Strategic Reference Framework*. Retrieved 23.2.2016 from <http://www.hzinfra.hr/fondovieu>.
 17. *Operational Programme "Transport 2007-2013"*. (2013). Retrieved 17.2.2016 from http://www.strukturnifondovi.hr/UserDocsImages/kako_do_fondova/korak1/uvjeti/operativniprogrampromet_2007-2013-hrvatskijezik-1383573060.pdf
 18. Radionov Radenković, N, Popović, N. (2006). *Liberalizacija željezničkog prometa i državne potpore u željeznicama*. In Zbornik Pravnog fakulteta u Zagrebu. Vol. 55, No. 6, p. 1461-1495. Zagreb: Pravni fakultet Sveučilišta u Zagrebu.
 19. Radionov Radenković, N. (1999). *Restrukturiranje tržišta željezničkih usluga u Europskoj uniji i nova Konvencija o željezničkom prijevozu (COTIF 1999)*. In Zbornik Pravnog fakulteta u Zagrebu. Vol. 53, No. 3-4. Zagreb: Pravni fakultet Sveučilišta u Zagrebu (Radionov1).
 20. Radionov, N, Popović, N. (2013). *Liberalizacija mrežnih djelatnosti i javnopravna regulacijska funkcija*. In Hrvatska i komparativna javna uprava, Vol. 13, No. 3, p. 821-857. Zagreb: Institut za javnu upravu,
 21. Radionov, N. (2002). *Hrvatsko željezničko pravo i mjere prilagodbe pravu Europske unije prema planu provedbe sporazuma o stabilizaciji i pridruživanju*. In Zbornik Pravnog fakulteta Sveučilišta u Rijeci, 23 p. 307-324. Rijeka: Pravni fakultet Sveučilišta u Rijeci (Radionov2)
 22. Radionov, N. (2011). *Europsko prometno pravo*, Zagreb: Pravni fakultet Sveučilišta u Zagrebu.
 23. Railway Act. (2003). *Official Gazette*, 123/03, 194/03, 30/04, 79/07, 120/08, 75/09, 94/13, 148/13.
 24. *Railway infrastructure*. Retrieved 11.2.2016 from <http://www.mppi.hr/default.aspx?id>
 25. Railway Safety and Interoperability Act. (2013). *Official Gazette*, 82/13, 18/15.
 26. Railway Transport Contracts Act. (1996). *Official Gazette* 87/96.
 27. *Restructuring and development of the Croatian Railway System within the framework of EU legislation*. Retrieved 17.2.2016 from <http://www.mppi.hr/default.aspx?id=8845>
 28. Romštajn, I, Vasilj, A. (2006). *Hrvatsko prometno pravo i osiguranje*, Osijek: Pravni fakultet Osijek.
 29. *The history of rail transport in Croatia*. Retrieved 11.2.2016 from <http://www.enciklopedija.hr/Natuknica.aspx?ID=67678>
 30. *The new White Paper of the European Commission on transport*. Retrieved 17.2.2016 from <http://www.szh.hr/nova-bijela-knjiga-europske-komisije-o-transportu>
 31. *The restructuring programme of the Croatian Railways Infrastructure Company Ltd*. Retrieved 23.2.2016 from [http://www.mppi.hr/UserDocsImages/4.PREZENTACIJA%20-%20PROGRAM%20RESTRUKTURIRANJA\[1\]%20infrastruktura.pdf](http://www.mppi.hr/UserDocsImages/4.PREZENTACIJA%20-%20PROGRAM%20RESTRUKTURIRANJA[1]%20infrastruktura.pdf)
 32. Vrbanc, M, Malić, A, Vrbanc, M. (2006). *Usklađivanje prometnog sustava Republike Hrvatske s prometnim sustavom Europske unije*. In Suvremeni promet, Vol. 26, No. 1-2, p. 1-152, Zagreb: Hrvatsko znanstveno društvo za promet

ACTUAL QUESTIONS REGARDING THE CRIMINAL OFFENCE OF ABUSE OF TRUST IN BUSINESS ACTIVITY

Damir Primorac

*“Primorac & Partners”, Law Firm, Split, Croatia
damir.primorac@primorac-partners.com*

ABSTRACT

The criminal offence of abuse of trust in business activity is one of the most important criminal offences from Chapter Twenty-Four (XXIV.) of the Criminal Code, titled Criminal offences against the economy. From the entry into force of the Criminal Code and to this day, due to the complexity of this criminal offence, there have been numerous dubious questions, the key one being related to determining the existence of legal continuity between repealed criminal offences and the new criminal offence. It is for this reason that the author will try to offer in his work, through analysis of the criminal offence of abuse of trust in business activity, the answers which apply to these problems. An overview of how the past judicial practice answered certain dubious questions in this field is also covered.

Keywords: *abuse of trust, business activity, legal continuity, repealed criminal offences.*

1. INTRODUCTION

Although many practitioners and theoreticians that deal with criminal law have advocated changes to the criminal legislature in the parts that relate to economic crimes, until entry into force of the Criminal Code 1st January 2013 (henceforth referred to as: CC/11) there have not been any significant changes. First major reason for these changes was the passing of the Companies Act (henceforth referred to as: CA), the application of which began 1st January 1995 and which was, even at that time, harmonized with the EU's legislation. However, in spite of that, the Croatian economic criminal law did not follow that path, but kept dwelling on the foundations of the former legal system which, for the most part, was obsolete i.e. it was not adapted to the existing system of the time. Even the repeated critique that it was finally necessary to incorporate the economic crimes into a single chapter of the CC (as it is now-Chapter XXIV, titled Criminal offences against the economy) did not help, so they were split into separate Chapters – Criminal offences against the safety of payment and business activity, and Criminal offences against official duty. On the other hand, this unadjusted economic criminal law created problems in practice, since the descriptions of particular criminal offences overlapped, there was no clear distinction between economic and official's criminal offences etc. Precisely for that reason there was no uniform practice in actions and there was also legal insecurity.

It is undeniable that the problem of economic crimes is a complicated and dubious one, not just in Croatia, but also in other states, but it is still unclear why there have not been changes to economic criminal offences especially when considered that they threaten and attack the security of doing business in a particular country. Besides that, the economy has a large social and political significance; therefore it is absolutely logical that the state has substantial interest in making certain interventions with the goal of protecting business activity (Primorac; Filipović and Peronja, 2010. p. 769-770).

The most important changes to the new CC in the area of economic crime relate to the criminal offence of Abuse of Trust in business activity. Consequently, it is a criminal offence that is the basis of economic criminal offences. The intention of the legislator was to include four criminal offences from the former CC (henceforth referred to as: CC/97) which are Economic

Mismanagement from article 291 CC/97, Abuse of authority in business activity from article 292 CC/97, Entering into harmful contracts from article 294 CC/97 and the Abuse of position and authority from article 337 CC/97, noting here that this last criminal offence is included only in part that refers to responsible persons (Novoselac and Roksandić-Vidlička, 2010, p. 702). Therefore, the legislator has deleted in their entirety the ordinances of article 291, 292 and 294, CC/97 and just in part the ordinance of article 337. CC/97, the part that refers to responsible persons, while the part of the ordinance that applies to officials or responsible persons that abuse a public authority entrusted to them, has been moved to the criminal offence from article 291 CC/11, Chapter XXVIII. CC/11 titled Criminal offences against official duty. This way, the art. 337 CC/97 remained only as an official's criminal offence so it should not happen any more that the responsible persons from the economic sector are held responsible for an official's criminal offence, which has been the case previously (See: page 249. of the Final Draft of the Criminal Code dated 6th October 2011 - <http://www.sabor.hr/Default.aspx?art=41259>).

Taking into account that it was expected that these changes would bring certain difficulties in practice, it is clear that the courts had the ultimate responsibility for judging the existence of legal continuity between the repealed criminal offences and the criminal offence from the art. 246 CC/11, therefore it should not come as a surprise that in the beginning there were certain disorientations which have been eliminated for the most part during time, of which we will discuss further in the text.

2. CRIMINAL OFFENCE OF ABUSE OF TRUST IN BUSINESS ACTIVITY FROM ART. 246 CC/11 – CURRENT QUESTIONS

The legal description of the criminal offence of Abuse of trust in business activity from art. 246 CC/11 states:

(1) Whoever in business activity breaches the duty to protect property interests of another established by law, administrative or judicial decision, contract or trust, and thereby acquires for himself or another unlawful pecuniary gain, or thereby, or by some other means, causes damage to another whose property interests was required to ensure, shall be punished by imprisonment between six months and five years.

(2) If a considerable pecuniary gain is acquired as a result of the criminal offence referred to in paragraph 1 of this Article or a considerable damage is caused, the perpetrator shall be punished by imprisonment between one and ten years.

The criminal offence of Abuse of trust in business activity is placed in Chapter XXIV. which bears the title Criminal offences against the economy, and is a typically economic deed. While there have been certain wanderings in the earlier CC/97 as, for example, when the actions of responsible persons within the juridical person that performs economic activity (so we are referring to persons within the management structures of companies-members of the supervisory board and similar), were treated as so called official's criminal offences (art. 337, CC/97), CC/11 has in that part drawn closer to more developed modern European criminal legislature, so this criminal offence from art 246 CC/11 became the central economic criminal offence. This criminal offence is not new in legislatures of particular EU member states such as Germany, Austria, Switzerland, et al., and the purport of all of these criminal offences is the protection of another's property (Pavlović. 2013, p. 627-628). It is also important to note that the criminal offence of Abuse of trust in business activity is a *lex specialis* in regard to the criminal offence of Abuse of trust from art. 240 CC/11 which is in Chapter XXIII and titled Criminal offences against property. Consequently, the fundamental difference between these two criminal offences is in the fact that the criminal offence of Abuse of trust in business activity

only applies to abuse of trust i.e. failure to protect another's property in economic activity (this offence can be perpetrated by, for example, a company's members of the supervisory board, directors of private limited companies, bankruptcy trustees et. al.), while the criminal offence of Abuse of trust only refers to abuse of trust i.e. failure to protect another's property outside of the economic activity (for example the perpetrators can be somebody's parents, legal guardians, lawyers and others).

Although the description of this criminal offence begins with the words "Whoever", from which it would follow that anyone could perpetrate this offence (*delictum communium*), it is emphasized that this criminal offence can be perpetrated only by a person with certain properties (*delictum proprium*). Consequently, the perpetrator can only be a person that in performing business activity does not take care of another's property and/or property interests entrusted to him on the basis of law, a decision by the administrative or judicial authority, legal affair or relationship of trust.

Considering that there are several places in the CC/11, where in the title of the criminal offence or in its description the words "business activity" are mentioned (for example Fraud in business activity from article 247 CC/11, Bribing in business activity from art. 252 CC/11 and other), as well as in the case of the criminal offence we are discussing, it is clear that a question is posed about what is included implicitly under the notion of business activity or economic activity. Namely, by defining this notion it will be easier to analyse this criminal offence as well as to answer certain questions that apply to this problem. Under this notion it is primarily referred implicitly to that activity which relates to the exchange of goods and services in the market for the purpose of making a profit, income or other economically distinguishable benefit (art. 39 paragraph 2 of the General Tax Act, henceforth referred to as: GTA).

As was said earlier, the perpetrator of the criminal offence of Abuse of trust in business activity can only be a person that is performing an economic activity within the legal entity, and who thereby causes damage to another whose property interests he was required to ensure on the basis of law, administrative or judicial authority decision, legal affair or relationship of trust.

2.1.Breach of duty to protect another's property interests based on law

This breach refers to the management structures (or: management) within companies, so the perpetrators can be members of the supervisory board, directors of private limited companies and others. Specifically, these are the persons responsible for control of the company's business operations, and not the persons who are founders of the company. The founders, which are not part of the management structure, are not obligated to handle the company's business affairs, or take special care of the protection of company's property interests, because that is within jurisdiction of the management structure. Handling the business affairs of the company is within exclusive jurisdiction of the management structure who are obligated to take appropriate legal actions towards anyone with the purpose of protecting the company's interests i.e. achieving the goal for which it is founded. These legal actions can be directed towards the founders of the company, even if there is only one founder (see the decision of the Supreme Court of Croatia, I KŽ-317/04 dated 7th of March 2006). However, in certain situations, even the founders or third persons that are formally not part of the management structure can perform a breach of duty to protect another's property interests, more of which later on, when we discuss the breach of duty to protect another's property interests based on a relationship of trust.

It should be pointed out that in the case a single founder is also being part of the management structure, he can still be held accountable for this criminal offence, because the property of the legal entity is another's property (Garačić, 2009, p.773).

Equally so, the perpetrators of this criminal offence can be members of the supervisory board, who even though they do not run the business operations of a company, can be held responsible if for example a legal act of a company stipulates that the management can perform certain duties only with the previous consent given by the board (Novoselec, 2007, p. 373).

In certain situations when a company has more than one member of the management, it can be questioned whether that means that there is a joint responsibility for the breach of duty to protect another's property interests, or whether the role of every member of the management and his responsibility must be established beforehand. Of course, in such case there is no collective responsibility, but rather the individual responsibility must be established for every individual member, especially if there was no uniform consent between the members. A simpler situation is when we encounter private limited companies where the duty of managing is entrusted to a single person - the director, so it is a lot easier to determine whether there was culpable behaviour or not (Derenčinović. 2009, p.4).

Furthermore, there have been cases in practice so far, which the courts often accepted, where the State Attorney's office used in the indictment the terms "founder and owner of the company" as synonyms, which is incorrect. In this matter we must be guided by consideration that the notion of "owner of a company" represents an extra-legal, colloquial category unknown to the CA. Namely, the CA talks about company's founders who after the foundation become members, and especially about the organs of the company which was founded. The circumstance that somebody is a company member, specifically a member of a private limited company, even if he is the sole member, does not give him "ownership over the company", but only the rights determined by law. After the company is founded, the care of the company's business activity is in the hands of the company's organs, and especially of the company's management. The founder of the company, even if there is only one, can reappear as the company's creditor or debtor and the CA specifically regulates the matters of legal relationships between the company and its members (Decision of the Supreme Court of Croatia, I KŽ-317/04 from 7th of March 2006.)

2.2.Breach of duty to protect another's property interests based on an administrative or judicial authority's decision

This breach can be perpetrated by for example, a bankruptcy trustee, who was appointed as a trustee by a decision on opening the bankruptcy proceeding made by the Commercial Court. The bankruptcy trustee is the legal representative of the bankruptcy debtor on the basis of a court's decision.

If the bankruptcy debtor continues to do business during the bankruptcy proceedings, the business operations are run by the bankruptcy trustee. Consequently, the bankruptcy trustee manages another's property in the name of the court that is carrying out the bankruptcy proceeding. The duties of the bankruptcy trustee are regulated by the Bankruptcy Act (art. 88 and 89 of the Bankruptcy Act – henceforth referred to as: BA), and some of his duties are: to take care as a good manager about the completion of the started and unfinished business operations of the debtor and debtors business operations necessary to prevent damage over debtor's assets, to take care of the realization of debtor's claims, to conscientiously conduct the affairs of the debtor, to collect, i.e. charge for the assets and rights of the debtor with the attention of a good manager etc. The bankruptcy trustee is obligated to perform his duties conscientiously and in order, and his work is overseen by the bankruptcy judge, board of creditors and the creditor assembly (see: <http://www.sudacka-mreza.hr/stecaj-upravitelji.aspx>).

2.3. Breach of duty to protect another's property interests based on a legal affair

This breach can be perpetrated for example by the authorized person in a company (representation based on a power of attorney or authorized by employment) and by a procurator. The authorized person is the one authorized on the basis of a power of attorney from the legal representative of the company, and the power of attorney can be given within the legal limits of authority of the representative that are registered in the court registry (art. 42 CA). Following is an example from practice, where the capacity of responsibility was acquired by the person that was authorized by power of attorney, and it is the decision of the Supreme Court of Croatia no. I Kž 122/06-5 from 5th of June 2008, which states, among other things: "The accused had the capacity of the authorized by power of attorney in the company D. Ltd. O., according to the general power of attorney given to him and signed by the company's director D.B. On the basis of the general power of attorney the accused had the authority to conclude contracts and conduct other affairs in the name and for the account of the company D. Ltd. O., which he did, thereby acquiring the capacity of the responsible person within the legal entity consistent with article 89 point 7 of the CC. In this matter, contrary to the appeal, it is a general power of attorney verified at the notary public's office, which is observable in sheet 91 of the file. The circumstance of whether the same general power of attorney was registered with the Commercial Court in Osijek, is not of relevant influence in this matter since it is undoubtedly established on the basis of existing documentation in the file, the testimony of the witness S.K., and in part on the basis of the accused's defence itself, that the accused had factually concluded contracts and legal transactions in the incriminated period in the name and for the account of the company D. Ltd. O. Namely, it is decisive that the accused, having power of attorney, factually functioned in the company's business operations and that his contracts and legal transactions concluded with other legal subjects in the name of the company, had legal repercussions. In the absence of his brother D.B., the owner and sole member of the company's management, the accused ran the company's business operations as authorized by D.B., signing also a contract on business cooperation between D. Ltd. O. and R. Plc. I., and contracting purchase of brick making products, which was undoubtedly realized between these companies. The same follows from the testimony of R. Plc. I. company's president of the management board, witness S.K. Therefore it is without doubt that the accused, in the absence of his brother who was hiding for a longer period of time in F. in spite of an arrest warrant issued against him, did factually manage business in the name and the account of the company as a person authorized by a power of attorney, thereby acquiring the capacity of the responsible person as consistent with the ordinance of art. 337 paragraph 1 of the CC".

A person whose duty as the company's employee is to perform tasks that regularly include concluding particular contracts, i.e. taking particular legal actions, is authorized as if it were a person with the power of attorney to conclude these contracts and take these legal actions within limits of the work he/she performs (authorized legal representative by employment- art. 43 CA).

A procurator can conclude all contracts and take legal actions in the name and for the account of the company and represent the company in procedures before administrative and other state organs, institutions with legal public authority, and state and selected courts. However, the procurator cannot without special authorization misappropriate or encumber the real-estate of the company and cannot give depositions or take legal actions which would start a bankruptcy procedure or any other procedure that would lead to the termination of the company. A procurator cannot give the power of attorney to other persons. The contents and authority of the procura as commercial authorization are determined by CA (art. 44 CA).

2.4. Breach of duty to protect another's property interests based on a relationship of trust

This breach is constituted when, for example, a company's factual organ i.e. a person that is formally not in the management structure of a company, but on the other hand manages the affairs of the company. The best example would be when, for instance, a member of a private limited company appoints his wife as director of the company, and in reality he controls the company's affairs. In this case the wife, as director of the company (i.e. a formal organ), poses as a so called straw man, while the so called factual organ (the other spouse) is pulling all the strings in reality (Novoselec, 2007, p. 377; Schmid, 2006, p. 835). Consequently, regardless of the fact that somebody is not registered as the director with the court, i.e. as the responsible person, and he is merely a company member, he is held responsible if he factually performed duties of the company's responsible person (found and arranged business deals for the company, issued invoices, took payments and similar). In favour of this line of thinking stands the decision of the Supreme Court of Croatia number I Kž 335/15-4 dated 9th of September 2015 which, among else, explicitly emphasizes that: "...These conclusions by the complainant would relate to regular conditions in company's business operations, but not on the fictitious business operations of a company that serves as a front for illegal "laundering" of financial assets, in order to introduce these assets into the monetary system as legal. Furthermore, these conclusions would indicate the existence of "objective responsibility" because in that context the person registered as the director or a member of management, would be liable for all illegalities in company's operations, which is unacceptable in criminal law where the imperative, among other things, is to establish the guilt of the perpetrator. According to stated logic of the complaint, in this particular case M.R. should be included in the indictment, because he was the director of P.M. after 26th of December 2006 and throughout 2007, during which period a double amount of money (over 6 million Croatian kuna) than the amount mentioned in the incriminated period was withdrawn from ATM machines from the company's account using the same modus operandi. However, although investigative actions were taken against this person, he was not indicted, obviously because of the fact that R. spent most of the alleged period in prison in S. However, from stated facts it follows that nobody was indicted for the withdrawal of money from the company's account during 2007, because it is unknown who withdrew stated sums totalling millions, which indicates that the prosecutor did not, in relation to this event, see the circumstance of the responsible person being formally registered as sufficient evidence for indictment, which is correct. Therefore, having in mind stated circumstance, we must evidently conclude that the role of the indicted, a person who at the time at which the criminal offence was committed was only 19 years old and had absolutely no experience with business operations within companies, was peripheral, and that the company P.m. was founded for concealing other activities..."

The subjective trait of the criminal offence of Abuse of trust in business operations is the intent to acquire unlawful property gain for oneself or another, thereby causing damage to those whose property interests one is required to insure. Consequently, this criminal offence can only be committed with intent, direct or indirect.

As previously emphasized, there have been certain wanderings about the existence of legal continuity between the criminal offence from art. 292 paragraph 1 clause 6 of CC/97, and the criminal offence from art 246 of the CC/11. According to the former CC/97 it was enough for the perpetrator to perform actions with the goal of acquiring unlawful property gain for himself or another legal entity, it was now necessary that the that the perpetrator acquires for himself or another unlawful property gain, thereby or in other way causing damage to those whose property interests he was required to insure. Namely, this means that for the existence of criminal offence from art. 292 paragraph 1, subs. 6 of the CC/97 it was only required that the perpetrator acts with the intent to acquire unlawful property gain, which means such gain need

not be actually acquired (Novoselec, 2007, p. 397), in the case of the criminal offence from art. 246 of the CC/11, it is required that the perpetrator acquires for himself or another unlawful property gain, thereby or in other way causing damage to those whose property interests he was required to insure.

In this sense there were some disorientations of courts and State Attorney's offices about whether there was legal continuity between these two criminal offences or not, in the case of the perpetrator acquiring unlawful property gain for the company. At this initial disorientation, the State Attorney's Office and significant number of first-instance courts thought that even in such a case there was a legal continuity, so State Attorney's Office didn't modify factual descriptions as they had been initially set. That it was so, is best evident from some decisions of Superior Court of Republic of Croatia (no. 1 Kž 345/12-6 of the 10th of December, 2014 and others) whereat was explicitly quoted that in situation if perpetrator, as responsible person, acquired a property benefit to society whose interests he as a director was obliged to take care, then he caused a damage to the others, then it can be considered as existence of legal continuity of between criminal offences from article 292, subs. 1 clause 6 of CC/97 and criminal offence from article 246 of CC/11. Conclusion of Supreme Court of Republic of Croatia that possibly it may be case that the perpetrator (responsible person who acquired property gain to his society) encouraged another responsible person (of another society to which damage was done) or he helped him in committing the criminal offence, but as it did not result from factual description, the higher court did not concern this problem. Also, in one other decision of Supreme Court of Republic of Croatia (1 Kž-267/11 of the 2nd of April) the opinion was presented that in some situations there might a matter of legal continuity between art. 292 subs. 1 clause 6 of CC/97 and criminal offence of Fraud in Business Management from art. 247 of KZ/11 under condition that another person was mislead and induced to do something to the detriment of his property.

Furthermore, it should be emphasized that now is evident from disposition of art. 246. item 1 of CC/11 that unlawful proprietary gain has to be provided to oneself or to other person. By idea oneself means „to oneself as physical person“, then by idea other person means “other physical or legal person“, but not, as it was emphasized earlier, a legal person whereat committer fills a post of responsible person (also, see about decision of Supreme Court of Republic of Croatia no. I Kž-267/11 of the 2nd of April, 2014).

The heaviest form of this criminal offence is regulated in art. 246 item 2 of CC/11. It implies that committer of basic form of criminal offence (that is, the criminal offence from art. 246 item 1 of CC/11) provides to himself or to other person significant property gain or causes significant damage to one whose property interests he is obliged to take care. Legal mark of significant property gain that is of significant damage, pursuant to legal understanding of Criminal Department of Supreme Court of Republic of Croatia of the 27th of December, 2012, exists when the value of property gain that is, of damage, surpasses 60.000,00 Croatian kuna. For basic form of criminal offence from art. 246 item 1 of CC/11 six months to five years, then for heavier form of offence from art. 246 item 2 of CC/11 the imprisonment is prescribed from one to ten years.

3. CONSLUSION

Economy criminal offences' description as they were regulated until entering into force the CC/11 in practice were causing huge problems since they were conformed to existing legal system. The biggest news regarding economy criminal offences is relating to criminal offence of Abuse of trust in economy business. As it was pointed out in Final proposal of CC from year 2011, it was made on the model of German, Austrian and Swiss Criminal Code. Obtaining

basic foundations of this criminal offence from these developed European countries, it is clear that Republic of Croatia didn't want to make any new experiments, but it determinedly joined struggle against all forms of economy criminal offences.

Criminal offences of Abuse of Trust in economy management, comprised four criminal offences from CC/97, and that are Irresponsible Economy Management from art. 291 of CC/97, Abuse of Authority in economy Management from art. 292 of CC/97, Contracting of Detrimental Contract from art. 294 of CC/97 and Abuse of Position and Authority from art. 337 of CC/97, thereby this last criminal offence is included only in a part relating to responsible persons. By this sole act is evident that the proponent, that is the legislator, by enactment of CC/11, assumed extremely huge responsibility in view that courts were conferred very heavy task related to establishment of existence of legal continuity between former criminal offences and new criminal offence from art. 246 of CC/11. Although at the beginning there were some disorientations in work of State Attorney's Office and courts regarding an existence of legal continuity, it should be pointed out that in the meantime courts took the clear views and formed specific practice. In that sense, the initial fear also passed regarding fact whether the continuity of criminal offences will be preserved in field of economy, particularly in those matters that were of huge public interest. Conclusively, by regulating this criminal offence and abrogating the aforesaid criminal offences, did not mean that former committers' deeds described in these criminal offences remained with impunity since now they have been included in this new criminal offence. Consequently, what is the most important, the legal continuity is preserved, then criminal offence of Abuse of Trust in Economy Management ensured bigger protection than those four abrogated criminal offences which in view of today's legal system of Republic of Croatia are inadequate and out of date.

LITERATURE:

1. Derenčinović, D. (2009). Sedam pitanja u vezi s utvrđivanjem pojma »odgovorne osobe« u hrvatskom kaznenom pravu i praksi, *Pravo i porezi*, 2009. (no.9.), p.4.
2. Garačić, A. (2009). *Kazneni zakon u sudskoj praksi*. Organizator. Zagreb.
3. <http://www.sudacka-mreza.hr/stecaj-upravitelji.aspx?>
4. Criminal Code (Narodne novine, no.110/97, 27/98, 50/00, 129/00, 51/01, 111/03, 190/03, 105/04, 84/05, 71/06, 110/07, 152/08 and 57/11).
5. Criminal Code (Narodne novine, no. 125/11, 144/12, 56/15 and 61/15).
6. Final Draft of the Criminal Code (2011). <http://www.sabor.hr/Default.aspx?art=41259>
7. Novoselec, P. (2007). Aktualni problemi hrvatskog gospodarskog kaznenog prava, *Hrvatski ljetopis za kazneno pravo*, 2007. (no.2.), p.373, 377, 397.
8. Novoselac, P.; Roksandić Vidlička, S. (2010). *Gospodarska kaznena djela u novom Kaznenom zakonu*, *Hrvatski ljetopis za kazneno pravo i praksu*, 2010. (no.2.), p.702,703.
9. Decision of the Supreme Court of Croatia, no. I Kž-317/04 from 7. March 2006.
10. Decision of the Supreme Court of Croatia, no. I Kž 122/06-5 from 5. June 2008.
11. Decision of the Supreme Court of Croatia, no. I Kž-267/11 from 2. April 2014.
12. Decision of the Supreme Court of Croatia, no. I Kž 345/12-6 from 10. December 2014.
13. Decision of the Supreme Court of Croatia, no. I Kž 335/15-4 from 9. September 2015.
14. General Tax Act (Narodne novine, no. 147/08, 18/11, 78/12, 136/12, 73/13 and 26/15).
15. Pavlović, Š. (2013). *Kazneni zakon*, Libertin naklada, Rijeka.
16. The legal concept of the Criminal Division of the Croatian Supreme Court from 27. December 2012. - http://www.vsrh.hr/CustomPages/Static/HRV/Files/AGaracic_Pravna-shvacanja-o-neodredjenim_Opatija_2013.pdf.

17. Primorac, D.; Filipović, I.; Peronja, I. (2010). Kazneno djelo zlouporabe ovlasti/povjerenja u gospodarskom poslovanju (u športu) te uloga sudskih vještaka knjigovodstvene financijske struke u tim kaznenim postupcima, Zbornik radova Pravnog fakulteta u Splitu, 2012. (no.4), p.769-770.
18. Schmid, O. (2006). Wirtschaftsstrafrecht, 4. Aufl., Köln.
19. Bankruptcy Act (Narodne novine, no. 71/15).
20. Companies Act (Narodne novine, no. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13 and 110/15).

THE PROTECTION OF MENTAL HEALTH IN THE WORKPLACE

Anton Petricevic

*Faculty of Law, University of JJ Strossmayer
Osijek, Republic of Croatia
apetrice@pravos.hr*

ABSTRACT

According to the UN Convention on the Rights of Persons with Disabilities which include persons with mental defects, it is necessary To ensure the realization of all human rights for this category of persons. The Republic of Croatia and the implementation of EU legislation must persist in applying the principle of reasonable accommodation of this category of employees, which is reflected in the support for life and work in the community, particularly in the area of work through the examples of good practice. The goal is to create guidelines that would be the foundation of greater involvement of people with mental disorders into the labor market and the protection of such persons in the workplace. Today, almost all people are exposed to stress that negatively affects mental health. There are campaigns against causing stress in the workplace, to raise awareness in the fight for the so-called. "Healthy Workplaces". Campaigns gather various experts, from those involved in the protection of health, safety at work as well as those involved in the organization of recreational activities. Stress is an inevitable part of human activity. The factors that cause it are called stressors. Stress can cause the development of serious illnesses (anxiety, depression, reduced functioning of the immune system). When it comes to the workplace, and today it is often the case, workers are insecure, which is an indicator of stress. Sudden changes in the workplace, necessity of performing additional tasks at home, burnout syndrome, insufficient holidays and low wages is what affects the mental health of workers. This leads to anxiety, concentration problems, constant fatigue, social isolation, bitterness and finally taking psychoactive substances. Work then becomes a heavy burden for worker. The goal is to raise awareness and the general public and especially among employers and employees about the importance of stress prevention.

Keywords: *principles of reasonable adjustment, stress, mental health workers.*

1. INTRODUCTION

Mental health is an integral part of the general health of people, and presents an important source of strength and security for the individual and his family. A person who has good mental health is a happy, positive, able to start a family, accepts other people, is able to create and maintain friendships, productive in the workplace and easily copes with life's troubles and stresses.

World Mental Health Day is celebrated every year on October 10, organized by the World Federation for Mental Health (WFMH), in cooperation with the World Health Organization (WHO). The importance of promoting mental health and focusing attention on the problems of mental health is being highlighted at the world level. People with damaged mental health are considered to be persons with disabilities.

The rights of persons with disabilities in Croatia have been established in both international and domestic documents. Among domestic documents the most important is the Constitution. By following the basic principle of the Constitution on the special protection of persons with disabilities, many regulations have been developed that are related to the rights of persons with disabilities.

The Universal Declaration of Human Rights speaks of the equal and inalienable rights of all members of the human community, especially people with disabilities. The Convention on the Rights of Persons with Disabilities and the Optional Protocol to the Convention on the Rights of Persons with Disabilities, was signed by then Deputy Prime Minister Jadranka Kosor at the UN headquarters in New York on 30 March 2007, and the Parliament had ratified on June 1st 2007. The Convention for the Republic of Croatia entered into force on May 3rd 2008 and it is the basic document in the exercise and guarantee of human rights for persons with disabilities to be educated and employed on an equal basis with other citizens of the Republic of Croatia. Under the Convention, disability isn't only the physical damage that a person might have, but also might be the result of an interaction between people and environment. Therefore, society creates disabilities with its lack of adaptability, but it also provides tools and other forms of support for the disabled through technical adjustments of space and by ensuring aid and other forms of help.

The Convention clearly states that persons with disabilities are persons with physical, sensory, intellectual disabilities and persons with mental or psychosocial disabilities, which includes people with mental disabilities, mental illness or mental health problems.

Reasonable adjustment means that people with disabilities are being ensured equal enjoyment or exercise of human rights and fundamental freedoms as well as all other people. The Convention insists on the creation of a society of equal opportunities for all, equality and the protection of human rights for the disabled, because we are witnessing years of injustice to people with disabilities. Awareness of the need for active involvement of people with disabilities in all aspects of social life slowly moves forward momentum. It is necessary for this purpose to take advantage of the European funds that can financially enable the full inclusion of people with disabilities in the sphere of social work and life. This course includes employment as the most important element of personal achievement and independence in every respect. The institutions that are active in order to involve people with disabilities in social life and the labor market are Croatian Chamber of Economy, Croatian Chamber of Crafts, Croatian Employers' Association, various associations of persons with disabilities, Ministry of Labour and Social Welfare, the Ombudsman for persons with disabilities, the Croatian Bureau of Employment

The new regulations in the Republic of Croatia envisage integrative workshops that will be a link between the open labor market and work in a fully protected conditions. There will employ people who need a lower level of support from people who work in protected conditions. This creates a flow towards the open labor market by increasing independence in their work.

The necessity to protect particularly vulnerable groups of the population has always been an important segment of human rights and fundamental freedoms. In recent years, there is a notable tendency of interest in legal protection and full integration into society of persons who have physical, sensory and mental impairment. While this is so, however, a situation where a person with disabilities is deprived of their right of priority in employment is very often.

Until the institution of unique expertise fully enters in implementation the expertise of which will be valid at achieving their overall rights, there is no relief for people with disabilities in terms of access to the labor market and employment. We live in a time of aversion to the disabled, but it is proven that people with disabilities often are diligent workers because they want to prove themselves at work. Employers have prejudices about persons with mental disorders and even to people with disabilities. From day to day we have witnessed cheating in the way Human Resources selection process in which an employer conducts tests and interviews just to eliminate a person who called in accordance with the provisions of the Labor

bill indicating that he or she was suffering from a mental disorder, but that it will not interfere with the performance of task job from the competition. So prejudices about mental illness are the basis for elimination of such a person, and a tool that will make it happen is by conducting tests and interviews (for which we know in advance that only a facade hiding the reality)

2. PSYCHOLOGICAL ASPECTS IN THE FIELD OF MENTAL HEALTH CARE

Mental health disorders are real medical problem. Because of the frequent incidence of mental illness and mental disorders represent one of the major public health problems and a lot of attention should be focused towards protection and preservation of mental health. At the expert meeting on "Combating discrimination against people with disabilities in the workplace by applying the principle of reasonable accommodation ..." which was organized in 2016 in Zagreb it was hard listening to the testimony of a father who has a son with academic achievements who can't possibly get a job because of his mental illness. The father tearfully spoke of this category of young smart people about the silence of institutions or worse the discrimination itself to which this young man is exposed. Rare are those who will act according to the law, which will put themselves and their loved ones in this position, but will not watch it as someone else's problem. Thus, expert testimony could determine whether the person is able to do the work, and give her a chance under the same conditions, not to discriminate, for what God had given him, and a person certainly didn't ask, because who would seek for illness? It is important to carry out audit and if it is established that a person is able to perform the work tasks of this job, give her exactly the same opportunities as others who don't have disease. Inspections in this case should conduct the testing, not employers. But the institutions are silent ... Until when? Why do we have the legal framework when one can bypass it and trick it? This further deepens mental disorder of a person, creating a negative image of the institutions of the system and takes the disabled into despair. We need to talk about it.

Statistics on the number of patients, the causes of disability for work, the hospital treating mental disorders place mental disorders at the top of the list of the most common diseases of our time. In recent years, there is an increased incidence of depression. It is anticipated (according to World Health Organization WHO) that by 2020 depression will become the second in the list of leading disease.

One should not ignore the problems of mental health. Many physical diseases have underlying mental health disorder and the person's inability to successfully cope with stress.

Mental illness can happen to anybody. Research has shown that there are genetic and biological causes of mental disorders and that they can be successfully treated, but should react.

Croatia has a key document that represents a reference framework for action in the field of mental health care, which is the National Strategy for mental health care for the period 2011-2016 arising from measures and actions aimed at the preservation, prevention and mental health through three levels: primary, secondary and tertiary prevention¹

¹ Primary prevention-set of measures and procedures aimed at preventing the emergence and development of risky behaviors that can lead to disturbances in the perception and behavior (information, education and counseling, and empowering individuals to develop positive lifestyles

Secondary prevention is a set of measures and procedures aimed at preventing the emergence and development of risky behavior. Selective focused to individuals with an increased risk for mental health

Tertiary prevention is a set of measures and procedures involving complex psychosocial and medical treatment of people who have damaged mental health. Here is a typical direct individual approach in helping to resolve problem situations in life to be resolved further disruption of mental health

2.1. Clinical situation of a person disturbed mental health

Persons with disturbed mental health are often frightened, desperate, confused and in extreme cases need help and support from loved ones, and also from the society. They are stigmatized and rejected. The lack of recognition and treatment of mental illness can have tragic consequences that lead to suicide. According to the Statistical Office of the Republic of Croatia annually there is about a 1000 suicides, and that is one-third of those who are thinking about it.

3. THE ROLE AND OPERATION OF THE PUBLIC HEALTH INSTITUTE IN MENTAL HEALTH CARE

The Department of mental health, prevention and outpatient treatment at the Public Health Office deals with the part of mental health that focuses on prevention, early detection and as early as possible effective rehabilitation of mental health problems. The Department carries out systematic activities to assist high-risk population, patients, and is engaged in advisory work and support of their families.

The public health system is focused on health promotion and disease prevention through its psychologists who effectively intervene in the sphere of:

Exploration incidence (difficulties in mental functioning)

- * Creating prevention and counseling programs
- * Exploration of protective and risk factors for mental health
- * Promotion of health and healthy lifestyles in the media
- * Psychoeducational and specific training
- * Modification of behaviour
- * Advisory work with clients

4. REHABILITATION OF PEOPLE WITH MENTAL HEALTH DISORDERS

Experts deal with rehabilitation in this area and are applying coordinated psychosocial processes with the aim of promoting the development of a range of skills that are necessary for life in the community and that will help patients to function as independently as possible in the social, labor and other environments with the minimum level of professional support. It stimulates recovery, empowerment, social integration and improves quality of life for people diagnosed with a mental disorder that leads to serious difficulties in social and work functioning necessary for everyday life.

Methods of rehabilitation

- casemanagement (Coordinated treatment)
- social skills-training
- work with family
- aided employment
- support groups

5. THE CROATIAN REGISTER OF PERSONS WITH DISABILITIES

Law on Croatian Register of Persons with Disabilities ² regulates the method of collecting data on the cause, type, degree and severity of health impairment of persons with disabilities. It is chaired by the Croatian Institute for Public Health.

² Law on Croatian Register of Persons with Disabilities, Official Gazette 60/01

The general part of the Register includes information about the person: name, surname, sex, ID number, place of birth, residence, place of residence, education, occupation, employment, marital status.

The special part of the Register includes information on the types of physical and mental impairments including: vision impairment, hearing loss, speech and voice communications, damage to the loco-motor system, damage of the central nervous system, damage to the peripheral nervous system, damage to other organs and systems, mental disorders, autism, mental disorders, multiple disabilities.

Data collected in this Register may only be used as statistical indicators, they are secret, and the only persons that have data access to this Register are the people that are working in the Register and who signed a statement of data confidentiality.

6. EMPLOYMENT OF PEOPLE WITH MENTAL DISORDERS

The area of professional rehabilitation and employment of persons with mental disorders is regulated by the Bill on Professional Rehabilitation and Employment of Disabled Persons.³ The main objective of this law is to create possibilities for effective inclusion of people with mental health problems into the open labor market. Many of these people will have to undergo training and adjustment through sheltered workshops or work centers. What is the next step in this story is the obligation of employing persons with disabilities for employers in the public sector. Using this measure, employers become familiar with the capabilities of people with disabilities and the privileged position of employers in providing employment opportunities disabled person. But we know from research in the field that employers avoid hiring people with mental disorders. Eg. If you encounter people with physical disabilities and people with mental disorders, and have the same conditions, employers will opt to before a person with physical problems than a person with mental problems.

The formation of the Fund for professional rehabilitation and employment of persons with mental disabilities is one of the largest novelties issued by the Law on professional rehabilitation and Employment of Disabled Persons. This bill opened a systematic and permanent care for the better professional rehabilitation and employment of these categories of persons. Funds will be converted in this way that persons collected through passive protection. It is better for the community and them personally that these funds become active agents of protection of this category of people. In other words our goal is a combined approach of rehabilitation and integration of these people. We strive to create the conditions that will enable this category of persons exercising the right to choice and the quality of their own lives and create equal opportunities of life in the community.

In the area of employment biggest problem are prejudices about people with disabilities and their capabilities and ability to work. It has been said that it is trying to help these people in various ways and one of them is the introduction of a personal assistant, with which this population is given an opportunity of more independent planning and community involvement. It should oppose discriminatory and stigmatizing behaviors that directly or indirectly impede or hinder this category of people to participate equally in society.

³ The Law on Vocational Rehabilitation and Employment of Disabled Persons, Official Gazette 157/13,152/14

Although the right to work is often misunderstood, it does not require that the state guarantees a job for everyone, but calls for policies to achieve a balanced economic, social and cultural development and productive employment.

7. RECREATION, ENTERTAINMENT AND SPORTS FOR PEOPLE WITH MENTAL HEALTH IMPAIRMENTS

For overall health it is necessary that people with mental disorders emerge among people, to recreate, to play sports, to go to meetings, entertainment and leisure, improving the general state of their health, especially mental condition. These persons will deal with various activities and thus get out of the four walls and out of the gloomy thoughts. There are people who are able to develop the spirit of competition and compete with the support of the institutions of the Croatian Olympic Committee, the Croatian Para-Olympic Committee and pursuant to the sport, and thus realize their need to assert an equal member of society. Previously we have seen that most people with disabilities compete in swimming and diving and that this creates a sense of security, because they are equal to others in the water may alike be evaluated, not because of self-pity or worse prejudices on their already limited opportunities and that they won't get disqualified.

Civil society organizations contribute to creating a positive image in the public about people with disabilities and their possibilities and needs. The results are:

- obligatory respect for these people
- obligatory protection
- obligatory promotion

8. REASONABLE ADAPTATION OF PERSONS WITH MENTAL DISORDERS

No matter how much adjustment could go much faster, it must be recognized that through this institute in 2015 in relation to past periods the employment of the disabled was increased by 40%. Were it contributed benefits to employers in hiring the disabled and sanctions to be applied to the public sector if not hire people with disabilities it is a question for further research. Now quotas have become a limitation, because some employers want to hire more disabled person than the specified quota. We know that an employer who employs a disabled person must adjust the position for that person so that it can smoothly carry out the assignment, but not to be a burden to the employer. The employer can get for this purpose subventions from the Fund for Professional Rehabilitation and Employment of Persons with mental disabilities.

At an event in the Croatian Bar Association organized by then Ombudsman for the disabled it was discussed about the adjustments to the workplace, which includes among other things adaptation of premises and equipment, changing patterns of working time, reallocation of tasks, providing additional training and it's certainly not a disproportionate burden on the employer. If a person experiences uncertainty or has low self-esteem then the employer will provide support to the worker or help organize colleagues in certain situations. Colleagues can play a vital role in the adaptation. In accordance with the considerations of confidentiality, employers must ensure that this happens. In case of dispute that could arise from inadequate adjustment that might be a valid defense of a disabled worker that the staff were obstructive or did not want to help, when the employer tried to make reasonable accommodation. The employer must show seriousness in the process of reasonable accommodation and that it was dealt in an appropriate manner

8. 1. An example of reasonable accommodation

It was a depressive person. Depression persisted and the person had to contact his doctor to determine the reasonable adjustment of the workplace. Neither the doctor nor the patient could suggest that adjustments were efficient. Although the mentioned bill lacks specific guidelines

to the employer with respect to its obligations and the employer doesn't know all that belongs to the concept of disability and how to relate to anyone here on his own initiative the employer must consider giving its opinion on reasonable adjustments to the workplace. The employer had a good will to help and was up to the task when decided that working from home for a while would have positive effect on worker because she has experienced harassment from co-workers. This proved to be a sensible move from the employer and time has shown that colleagues understood their relationship with the worker had produced increased depression in her. After returning to her position worker continued her job without depression and in a positive working environment where her work efficiency came in full expression and her mental status was solidified. This is a positive example of reasonable adjustment to the persons with mental disabilities.

9. CONCLUSION

This paper draws attention to people with disabilities, and to mental health in the workplace. There is a legal both international and domestic legislation as a legal basis for the equalization of disabled people, which includes people with mental disorders, or the perception of the state against these persons is quite alarming. People with mental disorders, after expert analysis, may prove to be able to perform their work independently and thus be useful in the micro and macro environment. This is also evidenced by numerous examples of specific people with different kinds of incomplete functionality of the organism that manage to achieve top results in their work. People with mental disabilities only seek equal opportunities for all participants in the competition for jobs, asking to not be discriminated against in the job search and not mobbed at work, seeking work environment without stress and looking for reasonable adjustment in the workplace that cost the employer almost nothing and it mean a lot to them.

Mental health is crucial to the overall well-being of people, society, state, and therefore mental health should constitute an essential and important aspect of overall health care system.

People who have problems with mental health have emerged as a result of stress, difficulties with adjustment disorders of human relationships, the various tragedies and diseases, should be helped by experts in the sense that they listen, understand, talk to them, have sensitivity to their problem, and that they lead to output from this problem, mostly without medication. Worker with mental disability must have confidence in this person. Basically the general society is conceived on the principle on turning their heads away from problems and avoiding to solve problems of persons with disabilities. It is hard to say whether the situation will improve in the years to come. All of us are left to think about it, because it is difficult to live under the stigma of discrimination and being left alone with his problem.

Because of the differences that occur in cases of discrimination based on disability we should collect the best practices and experiences in Croatian law from the EU. Positive experiences should be sought in comparative national legislation and in everyday practice.

However, there is room for optimism and hope for this category of persons to be perceived as equal members of a community, with the same rights and responsibilities, and that the long-term goal will be the expansion of reasonable adjustment and the associated incidence through the faith, reconciliation of family and work obligations and family status.

LITERATURE:

1. Ajduković, M. i Ajduković, D.: Pomoć i samopomoć u skrbi za mentalno zdravlje pomagačima, Društvo za psihološku pomoć, Zagreb 1996.
2. Božičević, V.; Brlas, S.; Gulin, M.: psihologija u zaštiti mentalnog zdravlja,
3. Gracin, B.; Romac, D.: Služba za mentalno zdravlje i prevenciju ovisnosti,
4. Jesus Montero-Marin, Javier Garcia-Campayo, Domingo M. Mera i Yolanda L. del Hoyo: A new definition of burnout syndrome based on Farber's proposal, *Jurnal of Occupational Medicine and Toxicology*, 2009.
5. Leymann, H., How ill does one become of victimization at work?, 1996.
6. Ružić, K.; Medved, P.; Dadić-Hero, E.; Tomljanović, D.: Rehabilitacija u psihijatriji-socioterapija
7. Šimek, L.: Razumna prilagodba radnog mjesta osobama s invaliditetom, diplomski rad, Pravni fakultet, Zagreb, poveznica: <https://urn.nsk.hr/urn:nbn:hr:199:439363>
8. Legal documents:
9. Nacionalna strategija izjednačavanja mogućnosti za osobe s invaliditetom od 2007 do 2015. godine, NN 63/07.
10. Zakon o profesionalnoj rehabilitaciji i zapošljavanju osoba s invaliditetom, NN 157/13, 152/14
11. Zakon o pravobranitelju za osobe s invaliditetom, NN 125/11
12. Zakon o Hrvatskom registru osoba s invaliditetom, NN 64/01
13. Zakon o radu, NN 93/114
14. UN-ova Konvencija o pravima osoba s invaliditetom, NN 6/07
15. Internet:
16. <http://www.hup.hr/novi-zakon-o-zastiti-na-radu-19.06.2014>.
17. <http://www.zdravakrava.hr/clanak/5152/kako-sprijeciti-sagorijevanje-na-poslu>
18. <http://www.zzjz-ck.hr/?task=group6gid=18&aid=84>

FOSTER CARE AS THE FORM OF ALTERNATIVE CARE FOR CHILDREN

Ana Radina

Faculty of Law, University of Split, Croatia
ana.radina@pravst.hr

ABSTRACT

Family is considered to be the natural environment for the child's development and well-being. When the family does not fulfil its essential role in caring for the child who depends on it, the state must activate its social support mechanisms and provide alternative care for such a child. The importance of family and community-based forms of alternative care, as opposed to institutionalisation, is supported by all levels of governing. As one of the forms of alternative care for providing the child with domestic environment, foster care is strongly advocated by the United Nations, Council of Europe and European Union. Being bound by the Convention on the Rights of the Child as well as other relevant international agreements, and being an EU Member State, Croatia is making efforts to improve the foster care for children as part of the wider social welfare system reform. The purpose of this paper is to analyse the relevant international standards and the domestic approach to foster care in order to find out whether the practice of foster care in Croatia corresponds to legal requirements and to identify the possibilities for improvements with the purpose of protecting the foster children better.

Keywords: Child, Family, Foster care, Social support.

1. INTRODUCTION

All relevant international instruments regard family as the natural and most appropriate environment for the child's development. When the child is unable to live with its family and is left in a state of total dependence, the state comes *in loco parentis*, at least from a legal standpoint. For a long time institutionalisation was considered to be the most appropriate form of social protection of children without family care (del Valle, 2014, p. 2945-2947). The 20th century brought a new understanding and interpretation of childhood and, eventually, recognition of the specific needs of children as their rights. Today, the rights of the child are more than just a moral category; the rights of the child, like the human rights, are not "given" to children, they are immanent to the child's very existence (Jakovac-Lozić, 2005, p. 872).

That new perspective prompted the development of family and community-based forms of alternative care as more appropriate for the child. Foster care comes to focus as a form of alternative care that can meet the critical needs of the child precisely because it means care in the family environment; it allows the parallel development of affective relations with foster parents while retaining the affective relations with biological parents and identifying with them; it is a chance for biological parents to participate in the care of the child (Kletečki Radović, Kregar Orešković, 2005; referenced by Laklija, Sladović Franz, 2013, p. 11). The awareness of the benefits of foster care is reflected in the contributions of all the relevant international entities to establishing principles for developing and improving the foster care system. Foster care is strongly advocated by the United Nations and its bodies, especially Committee on the Rights of the Child and UNICEF; Council of Europe promotes foster care as being often the best mode of placement of children; European Union financially supports its Member States in the process of de-institutionalisation and developing quality family-based care. Unavoidably, as a member of international community, Croatia is participating in those processes and is making efforts to improve the foster care for children. Even though certain progress has been achieved, foster care system in Croatia is facing serious challenges.

2. UNITED NATIONS STANDARDS ON PROTECTION OF THE CHILD DEPRIVED OF FAMILY ENVIRONMENT

The United Nations (UN) have a rather rich history of engagement in the area of child protection. The Declaration of the Rights of the Child (1959) (UN General Assembly, 1959) states that the child shall, whenever possible, grow up in the care and under the responsibility of its parents and, in any case, in an atmosphere of affection and of moral and material security (principle 6). Awareness of the need to establish basic universal principles regarding alternative care for children led to adoption of the Declaration on Social and Legal Principles relating to the Protection and Welfare of Children, with Special Reference to Foster Placement and Adoption Nationally and Internationally (1986) (the 1986 Declaration) (UN General Assembly, 1986). This Declaration regards foster family as a possible substitute for the child in cases where the care of parents or other relatives is not available or appropriate (art. 4). The paramount consideration should be the best interests of the child with the special emphasis on the child's need for affection and the right to security and stability (art. 5). Also, the 1986 Declaration calls for proper involvement of prospective foster carers and, where appropriate, the child and its parents in all matters related to foster care which competent authorities should supervise in order to ensure the welfare of the child (art. 12). The foster care, while in principle of temporary nature, may, if necessary, last until adulthood, however, that should not preclude the possibility of the prior return of the child to its parents (art. 11). Clearly, the ultimate goal of any state intervention in the relations between child and its parents should be their earliest possible reunion.

Universally accepted Convention on the Rights of the Child (1989) (CRC), adopted by the UN General Assembly, (Službeni list SFRJ 15/1990, Narodne novine - Međunarodni ugovori 12/1993, 20/1997) proclaims the best interests of the child as a primary consideration in all actions concerning children, whether undertaken by public or private social welfare institutions, courts of law, administrative authorities or legislative bodies (art. 3). The states are obliged to respect the family's primary responsibility for the child (art. 5) and ensure that the child is not separated from its parents against parents' will, except when such separation is necessary in the best interest of the child (art. 9).

Article 20 obliges the state to provide the child with special protection and assistance in cases where the child is temporarily or permanently deprived of its family's environment or the child cannot be allowed to remain in that environment for the sake of its own best interest. The state is to ensure alternative care for such a child but the choice of the type of care must take into account the desirability of continuity in a child's upbringing and the child's ethnic, religious, cultural and linguistic background. Such alternative care can be provided, *inter alia*, in the form of foster placement. Article 20 speaks about the family, not solely the parents, which undoubtedly, and in accordance with Article 5, means that the state should seek placement for the child within its extended family before considering other solutions (Hodgkin, Newell, 2007, p. 278). The Committee on the Rights of the Child is also of the opinion that children feel better in their own environment which should be considered when they are placed into out-of-home care (Committee on the Rights of the Child, 2006). Continuity of upbringing implies continuity of contact, whenever possible, with parents, family and the extended community. Also, it means that the state should seek to avoid multiple placements of children in its care. When a child has already suffered the trauma of losing its family, everything should be done to avoid further disruptions in its life (Hodgkin, Newell, 2007, p. 288-289). Furthermore, the task of the state is not over once a child is placed in an alternative care since the Article 25 clearly demands periodic reviews of the treatment provided to the child and all other circumstances relevant to its placement.

Since children with disabilities are vulnerable to abandonment by their parents, it must be noted that the CRC obliges the state to ensure the effectuation of the rights of such children and enable

them to live a full and decent life (art. 23) while the Article 23 para. 4 of the UN Convention on the Rights of Persons with Disabilities (2006) (Narodne novine - Međunarodni ugovori 6/2007, 5/2008) explicitly states that the disability of the parent or the child is not sufficient ground for removing the child from its family.

In 2005, the Committee on the Rights of the Child held a Day of General Discussion on "Children without parental care" with the aim of improving the implementation of the CRC in this area and it proposed drafting a set of international standards and guidelines that would show flexibility for cultural aspects, be practical in nature and insist on effective monitoring mechanism (Committee on the Rights of the Child, 2006, para. 688-689).

2.1. Guidelines for the Alternative Care of Children

Following all the premises set in the above mentioned instruments, Guidelines for the Alternative Care of Children were adopted in 2009 (the Guidelines) (UN General Assembly, 2010). The Guidelines are a practical instrument intended for all those involved in providing alternative care for children, including the foster care, containing a number of provisions that policy makers and practitioners should follow in order to establish and implement the foster care system in the way which will best suit the child's well-being.

Naturally, the Guidelines aim to support the child in remaining and/or returning to the care of his family and devote considerable attention to promoting parental care (para. 32-38), preventing family separation (para. 39-48) and promoting family reintegration (para. 49-52). Removal of a child from the care of the family is regarded as a measure of last resort that should, whenever possible, be temporary and for the shortest possible duration (para. 14) while the poverty (para. 15.) should never be the only reason for taking a child into care. For the child taken into care, the Guidelines define a range of options that should be considered together with the individual needs of the child concerned and with respect for its rights and interests. Among others, the Guidelines highlight the need for full respect towards the child's right to receive necessary information, to be consulted and to have its views taken into consideration in accordance with its evolved capacities (para. 6); the desirability of leaving the child within its local community in order to facilitate contact and potential reintegration with its family (para.11); the importance of stability and continuous attachment to the caregivers (para. 12); treating the child with dignity and respect and ensuring effective protection from all forms of abuse, neglect or exploitation (para. 13).

According to the Guidelines, foster care is a formal type of alternative care that refers to situations where the child is placed by a competent authority in the domestic environment of a family other than the child's own family (para. 29). Decision-making on foster care should take place through adequate procedure, with legal safeguards including legal representation of the child; it should be based on rigorous assessment and planning and carried out by qualified professionals; it should include consultation with the child and its parents or legal guardians (para. 57). Assessment should take into account the child's immediate safety as well as its long-term well-being together with its personal and developmental characteristics, cultural and religious background, family and social environment and possible special needs (para. 58). Planning for foster placement should be carried out as early as possible, ideally before the child enters care while taking into account the child's need for stability and the fact that frequent changes in the care setting would be detrimental to its development and the ability to form attachments to its foster carers (para. 60-61). The child must have the opportunity to complain to the placement decision before a court (para. 66) and the right to regular and thorough review of the appropriateness of its treatment (para. 67). Once a child is placed in foster care, contact with its family and other persons close to it should be encouraged and facilitated (para. 81). Children in care should be provided with access to a person of trust in whom they may confide (para. 98). Foster carers should be provided with training on the rights of children without

parental care and the vulnerability of children in particularly difficult situations. They should also be sensitised on cultural, social, gender and religious aspects of providing foster care and be prepared to care for children with special needs, e.g. children with chronic illnesses or disabilities (para. 115, 117).

The competent authorities should devise a system, and train the expert staff accordingly, to assess and match the needs of the child with the characteristics of potential foster carers and to prepare all concerned for the placement (para. 118). Support and counselling services for foster carers should be made available before, during and after the placement (para. 120). Carers should have the opportunity to make their voice heard and to influence policy (para. 121) and be encouraged in establishing of associations of foster carers that can provide them with important mutual support (para. 122). The Guidelines also emphasise the importance of support for aftercare, stipulating that foster parents should, throughout the period of care, systematically prepare the child to fully integrate in the community, especially through the participation in the life of the local community and acquisition of social and life skills (para. 131). Aftercare should be prepared as early as possible in the placement (para. 134) and, whenever possible, the child should be allocated with a person responsible for helping it in acquiring independence after leaving care (para. 133).

3. COUNCIL OF EUROPE STANDARDS IN THE AREA OF FOSTER CARE

Council of Europe (CoE) is strongly committed to child protection in all areas, including the area of alternative care. Since an estimated 1.5 million children in the CoE live in some form of alternative care, CoE is actively promoting their right to live in a supportive, protective and caring environment that helps them develop their full potential. The family and community based forms of care are more likely to meet the needs of children so the CoE is advocating for de-institutionalisation and providing children with family-based placement like foster care, relying especially on the UN Guidelines for the Alternative Care of Children, (<http://www.coe.int/en/web/children/alternative-care>, 20.6.2016.). There are several CoE instruments aimed at developing standards of foster care, e.g. Resolution No. R (77) 33 on the placement of children, Recommendation No. R (87) 6 on foster families, Resolution 1762 (2010) on children without parental care: urgent need for action. Resolution No. R (77) 33 promotes foster care as being frequently the best mode of temporary placement, especially for young children, and, therefore, recommends member states to put effort in developing that type of care for children (Committee of Ministers, 1977, para. 2.13.). Recommendation No. R (87) 6 reflects awareness of the important role of the foster parents and suggests that after the foster child has integrated into the foster family, they should be able to apply to a competent authority for power to exercise certain parental responsibilities (Committee of Ministers, 1987, principle 5). Taking into account the close bond that can develop between the foster parents and the foster child, this document, in a way, anticipates the views of the European Court of Human Rights (the Court), as presented below. Dealing with the plight of children without parental care, Resolution 1762 (2010) reminds the member states of the need to promote alternative childcare arrangements of high quality and as close as possible to a family environment, such as foster care (Parliamentary Assembly, 2010, para. 6.2.),

Dedication to ensuring full respect of children's rights during time they spend in foster care is further demonstrated within the CoE programme "Building a Europe for and with Children". Building a Europe for and with Children: 2009-2011 strategy regards children without parental care as one of particularly vulnerable groups of children to whom the CoE made commitment to promote measures that ensure that children grow up in a family environment in their original families, foster homes or adoptive families (Committee of Ministers, 2008, p. 8). CoE Strategy for the Rights of the Child (2012-2015) reveals that, despite positive steps in this area, violence is still a major concern for children in alternative care which needs to be addressed together

with their fear of being unprotected. Also, consultations with children show that they are not properly prepared to enter care and that there is a lack of continuity in the provision of care as well as the failure in monitoring their personal situation (Committee of Ministers, 2012, p. 5 and 7). Strategy for the Rights of the Child (2016-2021) reaffirms commitment to paying special attention to children in all forms of alternative care and provide guidance to professionals in this field in implementing a child-rights based and participatory approach to their work (Committee of Ministers, 2016, p. 11).

Inevitably, we must mention the Convention for the Protection of Human Rights and Fundamental Freedoms (1950) (ECHR) (Narodne novine - Međunarodni ugovori 18/1997, 6/1999, 14/2002, 13/2003, 9/2005, 1/2006, 2/2010). Even though it does not mention expressly the child's rights or any form of alternative care, Article 8 of the ECHR protects everyone's right to privacy and family life. The Court's case-law shows how that provision is relevant in the area of foster care for children and complements all relevant instruments and standards in this regard.

The Court emphasises that in this kind of cases the child's interest must come before all other considerations (Johansen v. Norway, para 64; Haase v. Germany, para. 89). That interest dictates that family ties may only be severed in exceptional circumstances and it is for the respondent state to establish that a careful assessment of the impact of the proposed measure on the parents and the child, as well as of the possible alternatives to taking the child into care, was carried out prior to implementation of such a measure (Haase v. Germany, para. 90; Venema v. the Netherlands, para. 93). The fact that a child could be placed in a more beneficial environment will not justify on its own the removal from the care of the biological parents (K.A. v. Finland, para. 92; Kutzner v. Germany, para. 69). Placing the child in foster care solely on the basis of the parents' difficult financial situation instead of providing them with other available means of support is not acceptable (R.M.S. v. Spain, para. 85).

The mutual enjoyment of each other's company by parent and child is the fundamental element of family life which is not terminated by the taking of child into public care (Olsson v. Sweden (no. 1), para. 59). The taking of the child into care should be regarded as a temporary measure to be discontinued as soon as circumstances permit and implemented in consistency with the ultimate aim of reuniting the family (Haase v. Germany, para. 93; Olsson (no. 1), para. 81). The minimum expected from the authorities is to examine the situation anew from time to time to see if there has been any improvement in the family's situation (K.A. v. Finland, para. 139). Following the removal into care, the Court applies stricter scrutiny in respect of further limitations by the authorities, for example on restrictions of parental rights or access, because such further limitations entail the danger of curtailing the family relations between the parents and the child (Kutzner v. Germany, para. 67). Preparatory counselling before the reunion of parents with children who have lived in a foster family for some time is also very important (Scozzari and Giunta v. Italy, para. 175).

More than once the Court upheld the domestic courts' decisions favouring continuation of foster care over the child's return to its biological family, usually in cases where the child spent a longer period and had become so deeply rooted with the foster family that the removal against the child's will would jeopardise its welfare (Glesmann v. Germany, para. 106; Nanning v. Germany, para. 69, 71; Bronda v. Italy, para. 62) or where the improvement in the circumstances of the parents did not appear with reasonable certainty to be stable (Olsson v. Sweden (No. 1), para. 76). Moreover, according to its well established view that the existence of family life is a question of fact depending on the real existence of close personal ties, the Court acknowledged the relationship between foster parents and the foster child as falling within the notion of family life within the meaning of Article 8 of the ECHR because there had been a close inter-personal bond between them and the foster parents had behaved in every respect like the child's parents (Kopf and Liberda v. Austria, para. 35, 37; Moretti and Benedetti v. Italy, para. 49, 50). Also, the Court found no violation of rights in the fact that after the foster parent's death their

foster children were treated on a par with their biological children regarding division of the survivor's pension (*Ruszkowska v. Poland*, para. 62, 65).

Last, but not least, the Court found that local authorities violated the former foster child's right to respect for its private life by refusing to provide him with detailed information about its placement, where it was kept, by whom and in what conditions. Information they sought were, in the Court's opinion, related to its basic identity and people in the situation like this have a vital interest in receiving the information necessary to know and to understand their childhood and early development (*Gaskin v. the United Kingdom*, para. 11, 16, 39, 49).

4. FOSTER CARE IN THE LEGAL FRAMEWORK OF THE EUROPEAN UNION

European Union (EU) has important responsibilities in the area of child rights protection. Entering into force of the Treaty of Lisbon (2007) (OJ C 306, 17.12.2007.) in December 2009 opened a new era for action on children's rights at the EU level since for the first time the promotion of the rights of the child is explicitly stated as one of the Union's objectives (art. 2). The Treaty on European Union (OJ C 202, 7.6.2016.) proclaims fundamental rights as guaranteed by the ECHR as general principles of the Union's law (art. 6). The Charter of Fundamental Rights of the EU (2000) (the Charter) (OJ C 202, 7.6.2016.) guarantees the protection of the family (art. 7, 33) and affords the child with such protection and care as is necessary for its well-being, recognises the principle of the best interest of the child as well as the child's right to participation (art. 24. para. 1, 2). Also, Article 24 para. 3 protects one specific aspect of the right to respect for family life (*Korać Graovac*, 2013, p. 47). Namely, it is the right of every child to maintain on a regular basis a personal relationship and direct contact with both of its parents, unless it is contrary to its interests. In so far as the Charter contains rights which correspond to rights guaranteed by the ECHR, the meaning and scope of those rights shall be the same as those laid down by the ECHR (art. 52) which means that EU and its institutions have to take into account the ECHR's case-law. Furthermore, all Member States have ratified the CRC, which means they are all under obligation to afford the family with necessary protection and assistance and to ensure the realisation of the child's right to live in a family environment, while the EU and a majority of Member States have ratified the UN Convention on the Rights of Persons with Disabilities, which means they must respect those convention's provisions regarding alternative care for children with disabilities.

However, although universally accepted, the CRC principles as well as those contained in the non-binding UN Guidelines for the Alternative Care of Children are still unevenly understood and implemented by EU Member States. The entry of children into alternative care is more frequently linked to socio-economic factors, disability and discrimination than protection from abuse and neglect. Institutionalisation of children is still a reality in some Member States and is still perceived as good enough solution for certain groups, such as children with disabilities (*Eurochild*, 2014, p. 4). The high cost of transition towards family and community-based care is one of the main obstacles to this process but the EU is in the position to both support and coordinate its Member States' actions in this field (*Eurochild*, 2014, p. 5). The Commission Recommendation of 20 February 2013 on Investing in children: breaking the cycle of disadvantage (OJ L 59, 2.3.2013.) called the Member States to use the European Structural Funds for supporting the prevention and promoting quality, community-based care and foster care within family settings, where children's voice is given due consideration (art. 2.2.). A significant step forward was the adoption of the legislative framework for the use of EU's Structural and Investment Funds for 2014-2020 (European Commission, 2015, p. 8) which explicitly places transition from institutional to community-based services among investment priorities in the use of the European Regional Development Fund (European Commission, 2015, p. 208-209) and the European Structural Fund (European Commission, 2015, p. 222). All of this suggests a strong intention to strengthen families as well as an important opportunity to apply holistic approach to the development of family-based alternative care within the context

of systemic reforms of children's services (Eurochild, 2014, p. 36). It remains to be seen if the implementation will be successful.

5. FOSTER CARE IN THE REPUBLIC OF

CROATIA 5.1. Legal framework for foster care

The child's right to live with its parents is regarded as one of its fundamental rights in the Croatian legal order (Hrabar, 2007, p. 229). Accordingly, the Croatian Constitution (Narodne novine 56/1990, 135/1997, 113/2000, 28/2001, 76/2010, 5/2014) envisages the state's duty to protect children and to create social, material and other conditions promoting the right to a suitable life (art. 63). While the family enjoys special protection (art. 62) and the parents are primarily responsible for the upbringing, welfare and development of their children, the state is to devote special care to orphans and minors neglected by their parents (art. 64). The ratification of the CRC (Narodne novine-Međunarodni ugovori 12/1993, 20/1997) raised to a higher level the state's commitment to protect the child deprived of family environment. The Committee on the Rights of the Child emphasised the need to develop family-based forms of alternative care in Croatia (Zaključci Odbora za prava djeteta: Hrvatska, 2004, para. 42). Furthermore, Croatia is a CoE member, a party to the ECHR and an EU Member State which all add up to the foster care standards it is required to comply with.

Providing alternative care for children through foster placement is regulated by the Foster Care Act. Even though the foster care in Croatia started developing in the beginning of the 20th century (Laklija, Vukčević, Milić Babić, 2012, p. 109), the first Foster Care Act was not adopted until 2007 (Narodne novine 79/2007). However, in the context of the social welfare system reform focused on the de-institutionalisation, it became evident that the new law is necessary to deal with the challenges of that process. The new Foster Care Act was adopted in 2011 (Narodne novine 90/2011, 78/2012) and it defines foster care as a form of care outside the child's own family where the child is provided with accommodation and care in a foster family

(art. 2). The foster care is provided in accordance with the basic principles of social welfare, the principle of family environment which makes the foster child a full-fledged member of the foster family (art. 4), the principle of sustainability of family ties, unless contrary to the child's best interest (art. 5), the principle of participation that gives the foster child an active role (art. 6) and the principle of the best interest of the foster child (art. 7). The Foster Care Act allows the placement of no more than three children in one foster family (art. 25) which is a welcomed limitation that allows providing adequate care for each foster child.

The types of foster care provided according to the child's needs can be traditional, specialised, emergency and occasional foster care (art. 8-12), while according to the foster parent's status it can be kinship or non-kinship foster care (art. 13-15). The requirements for foster parents and foster families stipulated in the Foster Care Act include the minimum of the elementary education completed (art. 18); the age difference of 20-50 years between the foster parent and the foster child (art. 20); housing, social and other conditions for providing foster care (art. 21); mandatory training for foster parents before obtaining license (art. 22) as well as the later continuous training (art. 54). The foster parent is entitled to foster fees and fees for accommodation and other foster child's costs (art. 34, 36).

The social welfare centre must prepare the child and its family for out-of-home care according to the child's individual plan. The centre is supposed to select the foster family according to the child's needs and, whenever possible, the foster carer should be chosen within the circle of relatives or other persons close to the child (art. 43). The foster parent has a number of very important duties towards the foster child that reflect the significance of their role in the child's life and show how much impact can a foster parent have on the child, both positive and negative, depending on the number of factors, starting from the proper selection of foster family and adequate preparation for the placement of all concerned. The foster parent is required to

properly nurture the foster child, provide it with appropriate accommodation, nutrition, clothing and to take care of its health; develop the proper attitude towards learning, encourage it in acquiring working habits and professional qualifications; help the child in forming its own identity and include it in the local community. Not only must the foster parent enable and encourage contacts between the child and its family members, they must also decide on all important questions about the child's care and education in agreement with the child's parents and the competent authorities (art. 44).

The Foster Care Act states that the child must participate in the making of the individual plan (art. 48) which contains goals of placement, activities and the persons responsible for their implementation, the time frame and the monitoring criteria. Individual plan contributes to overcoming difficulties of the initial period of placement in the foster family and maintaining continuity in the child's life (Laklija, Sladović Franz, 2013, p. 16-21). Every child has its own specific needs as well as different experiences prior to the placement which must be taken into account together with the need for stability in the child's life. The individual plan enables regular monitoring of the child's situation because it has to be reviewed and, if necessary, amended on an annual basis. Also, experts from the social welfare centre must visit the child regularly (art.

49) which should, together with the child's right to complaint to the competent authorities (art. 53. para. 1), ensure the direct insight into the child's situation as well as the swift and appropriate reaction of the competent authorities, if necessary. In line with relevant international standards, the Foster Care Act stipulates a number of foster child's rights including the right to be informed about all stages of the process of leaving its family; receive emotional help and support from foster parents to understand the reasons of its parents' inability to care for it; the right to affection and emotional closeness with foster parents; support in developing its own identity; privacy and access to official information and documents relating to its family (art. 53). After the placement is over, the former foster child has the right to contact with its foster family (art. 50). Also, one year extension of accommodation with the foster family is possible if the foster child can't get a job after graduation (art. 50). That measure shows that the state's responsibility to provide support does not end with the foster child coming of age or with the formal termination of foster care. Improvement of the foster care is set among the priorities of the Strategy of Social Welfare System Development in the Republic of Croatia 2011-2016 (Vlada Republike Hrvatske, 2011, p. 21). Similarly, the Plan for Deinstitutionalisation and Transformation of Social Welfare homes and Other Legal Persons Performing the Activity of Social Welfare in the Republic of Croatia 2011-2016 (2018.) intends to intensify the process of transferring children without parental care to non-institutional forms of care, primarily to foster families (Ministarstvo zdravstva i socijalne skrbi, 2010).

5.2. Challenges of the Croatian system of foster care

Unfortunately, the professional foster care in Croatia does not exist. It was introduced by the Foster Care Act 2011 and intended for users with additional needs that require an expert foster carer. However, already in 2012 the Foster Care Act was amended (Narodne novine 78/2012). Croatia was not able to meet all the necessary procedural and financial conditions (Vlada Republike Hrvatske, 2012, p. 3) so the relevant provisions about the professional foster care were simply abolished. Another significant amendment was the lowering of the criteria of minimum level of education for foster parents from high school level to elementary school level. The argument provided was that the practice shows that the high school level does not guarantee better care for the child. Also, the reference was made to the research showing how only one out of 12 European countries included in the survey applies that sort of criteria at all (Vlada republike Hrvatske, 2012, p. 2-3). Although we agree with the statement that other characteristics of foster parents are more crucial, we believe that lowering the criteria was not a good solution, especially when considered together with other problems that accompany

foster care in practice. It is simply a fact of life that people with lower qualifications are at greater risks of unemployment, poverty and social exclusion. The research also shows that the experts do not share the legislator's opinion in this regard (Sabolić, Vejmelka, 2015, p. 32). Furthermore, the Social Welfare Act (Narodne novine 157/2013, 152/2014, 99/2015, 52/2016) does not prohibit the placement of children under seven years old in institutional care nor the placement in alternative care due to family poverty (art. 91) which, in principle, is contrary to the UN Guidelines. However, those possibilities are rather limited or, at least, they should be interpreted and applied as such: the first one is envisaged only in cases when there is no possibility of placing the child with foster family at the very moment the need for taking the child into care appeared, and it cannot last longer than six months, while the second one is conditioned upon the child's best interests. Notwithstanding of the foregoing, it might be said that the legal framework of foster care in Croatia is relatively satisfying and in line with demands of relevant international instruments, at least formally. Despite the challenges it is faced with, including the frequent legislative changes and the lack of assessment of the effects of the legislative acts (Sherwin, Lerch, 2012, p. 4), the main problem is inadequate enforcement of the existing laws in practice. Most research show that the main motives for foster parents are of altruistic nature and unrelated with the financial issues, for example, the love for children or desire to help them, the sense of loneliness and the need to fill the void after a personal loss (Žižak, 2010, p. 26; Laklija, Vukelić, Milić Babić, 2012, p. 113-114; Sabolić, Vejmelka, 2015, p. 18-19). However, research also show that some people are motivated solely by the job loss and the shortage of financial means (Laklija, Vukelić, Milić Babić, 2012, p. 114). We find the latter unacceptable and contrary to relevant legislation. Considering all the foster parent's duties towards the child discussed above, it is unlikely that a person whose only motive for fostering was lack of financial means will rise to the challenge of such a demanding role. The question remains, was the motivation of those foster parents even established, or was it considered unimportant? Furthermore, research show the dissatisfaction of foster parents with the indifference of the competent authorities, the lack of expert support and the regular supervision, even though it is mandatory, which makes them feel they are left alone in dealing with all the challenges of fostering the child (Sabolić, Vejmelka, 2015, p. 23-24). This is especially difficult in the cases of specialised foster care for children with disabilities (Laklija, Vukelić, Milić Babić, 2012, p. 115-116). The research also show the need for greater participation of children in all stages of foster placement (Žižak, Koller-Trbović, Jeđud-Borić, Maurović, Miroslavljević, Ratkajec-Gašević, 2012, p. 132-136). It is particularly worrying that the obligation of making the individual plan can be completely ignored in the case of the child with disabilities (Laklija, Vukelić, Milić Babić, 2012, p. 115). Needless to say, not only do the lack of appropriate training, expert support and supervision have a negative impact on foster parents, it also jeopardises the welfare of the foster child. Foster families are also struggling with different practices of the social welfare centres, difficulties in the process of adapting, high demands of the foster parent's role, difficulties in balancing between the needs of the foster child and the needs of the foster parent's own family, difficulties in communication with the child's biological family, insufficient amount of fees for the child (Žižak, 2010, p. 60; Laklija, Vukelić, Milić Babić, 2012, p. 115-116; Sabolić, Vejmelka, 2015, p. 21-25). These are all very serious problems that should have prompted the competent authorities to undertake thorough changes of the foster care system at its core. However, the Ministry of Social Policy and Youth recently adopted Plan for Development of Foster Care 2016-2017 that is supposed to focus on increasing the number of foster families by the means of raising public awareness on the issue and slightly increasing the amount of foster fees (http://www.mspm.hr/novosti/vijesti/ministarstvo_izradilo_plan_razvoja_udomiteljstva_za_djecu_za_razdoblje_2016_2017, 15.5.2016.). Since the Plan itself is not published, from the information available one can assume that the competent authorities continue ignoring the

fundamental problems of the system. Though the increase of the foster fees is welcome, it is barely 'scratching the surface'.

6. CONCLUSION

Every society should seek the basis of its safety, prosperity and survival in the happy individual and the stable family (Jakovac-Lozić, 2007, p. 320). The same applies to foster families. The definition of a successful foster placement relates, for the most part, to how the children feel when they are there (Randle, 2013, p. 16). Obviously, the goal of every child taken into public care living in the family is not easy to accomplish. As we have seen, there are plenty of standards and guidelines that can be applied in order to protect the well-being of the child placed in the foster family. As the Committee on the Rights of the Child noted already in 2005, all the participants of the process of fostering the child need to focus on existing international and regional instruments with a view to effectively implement them and to monitor the progress in the implementation (Committee on the Rights of the Child, 2006, para. 685). This is particularly applicable to the Croatian foster care system. It is clear from all the above what are the main flaws of that system and, accordingly, which improvements are necessary. The most obvious ones are increasing the number of professionals who work in foster care; increasing the range and availability of training for foster parents; thorough and careful selection of foster parents according to the child's specific circumstances; regular supervision; continuous expert support; enabling professionalisation of foster care; increasing the foster fees. Besides that, there is plenty of space for numerous other improvements, for example, recognising the right of foster parents to maternity leave and benefits; providing them with possibility of paying social and pension contributions; building a web-site for foster carers, helping them to connect with each other and exchange experiences (Sabolić, Vejmelka, 2015, p. 26-36; Laklija, Vukelić, Milić Babić, 2012, p. 117-118). However, the well-known reason for this highly unsatisfactory situation is the high cost or, in other words, the shortage of funds. Therein lies the problem – in perceiving the allocation of funds as the cost, instead of investing in children. To say that children are our future is not just another empty phrase. The calculation is rather simple: investing in children and enabling them to grow and develop in the environment of care, love and stability means enabling the full development of their potentials. The result is an adult, functional individual capable of contributing to their community and to society as a whole. One can only hope that decision makers will change their attitudes as soon as possible and start changing the system at its core, instead of just ignoring the dangers of the present state.

LITERATURE:

1. *Alternative care*. Retrieved 1.7.2016. from <http://www.coe.int/en/web/children/alternative-care>.
2. *Bronda v. Italy* (40/1997/824/1030), Judgment of 9 June 1998.
3. *Charter of Fundamental Rights of the European Union*, OJ C 202, 7.6.2016, p. 389–405.
4. *Commission Recommendation of 20 February 2013, Investing in children: breaking the cycle of disadvantage* (2013/112/EU), OJ L 59, 2.3.2013, p. 5–16.
5. Committee of Ministers of the Council of Europe (2008). *Building a Europe for and with Children: 2009-2011 Strategy*. Retrieved 25.6.2016. from <https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=090000168045d226>.
6. Committee of Ministers of the Council of Europe (2012). *Council of Europe Strategy for the Rights of the Child (2012-2015)*. Retrieved 25.6.2016. from <http://www.coe.int/t/DGHL/STANDARDSETTING/CDcj/StrategyCME.pdf>.
7. Committee of Ministers of the Council of Europe (2016). *Council of Europe Strategy for the Rights of the Child (2016-2021)*. Retrieved 25.6.2016. from <https://rm.coe.int/CoERMPublicCommonSearchServices/DisplayDCTMContent?documentId=090000168066cff8>.

8. Committee of Ministers of the Council of Europe (1987). *Recommendation No. R (87) 6 on foster families*. Retrieved 5.7.2016. from http://www.coe.int/t/dghl/standardsetting/family/Resolutions_recommendations_cm_en.asp.
9. Committee of Ministers of the Council of Europe (1977). Resolution No. R (77) 33 on the placement of children. Retrieved 5.7.2016. from http://www.coe.int/t/dghl/standardsetting/family/Resolutions_recommendations_cm_en.asp.
10. Committee on the Rights of the Child (2006), *Day of General Discussion – Children without Parental Care*, CRC/C/153, 17 March 2006. Retrieved 29.6.2016. from <http://www.ohchr.org/EN/HRBodies/CRC/Pages/DiscussionDays.aspx>.
11. *Consolidated version of the Treaty on European Union*, OJ C 202, 7.6.2016, p. 13-45.
12. Eurochild (2014). *Deinstitutionalisation and Quality Alternative Care for Children in Europe, Lessons learned and the way forward*. Retrieved 1.7.2016. from http://www.eurochild.org/fileadmin/public/05_Library/Thematic_priorities/06_Children_in_Alternative_Care/Eurochild/DI_Lessons_Learned_web_use.pdf.
13. European Commission (2015). *European Structural and Investment Funds 2014-2020: Official texts and Commentaries*. Luxembourg: Publications Office of the European Union.
14. *Europska konvencija za zaštitu ljudskih prava i temeljnih sloboda*, Narodne novine-Međunarodni ugovori 18/1997, 6/1999, 14/2002, 13/2003, 9/2005, 1/2006, 2/2010.
15. Gaskin v. the United Kingdom (Application no. 10454/83), Judgment of 7 July 1989.
16. Glesmann v. Germany (Application no. 25706/03), Judgment of 10 January 2008.
17. Haase v. Germany (Application no. 11057/02), Judgment of 8 April 2004.
18. Hrabar, D. (2007). Pravni odnosi roditelja i djece. In M. Alinčić, D. Hrabar, D. Jakovac-Lozić, A. Korać Graovac, *Obiteljsko pravo* (3rd edition) (p. 123-307). Zagreb: Narodne novine.
19. Hodgkin, R., Newell, P. (2007). *Implementation Handbook for the Convention on the Rights of the Child* (3rd edition). Geneva: United Nations Children's Fund.
20. Jakovac-Lozić, D. (2005). Susreti i druženja djeteta s odvojenim roditeljem u presudama Europskog suda za ljudska prava. *Zbornik Pravnog fakulteta u Zagrebu*, vol. 55, no. 3-4 (p. 869-925).
21. Jakovac-Lozić, D. (2007). Posvojenje. In M. Alinčić, D. Hrabar, D. Jakovac-Lozić, A. Korać Graovac, A., *Obiteljsko pravo* (3rd edition) (p. 309-361). Zagreb: Narodne novine.
22. Johansen v. Norway (Application no. 17383/90), Judgment of 7 August 1990.
23. K.A. v. Finland (Application no. 27751/95), Judgment of 14 January 2003.
24. *Konvencija o pravima djeteta*, Službeni list SFRJ 15/1990, Narodne novine - Međunarodni ugovori 12/1993, 20/1997.
25. *Konvencija o pravima osoba s invaliditetom*, Narodne novine - Međunarodni ugovori 6/2007, 5/2008.
26. Kopf and Liberda v. Austria (Application no. 1598/06), Judgment of 17 January 2012.
27. Korać Graovac, A. (2013). Povelja o temeljnim pravima Europske Unije i obiteljsko pravo. In N. Bodiroga-Vukobrat et. al., *Europsko obiteljsko pravo* (p. 25-51). Zagreb: Narodne novine.
28. Kutzner v. Germany (Application no. 46544/99), Judgment of 26 February 2002.
29. Laklija, M. (2009). Izazovi udomiteljstva djece s emocionalnim poteškoćama i poremećajima u ponašanju u Republici Hrvatskoj. *Kriminologija i socijalna integracija*, vol. 17, no. 2 (p. 71-86). Zagreb: Edukacijsko-rehabilitacijski fakultet.
30. Laklija, M., Vukelić, N., Milić Babić, M. (2012). Specijalizirano udomiteljstvo djece s teškoćama u razvoju - Iskustva udomitelja. *Hrvatska revija za rehabilitacijska istraživanja*, vol. 48, no. 2 (p. 109-123). Zagreb: Edukacijsko-rehabilitacijski fakultet.
31. Laklija, M., Sladović Franz, B. (2013). *Individualni plan skrbi za dijete u udomiteljskoj obitelji*. Zagreb: Sirius - Centar za psihološko savjetovanje, edukaciju i istraživanje.
32. Ministarstvo zdravstva i socijalne skrbi (2010). *Plan deinstitutionalizacije i transformacije domova socijalne skrbi i drugih pravnih osoba koje obavljaju djelatnost socijalne skrbi u Republici Hrvatskoj*. Zagreb. Retrieved 3.6.2016. from http://www.mspm.hr/djelokrug_aktivnosti/socijalna_skrb/reforma_sustava_socijalne_skrbi.
33. Moretti and Benedetti v. Italy (Application no. 16318/07), Judgment of 27 April 2010.
34. Nanning v. Germany (Application no. 39741/02), Judgment of 12 July 2007.
35. Olsson v. Sweden (no. 1) (Application no. 10465/83), Judgment of 24 March 1988.
36. Parliamentary Assembly of the Council of Europe (2010). *Resolution 1762 (2010) on children*

- without parental care: urgent need for action*. Retrieved 3.7.2016. from <http://assembly.coe.int/nw/xml/XRef/Xref-XML2HTML-en.asp?fileid=17912&lang=en>.
37. R.M.S. v. Spain (Application appl. no. 28775/12), Judgment of 18 June 2013.
38. Randle, M. (2013). Through the Eyes of Ex-Foster Children: Placement Success and the Characteristics of Good Foster Carers. *Practice: Social Work in Action* (p. 3-19). London: Routledge-Taylor&Francis Group.
39. Ruszkowska v. Poland (Application no. 6717/08), Judgment of 1 July 2014.
40. Sabolić, T., Vejmělka, L. (2015). Udomiteljstvo djece u Hrvatskoj iz perspektive udomitelja i stručnjaka. *Holon*, vol. 5, no. 1 (p. 6-42). Zagreb: Hrvatsko društvo za integralnost.
41. Scozzari and Giunta v. Italy (Appl. nos. 39221/98 and 41963/98), Judgment of 13 July 2000.
42. Sherwin, E., Lerch, V., (eds.) (2012). *A snapshot of Alternative Care Arrangements in Croatia*. Innsbruck: SOS Children's Villages International.
43. Sladović Franz, B. (2016). Djeca u alternativnoj skrbi. In D. Hrabar (ed.), *Prava djece – Multidisciplinarni pristup* (p. 225-241). Zagreb: Pravni fakultet Sveučilišta u Zagrebu.
44. *Treaty of Lisbon amending the Treaty on European Union and the Treaty establishing the European Community*, OJ C 306, 17.12.2007, p. 1–271.
45. United Nations General Assembly, *Declaration of the Rights of the Child*, A/RES/1386(XIV), 20 November 1959. Retrieved 3.7.2016. from <http://www.un-documents.net/a14r1386.htm>.
46. United Nations General Assembly, *Declaration on Social and Legal Principles relating to the Protection and Welfare of Children, with Special Reference to Foster Placement and Adoption Nationally and Internationally*, A/RES/41/85, 3 December 1986. Retrieved 4.7.2016. from <http://www.un.org/documents/ga/res/41/a41r085.htm>.
47. United Nations General Assembly, *Guidelines for the Alternative Care of Children*, A/RES/64/142, 24 February 2010. Retrieved 6.7.2016. from http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/64/142.
48. *Ustav Republike Hrvatske*, Narodne novine 56/1990, 135/1997, 113/2000, 28/2001, 76/2010, 5/2014.
49. del Valle, J. F. (2014). Children in State Care. In A. Ben-Arieh, F. Casas, I. Frønes, J. E. Korbin (eds.), *Handbook of Child Well-Being: Theories, Methods and Policies in Global Perspective* (p. 2945-2963). Dordrecht: Springer Netherlands.
50. Venema v. the Netherlands (Application no. 35731/97), Judgment of 17 December 2002.
51. Vlada Republike Hrvatske (2011). *Prijedlog zakona o udomiteljstvu, s Konačnim prijedlogom zakona*. Zagreb. Retrieved 3.7.2016. from <http://www.sabor.hr/fgs.axd?id=18425>.
52. Vlada Republike Hrvatske (2011). *Strategija razvoja sustava socijalne skrbi u Republici Hrvatskoj 2011.-2016*. Zagreb. Retrieved 1.6.2016. from http://www.mspm.hr/djelokrug_aktivnosti/socijalna_skrb/reforma_sustava_socijalne_skrbi.
53. *Zakon o socijalnoj skrbi*, Narodne novine 157/2013, 152/2014, 99/2015, 52/2016.
54. *Zakon o udomiteljstvu*, Narodne novine 90/2011, 78/2012.
55. *Zaključci Odbora za prava djeteta: Hrvatska*, CRC/C/15/Add.243.1, listopad 2014. Retrieved 23.6.2016. from http://www.dijete.hr/index.php?option=com_joomdoc&task=cat_view&gid=947&Itemid=103
56. Žižak, A. (2010). *Udomiteljstvo djece u Hrvatskoj: analiza stanja i prijedlog smjernica*. Zagreb: Ured UNICEF-a za Hrvatsku.
57. Žižak, A., Koller-Trbović, N., Jeđud Borić, I., Maurović, I., Mirosavljević, A., Ratkajec Gašević, G. (2012). *Što nam djeca govore o udomiteljstvu: Istraživanje dječje perspektive udomiteljstva u Hrvatskoj s preporukama za unapređenje*. Zagreb: Ured UNICEF-a za Hrvatsku.

IS ABSENCE OF REGULATION AND FRANCHISING LAW OBSTACLE FOR FRANCHISING EXPANSION IN CROATIA – COMPARISON WITH OTHER COUNTRIES

Aleksandar Erceg

*Faculty of Economics Osijek, Josip Juraj Strossmayer Osijek, Croatia
aerceg@efos.hr*

ABSTRACT

Franchising plays important role in world economy since in the western developed countries almost 2/3 of sales are made in franchising locations and franchising create significant turnover and influences growth and employment. Overview of the legal characteristics of the franchising points out that in most countries this form of business is not regulated by specific laws and, in case of existing legal regulations governing franchising, it is re, mainly related to the contractual relationship between the franchisor and the franchisee. Currently there are around 30 countries in the world which have specific franchising laws and there are other countries in which franchising are regulated with other laws. Although franchising is present in Croatia from mid-1960-ties it is still in its early phase of development. Croatia is also one of the countries in which franchising is not legally regulated by specific franchising law or any laws at all. Aim of this paper is to make a comparative analysis between Croatia and the countries that have set a regulation system that supports franchising development. This paper tries to answer the question whether the absence of the legal regulation of franchising in Croatia represents an obstacle for its development and expansion.

Keywords: Croatia, franchising, franchising law, franchisee, franchisor.

1. INTRODUCTION

In recent time, many hybrid organizational forms as strategic alliances, joint ventures and franchising are becoming more and more common. These organizational forms are formed by contract between at least two independent parties. Among them franchising is the oldest organizational form that is often used in economically developed countries, but its usage has grown dramatically in USA and Europe in recent years (Alon and McKee, 1999). Boroian and Boroian (1987) define that franchising occurs when company (franchisor) license its brand and way of doing business to another company (franchisee) which agrees to work in accordance to the franchising contract. Michael (2000) concludes that franchisor and franchisee are legally independent but economically interdependent. As such, this organizational form can be seen from both, economic and legal perspective. Emerson (1990) states that franchising is an alternative for formal integration of production and distribution activities in unique organization. Franchising is used by companies that want to grow in geographical sense and don't rely on their own financial resources and companies which want to enter certain industry

(Alon, Alpeza and Erceg, 2010). The franchising influence on world economy is growing and the reason is that there are numerous advantages for franchisor and franchisee which are taken together with growing middle class in many world countries and increasingly homogenized consumption culture (Zeidman 2014). Franchising has huge impact on worldwide economy and based on FranData (2015) research franchising accumulates 1,6 trillion USD turnover which is 2,3% of global GDP, has 2,2 million companies involved and employs 19 million people and franchising economic output represents significant share of national GDP on average of 4% (World Franchise Council, 2016). Castrogiovanni and Justis (1998: 170) state that *the importance of franchising is expanding beyond domestic borders with franchising rapidly becoming the fastest growing form of business in the global economic system.*

Due to the fact that franchising is fastest growing form of business in global economy it is important to examine legal regulation of franchising and to see whether there is connection between legal regulation and franchising expansion in the world. Paper is consisted from several parts. First part of the paper will present franchising regulation in the world. Second part will present franchising in Croatia and its regulation which will be a good base to examine the relation between franchising regulation and its expansion in the world. Last part of the paper represents conclusion and propose recommendations for further research about this topic.

2. LEGAL REGULATION OF FRANCHISING IN THE WORLD

Economic perspective focuses on interest and benefits that involved parties may have from franchising relationship. On the other side legal perspective is more based on rights and obligations between parties in franchising relationship. Abell (2013) concluded that franchising legal architecture represents uniformed legal system regardless of system in which franchise business model operates and that industrial sector in which system operates doesn't have influence on franchising architecture.

Today franchising is present in almost every country in the world and in the most of them this business model is not regulated by a specific law. If there are laws and acts that are regulating franchising they are mostly regulating contractual relation between franchisors and franchisees. Currently there are around 30 countries in the world that have specific franchising laws. Figure 1 is showing countries in which there is a specific franchising law or there is partial legal regulation of franchising business model.

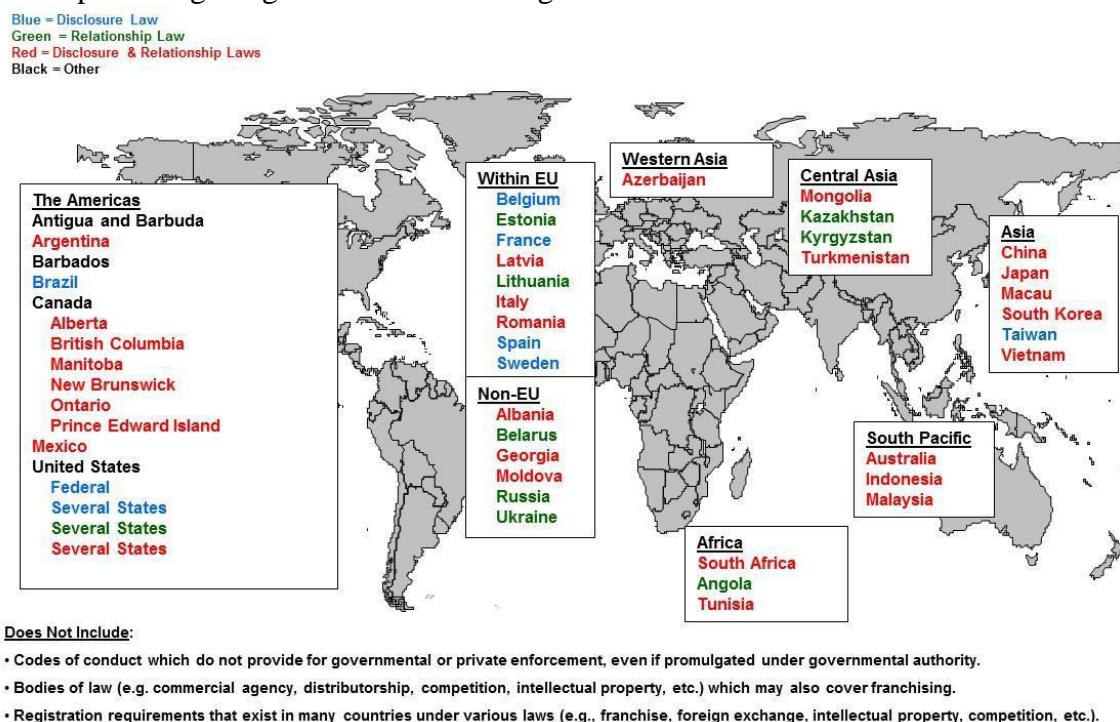


Figure 1: Franchising legal regulation worldwide (Zeidman, 2016)

Abell (2010) divided worldwide franchise orientated laws in three main categories: anti-trust regulations; foreign trade/investment regulations and pure franchise regulations. Every national franchise law can be put in one of these groups by its origin and content. First group of laws are found in Japan and Venezuela. European Union can also be put in this type of regulation since there is Article 101 of the Treaty on the Functioning of the European Union and Vertical Restraints Block Exemption. Second group can be found in China, Indonesia, Moldova, Ukraine, Belorussia and Vietnam and these laws are regulating entry of foreign business into

domestic market. Third group is connected with the most developed franchising markets and can be found among other in USA, Australia, Canada, Mexico and France. Zeidman (2010) identified six categories of countries regarding forms of disclosure or registration obligations for franchise companies: (1) countries with statutes imposing an obligation to prepare disclosure statement; (2) countries with statutes or regulations imposing the obligation to present a disclosure document; (3) countries with statutes imposing the obligation to deliver a disclosure document to prospective franchisee; (4) countries with statutes imposing an obligation to prepare and deliver a disclosure document even though the statute does not explicitly mention 'franchising'; (5) countries with no statute addressing franchising explicitly; and (6) countries with no specific statutes imposing a disclosure obligation. German and Christie (2010) stated following reasons why is specific franchising regulation needed. According to authors, contract law is not adequate to regulate the modern franchise relationship; franchising self-regulation is insufficient to deal with many abuses that are occurring in the franchise industry; and many franchise relationships are characterized by unequal bargaining power and financial resources.

In the USA which is the most developed country from the franchising standpoint the only regulation of the franchise business model is of an administrative nature. These are the uniform rules governing the content of the franchise offer and are known as Uniform franchise offering circular – offer to enter into a franchise agreement, and since 2008 Franchise Disclosure Documents – Documents for the assessment of the franchise. This regulation from United States Federal Trade Commission sets obligation to franchisors to disclose relevant information to potential franchisees. In this way franchisor has to give all data about franchise system so franchisee can estimate value of business in franchise system he/she would like to enter. It is important to state that this rule doesn't include obligation to report potential franchisees profits which is probably the most important information when making decision about franchise purchase. This regulation is protecting potential franchisees which could under influence false premises about franchise system invest and soon lose their capital. A total of 17 federal US states has in their legislation specific laws on registration of franchise contract and document disclosures. (Pražetina, 2006) Australia has similar obligation under Franchise Code of Conduct which is intended for all franchisor and for all companies which would like to grow their business by using franchising with final goal of giving better protection to potential and current franchisees. In Brazil Franchise Law regulates the mandatory content of the offer, based on the Franchise Offer Circular (COF), which sets out the required information a franchisor must provide to a prospective franchisees while in Canada some provinces like Alberta, Ontario, Manitoba have adopted franchise legislation. Finally, it is important to state that franchising in European Union as a legal matter today can be considered as recognized and regulated. Mlikotin-Tomić (2004) as a fundamental precedent for franchising regulation in European

Union cites the decision of the European Union Court. That Court decision was reason for adoption of EEC Regulation EEC on the application of Article 85 (3) of the Treaty to franchising agreements. In most of EU member states there are no specific franchising regulations except for some tax provisions, but there is developed contractual and commercial practices of franchising. France was the first European country that adopted regulation regarding franchise business model. Regulation defines which information franchisor to disclosure of relevant information to potential recipients. In some other countries (Spain and Russia) there are regulations relating to intellectual property and data. Problems of defining franchising are described in order to harmonize this matter and before defining the content and the problem of the legal work and exposure to different views of legal doctrine and court practice.

Main base for franchise regulation all over the world besides different laws and regulation is the franchising contract which was created by commercial and contractual practice and is

typical complex legal contract. Franchise contract has been created in accordance to practice of the American courts especially in disputes about violations of the competition law. In 1993 UNIDROIT began work on the study of the franchise contract and franchise regulation. The intention was to make the international codification in accordance to existing models of leasing laws and factoring. However, because of the content matter, "guide" was created and published in 1998 and it is containing complex contractual relationship with all its variations. The answer to the legal issues that are connected to franchising contractual relationship is not the commitment of one existing definition or creating a new one, but just the opposite: according to the analysis of economic and legal facts, their qualifications, research conditions and legal requirements the conclusion, execution and termination of the franchise system, will form and define franchising contract.

3. FRANCHISING – CROATIAN EXPERIENCE

3.1. Franchising in Croatia

Croatia discovered franchising in late 1960-ties when Diners Club Adriatic started to operate as Diners Club International franchisee in the former Yugoslavia. After that there were several domestic trials of starting franchise systems (among others companies like Varteks and Kraš) of which some were more or less successful. In the 1990-ties significant promotion of franchising was started when McDonalds entered Croatian market. In the next few months McDonald's made presentations in cities where they as franchisor looked for franchisees and with that generated great interest among potential franchisees and debates on the nature of the franchise contract (Alon, Alpeza and Erceg, 2010). It is important to state that franchising is still in the development stage in Croatia, in comparison with the other countries in Europe (especially with the transition countries). According to the data of Croatian Franchise Federation (Kukec, 2016) currently there are 180 franchise systems in Croatia, out of which 25 are of Croatian origin (12%). Franchise systems are operating in around 1,000 locations and employing around 16,500 people. The biggest franchise chain in Croatia is Hungarian franchise Pek-snack Fornetti (distribution franchise of frozen bakery products and business concept of the bakeries) which managed to spread quickly its business in the entire region by using franchising. Among the most known Croatian franchise systems are Aqua, Surf'n'fries, Centar energije, Bio-Bio, Galeb, Taxi Cameo, Mlinar, Diadema, Kraš, Body Creator and San Francisco Coffee House.

For growth of franchising in Croatia of great importance is institutional support which started in 2003 when first Franchising Centres in Osijek and Zagreb were founded. In 2003 Croatian Franchising Association organized first Franchising fair in Zagreb. All these organizations are major information and reference points in Croatia for all information about franchising and they are places in which franchising demand meets supply – places for both franchisors and franchisees. Besides organizing franchising fairs Croatian Franchising association is member of European Franchising Federation and World Franchising Council. Importance of franchising business model can be seen in fact that major Croatian companies are thinking about or even already using franchising of their own geographical expenditure (Mlinar, Agrokor, Hrvatska pošta, Ina).

3.2. Legal regulation of franchising in Croatia

During last several years Croatia approved number of laws and regulations regarding doing business which resulted with acceptance of Croatia to the WTO, CEFTA and EU. Nevertheless, there is no legal basis for franchising in Croatia since there is no specific franchising law or legal regulation. Franchising as a legal term was first time introduced in Croatia legal system in 2003 but it was business practice that developed and defined certain elements of franchising

contract. A provision in Article 21 of the Trade Act from 2003 (Official Gazette) stated that the *Franchise Agreement governs the business relationship where the franchisor – a specialized wholesale company and a company who developed a successful form of service business – provides the franchisee – a retail company or a service industry company, with the right to use the franchise for selling certain types of products and/or services*. Besides stating what the franchising contract does there was no definition or description about what franchising was or what are the most important contract parts. With the changes of Trade Act in 2008 there is no more mentioning of Franchise contract in Trade Act in Croatian legislation.

Besides Trade Act, franchising was regulated with Competition Protection Act from 1995 in which there was according to Article 12 obligation of presenting Franchise contract within 30 days from its conclusion to the Competition Protection Agency. This obligation ceased to apply with changes of Competition Protection Act from 2003 in which states that although franchising contract has certain limitations it is not forbidden. At the same time, according to Article 11 paragraph 4, the Agency can initiate evaluation procedure of franchising contract if the effects of the respective contract, individual or cumulative with other similar contracts in a relevant market do not fulfil the conditions for exclusion. With changes of Competition Protection Act from 2009 conditions for block exemptions were set and especially for vertical agreements which are considered agreements between entrepreneurs that aren't operating on the same level of production or distribution, in particular contracts on exclusive distribution, selective distribution, exclusive purchase and franchising.

Based on Competition Protection Act, Regulation on block exemption of vertical agreements between entrepreneurs was brought in 2011. This regulation states that block exemption is applicable to vertical agreements under Article 10, paragraph 2, item 1 of the Act containing certain vertical restraints, and in particular the franchise agreements except on industrial (technology) franchise agreements which are related to the relationship in production or technological process of those product manufacture. In Article 6 of the Regulation franchising agreement is defined as vertical agreement where one entrepreneur (franchisor) provides the other entrepreneur (franchisee) in exchange for direct or indirect financial compensation, the right to exploit the franchise, i.e. package of industrial or intellectual property rights, with purpose of selling a certain type of product. Package of industrial or intellectual property refers to the name and trademark, special knowledge and experience (know-how), models, designs, copyright, technological know-how or the patents which will be used for the resale of products to end users, which are subject of agreement.

Since a franchise business model takes advantage of all the economic functions of a trademark – guarantee, advertising, competitive and promotional – franchising is largely influenced by the provisions of the Trademark Act. The Trademark Act from 2003 no longer has provision that the trademark assignment has to be connected to the assignment of the technology which guarantees the same product and/or service quality, but a provision of Article 699 of the Civil Obligations Act (2005) can be applied which ensures the quality of the products offered under the same trademark in licensing agreements. The trademark owner has the right to perform necessary quality control actions to protect the quality standards of products and/or services sold under its trademark. Franchising contract is also not regulated in separate part of Obligation Act which is regulating contractual and extra-contractual relations in Croatia. However,

Pražetina (2005) states that Obligations Act contains general provisions on contracts, such as the presumption of validity that are applicable to this contract. According to the above, we can notice that the franchise contract is not fully defined and that there are shortcomings in the Trade Act. Therefore, commercial courts and lawyers apply the European code of ethics of franchising as a foundation and guideline for the conclusion and termination of franchise contracts in Croatia.

Research conducted in Croatia by Alon, Alpeza and Erceg (2007) and Alpeza, Erceg and Oberman (2015) shows perceptions of lawyers about threats and opportunities for franchising development in Croatia. Two main obstacles directly connected with legal regulation were stated: inconsistent legal system and inadequate protection of franchisors intellectual property rights. In research it was confirmed that franchising is still in early development phases in Croatia and that the biggest challenges for further development of franchising in Croatia are lack of franchising legal regulations and insufficient knowledge of franchising as a business model. At the end it is important to state that Zeidman (2016) concludes that Croatia is not unusual in this respect since not more than 30 countries in the world mention franchising in any significant way in their legal systems. However, the absence of clear legal precedent makes it difficult for Croatian lawyers to help their clients, especially during the contracting phase – whether franchisor or franchisee, whether foreign or domestic investor.

4. FRANCHISING LAW AND/OR FRANCHISING REGULATION – OBSTACLE OR BENEFIT FOR FRANCHISING EXPANSION

As previously stated in this paper there are countries which have franchising legislation or they have franchising as a way of conducting business implemented in their legal system in some other ways. In the following part we will compare number of franchising systems and franchising laws in the world countries and try to examine if franchise regulation is influencing its expansion in the world countries.

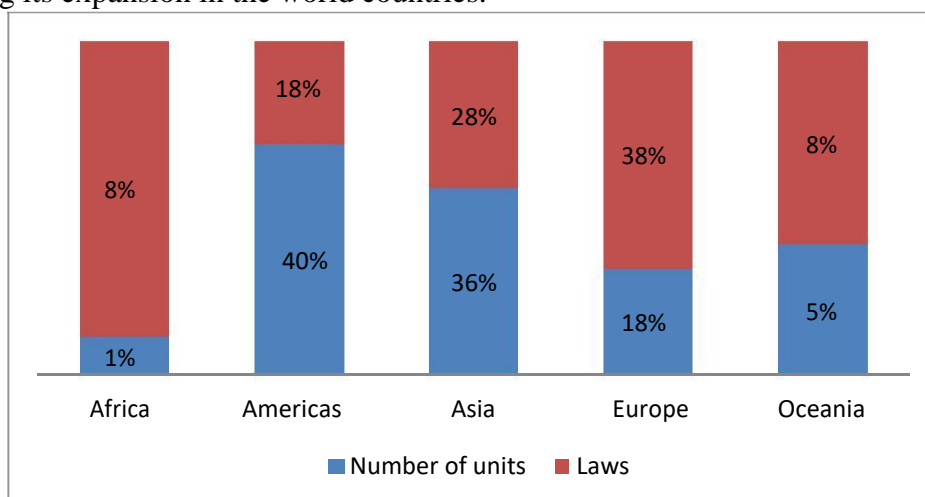


Figure 2: Comparison – share of world total franchised units and share of total world countries with franchising laws (authors compilation adapted from World Franchise Council Survey, 2016; Zeidman, 2016; European Franchise Federation, 2015)

Figure 2 shows that the highest share of total number of franchised units is in Americas and Asia while Europe and Asia have the highest share of total number of countries with franchising laws. Leading number of outlets in Americas is result of long time franchising tradition while Asia is leader in both sides – one of the highest number of outlets and high number of national franchising laws. Next tables are showing data for 38 countries regarding franchise systems, number of outlets, % of domestic brands, franchising economic impact and if the country has franchising law. (Tables 1 and 2)

Table 1: Countries with franchising law or with legal regulation of franchising (authors compilation adapted from World Franchise Council Survey, 2016; Zeidman, 2016; European Franchise Federation, 2015)

Country	Number of brands	Percentage of domestic brands	Number of units	Franchise Economic Output in mil. USD	Franchising law
Argentina	550	90	18.000	8.800	Yes
Australia	1160	86	79.000	126.500	Yes
Belgium	350	60	11.000	15.300	Yes
Brazil	2013	N/A	N/A	43.000	Yes
China	2100	N/A	120.000	30.000	Yes
France	1719	90	65.133	300.000	Yes
Indonesia	480	19	70.000	13.200	Yes
Italy	938	85	51.110	29.200	Yes
Japan	1304	N/A	252.514	N/A	Yes
Malaysia	667	79	7.525	7.500	Yes
Mexico	1400	81	75.000	1.000	Yes
Russia	595	N/A	22.800	28.000	Yes
South Africa	627	88	31.050	30.800	Yes
South Korea	3981	70	203.349	8.600	Yes
Spain	1199	80	44.619	14.700	Yes
Sweden	700	80	26.000	21.000	Yes
Switzerland	275	N/A	N/A	N/A	Yes
Taiwan	2433	88	128.305	70.000	Yes
Ukraine	320	N/A	32.000	1.600	Yes
USA	3828	95	769.683	844.000	Yes

Based on presented data it is possible to see the 20 of surveyed countries have franchising law and they have the most franchise systems, most outlets and the franchising impact on the economy is highest. Highest number of outlets and highest economic output is in USA where there is legal regulation of franchising.

Table following on the next page

Table 2: Countries without franchising law or with legal regulation of franchising (authors compilation adapted from World Franchise Council Survey, 2016; Zeidman, 2016; European Franchise Federation, 2015)

Country	Number of brands	Percentage of domestic brands	Number of units	Franchise Economic Output in USD	Franchising law
Austria	445	51	8.720	8.500	No
Croatia	180	12	1.000	1.600	No
Czech Republic	230	62	12.200	N/A	No
Denmark	188	75	7.500	N/A	No
Finland	280	75	4.555	6.700	No
Germany	994	80	76.500	78.500	No
Greece	456	65	11.113	N/A	No
Holland	749	86	30.785	39.400	No
Hungary	300	70	20.000	N/A	No
Lebanon	1100	42	5.500	1.500	No
New Zealand	485	88	22.400	15.400	No
Philippines	1500	65	130.000	14.000	No
Poland	941	75	58.396	29.400	No
Portugal	500	N/A	11.760	5.300	No
Slovenia	108	43	1.580	N/A	No
Turkey	1200	70	30.000	37.000	No
United Kingdom	935	82	39.000	17.800	No
Venezuela	530	58	12.500	30.808	No

In the second table there are several countries that don't have franchising laws but have high numbers of outlets and economic output. One of them is Germany which doesn't have legal regulation specific for franchising but has heavy regulatory burden imposed upon franchising – and has FRED (Franchise Regulatory Evaluation Data) score of 170 out of 180 (Abell, 2012). FRED score is calculated from following parts: pre-contractual duty to disclose information, mandatory pre-contractual cooling-off period, registration, and other regulations applicable to franchising. Austria, Holland, Hungary have also high FRED scores and have significantly developed franchising economy although they do not have franchising law and or legal regulation of franchising. Other EU countries have low FRED score and low franchising expansion. Countries with franchising law and/or legal regulation of franchising business have highly expanded franchising industry while countries with no franchising law and/or legal regulation of franchising business have much lower number of franchising businesses.

Currently there is no FRED score calculated for Croatia. It is important to be noted that there is low number of brands, low number of outlets and also not very high impact on national economy and since there are no three out of four main parts for calculating FRED score it would probably be very low. If we compare Croatia with the countries with same franchising experience – around 30 years – like Hungary, Poland, Slovenia it can be noted that Croatia has smallest franchising expansion among them. Although it is important to state that Slovenia and Poland have low FRED scores as well. With legal regulation franchising is put into certain framework that is needed to define basic relationship between franchisor and franchisee. One of the identified limitations for this higher use of franchising is insufficient number of lawyers that possess knowledge and practice related to franchising as way of doing business. Expansion of franchising in Croatia and probably other countries can only benefit from legal regulation of franchising. Abel (2013) states that franchising need regulation since dynamics of relationship

between franchisor and franchisees lead to the contractual environment which transcends sectoral divergence. Schaper (2015) confirms need for global franchise regulation since franchising is global phenomena so regulators need to recognize that also.

5. CONCLUSION

Not many countries in the world have laws and/or legal regulation for franchising - a specific business form that enables companies to expand geographically and which has significant impact on national economies worldwide. Franchising relies on set of established standards and relationship between franchisor and franchisees so regulation is needed. In some countries franchising business model is regulated by specific franchise laws that is mostly intended to protect franchisees while in other countries franchising is regulated by references to contract law.

Research showed that countries in which there is specific franchising law and/or legal regulation of franchising have the highest number of franchise systems, most outlets and the franchising impact on the economy is highest i.e. franchising has become significant part of economy. There are few countries which don't have franchise law but the franchising is heavily regulated with other laws and also in those countries we are witnesses of franchising expansion. Based on comparison results we can conclude that in countries with legal regulation of franchising there is franchising expansion so for further development of franchising in Croatia legal regulation is needed.

Further research should be conducted with current franchisors and franchisees in Croatia that would give an overview of what is needed in franchising regulation in Croatia and help establish framework for potential franchising law which should help franchising expansion.

LITERATURE:

1. Abell, M. (2011). *The Regulation of Franchising all over the World*. In M. Abell (ed), International Journal of Franchising Law, Vol. 9 (3), p. 3-20. London: Clearhut Publishing Ltd.
2. Abell, M. (2012). *In which EU Jurisdictions is Franchising Most Heavily Regulated and How Effective/Appropriate is that Regulation*. In M. Abell (ed), International Journal of Franchising Law, Vol. 10 (19), p. 19-26. London: Clearhut Publishing Ltd.
3. Abell, M. (2013). *The Law and Regulation of Franchising in the EU*, London: Edward Elgar Publishing Limited.
4. Alon, I, McKee, D. (1999). *Toward a Macro Environmental Model of International Franchising*. In Multinational Business Review, Vol. 7(1), p. 76-82. St. Louis: St. Louis University
5. Alon, I., Alpeza, M, Erceg, A. (2007). *Opportunities and threats regarding the development of the franchising business model in Croatia*, Seventh International Conference on "Enterprise in Transition", Bol.
6. Alon, I, Alpeza, M, Erceg, A. (2010). Franchising in Croatia. In I. Alon, (ed.), *Franchising globally: innovation, learning and imitation*. p. 138-154 New York: Palgrave Macmillan.
7. Alpeza, M, Erceg, A, Oberman Peterka, S. (2015). *Development of Franchising in Croatia – Obstacles and Policy Recommendations*. In Review of Innovations and Competitiveness, Vol. 1 (1), p- 5-24. Pula: Ekonomski fakultet.
8. Boroian, D. D, Boroian, P. J. (1987). *The Franchise Advantage - Make it work for you*, Chicago: Chicago Review Pr.
9. Castrogiovanni, G. J, Justis, R. T. (1998). *Franchising configurations and transitions*. In Journal of Consumer Marketing. Vol. 15 (2), p. 170-190. MCB UP Ltd
10. Civil Obligation Act. (2005). *Official Gazette*, 35/2005.
11. Civil Obligation Act. (2008). *Official Gazette*, 41/2008.

12. Competition Protection Act. (1995). *Official Gazette*, 48/1995.
13. Competition Protection Act. (2003). *Official Gazette*, 122/2003.
14. Competition Protection Act. (2009). *Official Gazette*, 78/2009.
15. Emerson, R. (1990). *Franchising and the Collective Rights of Franchisees*. In *Vanderbilt Law Review*, Vol. 43, p. 1523-1532. Vanderbilt University
16. European Franchise Federation. (2015). *Franchise Statistics – Europe*. Retrieved 10.05.2016. from <http://www.eff-franchise.com/130/franchise-data.html>
17. Schwarzer, P. (2016). *World Franchise Council – Survey on the Global Economic Impact of Franchising*. Arlington: FranData
18. German, S., Christie, A. (2010). *Franchising: to regulate or not to regulate*. In M. Abell (ed), *International Journal of Franchising Law*, Vol. 8 (11), p. 11-35. London: Clearhut Publishing Ltd.
19. Kukec, Lj. (2016). *Franšizno poslovanje i Hrvatska*. *Suvremena trgovina*, No. 2, p. 80-81. Zagreb: Seniko studio.
20. Michael, S. C. (2000). *Investments to Create Bargaining Power: The Case of Franchising*. *Strategic Management Journal*. Vol. 23, p. 497-514. New York: John Wiley and Sons Ltd.
21. Mlikotin-Tomić, D. (2004). *Ugovor o franšizingu – instrument sigurnog uspjeha ili promašaja*. In *Računovodstvo, revizija i financije*, 6, p. 128-138, Zagreb: RRIF-plus.
22. Pražetina, R. (2005). *Ugovor o franchisingu*. In *Hrvatska pravna revija*, 11, p. 30-36 Zagreb: Inženjerski biro.
23. Pražetina, R. (2006). *Ugovor o franchisingu*. In *Računovodstvo i financije*, 5, p. 115-120, Zagreb: Hrvatske zajednice računovođa i financijskih djelatnika.
24. Regulations on Block Exemptions Granted to Certain Agreements. (2011). *Official Gazette*, 37/2011.
25. Schaper, M. (2015). *Franchising Goes Global: The need for an International Regulators Network*. In M. Abell (ed), *International Journal of Franchising Law*, Vol. 13 (4), p. 3-5. London: Clearhut Publishing Ltd.
26. Trade Act. (2003). *Official Gazette*, 49/2003.
27. Trade Act. (2008). *Official Gazette*, 87/2008.
28. Trademark Act. (2003). *Official Gazette*, 173/2003.
29. Zeidman, P. F. (2000). *Recent Developments in International Franchising*. *International business lawyer: journal of the Section on Business Law of the International Bar Association*. Vol. 28 (4), p. 187-188. London: International Bar Association.
30. Zeidman, P. F. (2014). *With the Best of Intentions: Observations on the International Regulation of Franchising*. In *Stanford Journal of Law, Business and Finance*. Vol. 19 (2). p. 237-280. Stanford: Stanford Law School
31. Zeidman, P. F. (2016). *Countries with franchising laws*. DLA Piper. Retrieved 24.05.2016. from www.dlapiper.com
32. World Franchise Council (2016). *World Franchise Council Comparison Data Survey 2015*. Retrieved 20.06.2016. from <http://www.worldfranchisecouncil.net/>

Economic and Social Development

DETERMINANTS OF THE DEMAND FOR HIGHER EDUCATION SERVICES IN SELECTED EU COUNTRIES

Anetta Wasniewska

Gdynia Maritime University
ul. Morska 81-87; 81-225 Gdynia; Poland
Phone: +48 605 570 568
a.wasniewska@wpit.am.gdynia.pl

Katarzyna Olszewska

The State University of Applied Sciences ul.
Wojska Polskiego 1; 82-300 Elbląg; Poland
Phone: +48 691 464 035
k.olszewska@pwsz.elblag.pl

ABSTRACT

A sustainable development of Europe, which is discussed in the concept paper Europe 2020, is based to a large extent on a conscious and educated society, characterised by solidarity. That so, education is becoming a priority factor for the local, regional, national and EU development. On the EU level, The Directorate General for Education and Culture, responsible, among other issues, for education, trainings, sport etc., has prepared the Education and Training 2020 strategy (ET2020). Promotion of the development of the knowledge and abilities expected by the labour market is one of the fields of activities. On the national level of member states, these issues found reflection in their national development strategies. It is of importance to have a knowledge concerning those factors which most significantly motivate for constant education (life long learning), not stopping education prematurely, and increasing the level of education. A several years' period of implementation of the strategies associated with raising the level of education in the society, allows collecting experiences of selected EU countries in this respect and finding the crucial factors which determine achievement of the set educational objectives. The aim of the research was to isolate, from the set of the determinants for the demand for educational services, the stimulants and destimulants concerning the decision to take up higher education. In order to achieve the research objective, the authors have conducted an analysis of those EU documents associated with the development strategy which are related to the issue of education, particularly higher education.

A database was generated based on Eurostat and UNICEF data, which was used for conducting examinations involving coefficient values of Pearson's linear correlation.

Keywords: *higher education, Europe 2020, society, Bologna system.*

1. INTRODUCTION

In the future, the higher level of education will be able to guarantee better opportunities in the labour market, and the increase of employment will result in the fall in the citizens' poverty. Also, rise in the GDP share in research-and-development activities as well as more rational and effective use of the available resources will contribute to the improvement of competitiveness of the European Union's economies on the international arena. The increase in the competitiveness may be accompanied by growth in the number of available workplaces, increase in entrepreneurship and fall in the unemployment rate. The Europe 2020 Strategy highlighted the further development of an economy based on knowledge and innovation, putting emphasis on the development of societies through education quality, better use of the results of scientific research in practice, more effective innovation and knowledge transfer as

well as better use of information and communication technologies. The resulting new goods and services should support the sustainable development of Europe, but not only that. Innovative solutions can stimulate economic growth, provision of new workplaces and entrepreneurship not only in national terms. (Waśniewska, Skrzyszewska, Vrdoljak Raguž, 2016, pp. 604-610). Nowadays, the European Union seeks to achieve sustainable development. This development has been defined in the strategy Europe 2020, which enumerates the key objectives for the European Union. One of these objectives is to increase the proportion of people aged 30-34 with higher education. Also, the document highlighted the number of people who are educational early leavers. Attention was drawn as well to the employment rate for people aged 20-64, which should be at the level of 75%. (Table 1)

Table 1. The employment rate for people aged 20 - 64 (Europe 2020, 2010)

Priority	Europe 2020 Targets
I Smart Growth	
The employment rate of population aged 20-64 [%]	75.0
R&D in GDP [%]	3.0
II Priority Sustainable Growth	
Reduce greenhouse gas emissions compared to 1990 [%]	20.0 (or by 30.0) (base year: 1990)
Increase the share of renewable energy sources in final energy consumption [%]	20.0
Increase in energy efficiency [%]	20.0
Priority III Inclusive Growth	
Reduce the number of early school leavers [%]	10.0
Increase the share of population aged 30-34 having completed tertiary education [%]	40.0
Reduce the number of people out of poverty [000]	20 000

What is emphasised more and more frequently is the significance of lifelong learning, continuing education, raising the level of education and improvement in its quality, with special emphasis on practical skills, and not just theoretical knowledge. Completion of the process of education at the secondary level may not satisfy the current and future needs of the labour market.

2. EDUCATION SYSTEM

Education is one of the areas of life which is not subject to unification. The school and examination system can be freely shaped by each of the European Union member countries. This means that no single model of education is imposed, and each member state can create their own system of education. It is worth noting, however, that within the framework of the Community, we are looking for work and competing for places at universities. Thus, each educational system should be designed so as to create chances for every European to find their place in Europe. With regard to the provisions of the Consolidated version of the Treaty establishing the European Community, the sphere of education, both in terms of training and its content, remains the responsibility of each member country. Education is not subject to integration processes aiming to unify legislation that would impose the need for change. Responsibility for the design of the system and content of education lies with the Member States (Acts. Office. EU 2012 C 326). However, this does not mean absence of common action in this respect. Education is seen as critical to the success of integrating the whole of Europe. The main directions are defined in art. 165 and 166 of the Treaty on the Functioning of the European Union. Despite the full autonomy in the field of education, there are provisions related not as much to the content of education but to ensuring equal access to education at all levels, to all citizens of the Member States and to using the same mechanisms for recognition of qualifications for professional purposes (more in Directive 2005 / 36 / EC of the European

Parliament and of the Council of 7 September 2005 on the recognition of professional qualifications). In order to implement these regulations, many countries amended a number of laws in this area. There have been changes in the laws concerning: the education system, higher vocational schools, principles of recognition of acquired qualifications for regulated professions, undertaking or performing certain types of activities. In many countries, a reform was implemented of the organization of the school system, separating the lower secondary education - gymnasium or middle school - from primary education. The introduction of the three level educational system contributed to a change in the way of teaching and increased students' autonomy by providing the possibility of specialising in particular subjects in two or three years at school, according to individual interests or requirements of tertiary institutions. In all EU member states, the minimum requirement ensuring access to higher education is the completion of education at upper secondary level or equivalent. The requirement of candidates' passing an entrance examination, submitting a list of personal achievements or being interviewed are examples of procedures in many member states. In the modern world, no educational system is able to provide sufficient education for the whole life. Education, even at the highest level, should be the beginning of lifelong learning. The modern education system should prepare primarily for the so-called outside school education. (Olszewska, Aniskowicz, 2015, pp.706-708.). Along with the economical, political and social transformations, also educational systems have been changing. Striving to improve and reform the national educational structures is part of the process of connecting European countries. The ideal system does not exist and exchange of experience as well as the search for common solutions are a guarantee of education of the modern generation of Europeans.

3. BOLOGNA PROCESS

The European Single Market is not only the free movement of persons, the common market of goods and services and a common currency, but also the common area of education. The Europe-wide project called the Bologna Process was initiated in 1999 by the ministers responsible for higher education in 29 European countries signing a document called the Bologna Declaration (Kraśniewski, 2009, p.5.). "Europe of Knowledge" is an important factor of social development and an essential element in the process of building the national and European educational space. In 2010, the European Higher Education Area was created, which aims primarily to develop the principles of cooperation and implementation of mechanisms for comparing solutions to be found in Europe, at the same time taking into account the diversity and autonomy of the individual states and universities (Floud, 2006, ch. A 1.2-1.). Commitments that have been made by the ministers of higher education are shown in Fig. 1.

Figure following on the next page

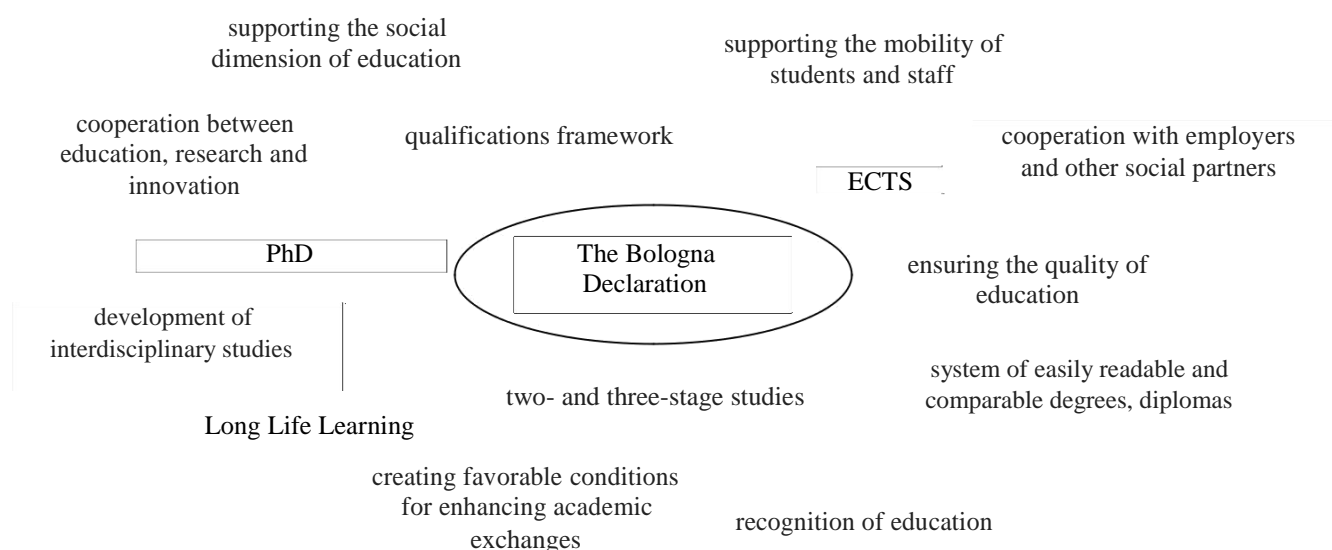


Figure 1. Bologna process - the objectives and activities (own study based on: Chmielecka, 2013, p. 108).

In March 2010, during the conferences in Budapest and Vienna, ministers of the countries participating in the Bologna Process found that it is necessary to further consolidate the systems, improve the implemented solutions and continuously strengthen the cooperation between universities and other institutions of higher education in Europe. "The Bologna Process and the resulting European Higher Education Area (...) has produced considerable interest in other parts of the world and made European higher education more visible on the map of the world" (Budapest-Vienna Declaration on the EHEA, 2010).

Implementation of the goals and activities aims to encourage the restructuring of higher education. The creation of a three-tier system of education, the system of accumulation and transfer of credits - ECTS, clarity of titles and diplomas, as well as promoting international cooperation for the quality of education are the main emphases in the Bologna Process. By multistage studying, the process assumes greater mobility and intra- and inter-system progression route.

The tools of the Bologna Process are complemented by the European Qualifications Framework, which was initiated in 2004. Not only the countries of the Bologna process decided to implement the Qualifications Framework in higher education. This was due to the following reasons: the increasing mobility of European citizens, including people with a university degree, availability of higher education to a much larger proportion of the society, the need for lifelong learning and the need to build societies and economies based on knowledge

(Chmielecka 2010, and Chmielecka, Kraśniewski, Marciniak, 2012, p. 165-193). At the level of a particular country, the concept's implementation takes the form of the National Qualifications Framework (describing the various stages of education through the learning outcomes divided into those of knowledge, skills and social competencies). Qualifications are defined here as professional titles, degrees, diplomas or other certificates attesting to achievement of specific learning outcomes. In principle, these aim to ensure comparability and recognition of diplomas as well as take into account the diversity of institutions and teaching programmes, the multifaceted nature of education, and the prospect of learning throughout life (more: The European Higher Education Area in 2015: Bologna Process Implementation

Report). To sum up, the European Framework Qualification allows the education systems to remain distinct and, simultaneously, makes it possible to compare the qualification level. It supports mobility, ensures transparency while maintaining the diversity of the content of education and types of educational institutions, allowing as well for a variety of routes leading to obtaining particular skills and qualifications. These changes are visible, among others, in the manner of education and adapting the education system to the requirements of employers. (Grobela, Marciszewska, 2016, p. 138-145).

4. EUROPEAN UNION SOCIETY

An increasingly marked and noticeable phenomenon in the European Union is that of ageing. From the demographic point of view, it is related mainly to the changing profile of the population structure in terms of age and gender. This process does not occur in the short term. Its long-term effect is the increase in the proportion of the elderly in the total population and the decline in the proportion of young people, which is also reflected in the demand for educational services. (Holzer, 2003, p.134)

Today, many countries visibly exhibit low fertility and high mortality, especially among the oldest generation. The likelihood of death increases along with the individual's age. (Dubas, 2013, pp 138-140).

The factors which influence ageing include, among others, (Błędowski, Szatur-Jaworska, Szweda-Lewandowska, Kubicki, 2012, pp.14-20.):

- economic growth, which has contributed to improving the quality of societies' lives, and, consequently, has led to a change in the model of family life. Numerous European countries note a shift from multi-generational families and departure from the model of a 2 + 2 family (two parents and two children) in favour of a 2 + 1 or 2 + 0 systems. Often the decision to start a family and have children is preceded by an economic analysis related to profits, gains, losses and lost opportunities that are related to having children.
- no generation replacement, which can also be seen in the number of children given birth by women of childbearing age (15-49 years). This ratio defines the fertility rate.
- improvement in the conditions of hygiene and health, with particular emphasis on the development of medicine and progress in medicine-related technologies, which have led to life expectancy increase. The lengthened life expectancy is accompanied by a shift in the median age (GUS, 2015, pp.15-19). Improving the conditions of hygiene and health also involves a reduction in mortality in the younger generation and growth of this indicator for the older one.

These transformations lead to changes in public attitudes to education. This frequently applies to study programmes, specialization or the number of years needed to obtain a specific diploma, and, thus, finding satisfaction in the future.

5. METHODOLOGY – HELLWIG'S METHOD

Several years of change, initiated by the strategic document Europe 2020, allows collecting experiences of selected countries of the European Union as regards the assessment of factors influencing the possibility of achieving educational goals. The analysis concerned countries of the former Eastern bloc, which include: Bulgaria, Croatia, The Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia and Hungary. The obtained results were compared to the situation in all EU countries.

The aim of the study was to isolate a set of determinants of the demand for educational services related to entering higher education. In order to determine the factors affecting the demand for

educational services, Hellwig's method was used, which is based on the calculated Pearson correlation coefficients. (Kowalik, 2014, pp. 31-40.)

In the initial phase, determinants of demand affecting the number of students (in thousands) were defined in each of the ten countries under analysis. Based on the available Eurostat and UNESCO data for the years 2005-2014, 26 endogenous factors (variables) were set that were justifiable. The list of potential variables is shown in Table 2.

Table 2. The potential explanatory variables set (own calculations based on Eurostat, UNESCO)

Variable	Description	Variable	Description
X1	Total population (in thous)	X14	Total employment rate, age group 20-64
X2	The male population (in thous)	X15	Total employment rate, age group 20-64 – male
X3	The female population (in thous)	X16	Total employment rate, age group 20-64 - female
X4	The median age of the total population	X17	The average duration of working life
X5	The median age of students	X18	The proportion of people with incomplete primary education, primary and secondary education at the age of 15-64 (level 0-2)
X6	Index 18-year-old learners	X19	The proportion of people with upper secondary education, post-secondary education at the age 15-64 (level 3-4)
X7	Total unemployment rate	X20	The proportion of people with higher education at the age 15-64 (level 5-8)
X8	The total unemployment rate for level 0-2	X21	Total life expectancy
X9	The total unemployment rate for level 3-4	X22	The average life expectancy for men
X10	The total unemployment rate for level 5-8	X23	The average life expectancy for women
X11	Proportion of people aged 0-14 (%)	X24	Long Life Learning (%)
X12	Proportion of people aged 15-24 (%)	X25	Youths not in further learning (%)
X13	Proportion of people aged 25-49 (%)	X26	People aged 30-34 with higher education

Due to the large set of the endogenous variables, their verification was conducted, based on the variation coefficient. For further analysis, only the ones characterised by highest variability were selected. In each of the countries, five determinants were selected, which underwent further analysis. The list of determinants for each of the analyzed countries and the EU are shown in Table 3.

Table 3. The list of explanatory variables relative to the countries (own study)

Country	Variable	Country	Variable
Bulgaria	X7, X8, X9, X10, X25	Croatia	X7, X8, X9, X10, X26
The Czech Republic	X9, X10, X19, X24, X26	Estonia	X7, X8, X9, X10, X24
Lithuania	X7, X8, X9, X10, X18	Latvia	X7, X8, X9, X10, X26
Poland	X7, X8, X9, X10, X26	Romania	X6, X10, X20, X24, X26
Slovakia	X7, X10, X20, X24, X26	Hungary	X7, X8, X9, X10, X26

In the case of countries belonging to the European Union explanatory variables that most significantly affect the demand for education are: X7, X8, X9, X10, X25.

In the next stage, for each country, the vector for exogenous variable (dependent variable) was calculated as well as a Pearson correlation coefficients matrix for endogenous variables (explanatory variables).

Then, Hellwig's method was used. The method is based on the integral media capacity. The carriers of information are all potential explanatory variables. On that basis, the number of all possible combinations of potential variables is determined and for each combination the individual information capacity is calculated (Kowalik, 2014, 31-40) using the formula:

$$H_i = \frac{1}{n} \sum_{j=1}^n r_{ij} \quad i = 1, 2, \dots, e$$

r_j - correlation between Y and x_j

r_{ij} - correlation between x_i and x_j

After determining the individual information capacity, the information capacity of all explanatory variables is determined present for the l -th combination in accordance with the formula:

$$H_l = \sum_{i=1}^e h_i \quad l = 1, 2, \dots$$

H_l – integral media capacity.

From all possible combinations, the one is selected for which the integral capacitance value takes the greatest value. For each of the ten countries, 31 potential combinations of variables were calculated and it was determined which combination has the greatest information capacity. On this basis, determinants of demand for educational services at university level were specified for each country, as shown in Table 4.

Table 4. The list of explanatory variables relative to the countries (own study)

Country	Variable	Country	Variable
Bulgaria	X10, X25	Croatia	X10, X26
The Czech Republic	X19, X24, X26	Estonia	X24
Lithuania	X7	Latvia	X26
Poland	X8	Romania	X6
Slovakia	X24, X26	Hungary	X26

For the European Union the determinant affecting the demand for educational services is the number of young people who are not in further education. This factor acts in a destimulating manner as regards the size of the reported demand.

Analysing in detail the results for selected EU countries, attention should be paid to:

1. people aged 30-34 with higher education – it is a stimulant of demand, which positively influences the behaviour of young people who see older siblings or acquaintances with higher education decide to increase their qualifications. Also, the behaviour of business entities (employer's market) forces the potential employees to obtain qualification on level 5-8. This relationship is clearly evident in the Czech Republic, Croatia, Slovakia, Latvia and Hungary.
2. the proportion of people involved in continuous education (lifelong learning) – it is a stimulant of demand, which affects the behaviour of not only young people but also people who are aware of the need to learn throughout their lives. They know that once acquired education does not necessarily bring benefits throughout the duration of working life. It is assumed that most people will be forced to retrain, even several times in their lives. This stimulant is particularly evident in the Czech Republic, Slovakia and Estonia.
3. the total unemployment rate for level 5-8 – it is a destimulant of demand. In Bulgaria and Croatia, the level of 5-8 does not necessarily guarantee the possibility of finding an advantageous employment, relevant to the person's qualifications or competence. In numerous countries, young people choosing to continue their education do not opt for the teaching programmes according to the demand reported by employers, according to future expectations associated with the increase in international competitiveness or sustainability, but are looking for the programmes which are in line with their own hobbies and interests. These are often humanities and social sciences, which do not guarantee a well-paid employment or even finding one. Graduates of these programmes usually supply the unemployment resources.
4. indicator of people continuing education at the age of 18 – it is a stimulant of demand for educational services occurring in Romania, which also indicates shortage of people with the necessary competencies in a competitive labour market based on the resources of knowledge and innovation.
5. the total unemployment rate - it is a stimulant occurring in Lithuania, where the high level of unemployment encourages people to expand their knowledge and acquire new skills and competences in order to leave the resource of the future potentially unemployed. What constitutes a problem is that it takes a relatively long time (up to a year) to complete education/retraining which is undertaken for the purpose of avoiding unemployment. After a period of study, one may find that there is no demand from businesses for the resulting level of education.
6. the total unemployment rate for level 0-2 - it is a stimulant of demand for educational services since people with low qualifications recognize the necessity to raise them and are aware that only in this way can they avoid unemployment. These people are often stimulators for their children or younger siblings, encouraging them to take action whose aim is to achieve higher levels of education. This phenomenon occurs in Poland.

7. the number of young people not in further learning - it is a destimulant of demand for educational services, which is an upsetting phenomenon. In the era of an ageing European Union (increasing average life expectancy, declining birth rate, increasing median age) and the loss of competitiveness in the global arena, the decision not to continue learning can lead to hindering development and economic growth, which is to be seen primarily in Bulgaria in the next few years.

6. CONCLUSION

The priorities identified in the Europe 2020 strategy on sustainable development highlight the importance of an educated society. In order to meet them, all the analysed countries of the European Union insist on adapting their education systems to the learning outcomes described in the EQF. The qualification frameworks designed and adopted in particular countries enable developing the students' skills so as to reach the appropriate EQF levels.

Demographic changes contribute to noting a different perspective both on the labour market and educational attainment. The decrease in the population of young people requires the labour market to assume a different perspective as regards the potential employee. Enterprises are looking for employees with specific qualifications and skills. In line with the EQF approach, the acquired skills in each of the countries studied allow market participants to use their diplomas to compete in the European labour market. Therefore, the demand for educational services will increasingly depend on the people's level of education, participation in the process of lifelong learning, the unemployment rate level and the number of people willing to continue their education. The Europe 2020 strategy also draws attention to these issues.

EQF allow both to preserve distinct education systems in the analysed countries and guarantee the possibility to compare levels of education, which contributes to increasing competitiveness in the global labour market.

LITERATURE:

1. Błędowski P., Szatur-Jaworska B., Szweda-Lewandowska Z., Kubicki P. (2012). *Raport na temat sytuacji osób starszych w Polsce*, Warszawa: IPiSS.
2. Chmielecka E. (2013). *Proces Boloński i krajowe ramy kwalifikacji dla szkolnictwa wyższego*. Warszawa: Studia Bas.
3. Chmielecka E. (2010)., *Autonomia programowa uczelni. Ramy kwalifikacji dla szkolnictwa wyższego*. Warszawa: MNiSW.
4. Chmielecka E, Kraśniewski A, Marciniak Z, (2013). *Krajowe Ramy Kwalifikacji w szkolnictwie wyższym* [w:] Raport o stanie edukacji 2012. Warszawa: IBE.
5. Dubas E. (2013). *Starość znana i nieznana – wybrane refleksje nad współczesną starością*, Warszawa: Rocznik Andragogiczny, Tom 20,
6. Floud R. (2006). *Convergence and Diversity, EUA Bologna Handbook*. Raabe Academic Publishers.
7. Grobelna A., Marciszewska B. (2016), *Undergraduate students' attitudes towards their future jobs in the tourism sector: challenges facing educators and business*, [in:] D. Vasilenko , N.Khazieva (Eds.), *Proceedings of the 4th International Conference on Management, Leadership and Governance, ICMLG 2016*, Saint-Petersburg State University of Economics, Academic Conferences and Publishing International Limited, UK
8. Holzer J.Z. (2003). *Demografia*. Warszawa: PWE.
9. Kraśniewski A. (2009). *Proces Boloński. To już 10 lat*. Warszawa: FRSE.

10. Kowalik, K. (2014): *On an implementation of the method of capacity of information bearers (the Hellwig method) in spreadsheets*, in: Banek, T. and Kozłowski, E., ed.: *Probability in Action*, Lublin: Politechnika Lubelska.
11. Olszewska K., Aniśkiewicz M. (2015). *The role of the State School of Higher Professional Education in Elblag in the development of the Warmia and Masuria region*, [in:] Ögr. Gör. Tuğrul AKTAŞ Ögr. Gör. Özgür Doğan GÜRCÜ (Eds.) *Proceedings of the 4th International Vocational Schools Symposium, The role of vocational schools in regional development*, UMYOS Proceedings Yalova 2015.
12. Budapest-Vienna Declaration on the European Higher Education Area (2010).
13. European Commission/EACEA/Eurydice, 2015. *The European Higher Education Area in 2015: Bologna Process Implementation Report*. Luxembourg: Publications Office of the European Union.
14. Consolidated Versions of The Treaty on European Union and The Treaty on the Functioning of the European Union (2012/c 326/01).
15. Dyrektywa 2005/36/WE Parlamentu Europejskiego i Rady z dnia 7 września 2005 r. w sprawie uznawania kwalifikacji zawodowych).
16. Waśniewska A., Skrzyszewska K., Vrdoljak Raguž I. (2016): *A comparative analysis of chosen determinants of the Croatian and Polish human capital in the context of the strategy Europe 2020*, in: 5th *International Scientific Symposium Economy of Eastern Croatia – Vision and Growth*, Osijek
17. GUS (2015). *Trwanie życia 2014*, Warszawa: GUS
18. Eurostat (2016). *data on-line*. May-July 2016 from <http://ec.europa.eu/eurostat>.
19. UNICEF (2016): *data on-line*, May-July 2016 from <http://www.uis.unesco.org>

PUBLIC EXPENDITURE AND ECONOMIC CRISIS IN ALGERIA

Abdelatif Kerzabi

University of Tlemcen, Algeria
kerzabi57@gmail.com

ABSTRACT

The budget policy in Algeria is regarded as an essential factor of economic growth. For this purpose, the public authorities launched out in a vast program of public expenditure. However, in spite of the injection of important sums the economic growth remains weak. The growth costs expensive and the economic reforms are blocked owing to the fact that Algeria of share its wealth gives the impression which it can satisfy the needs for the company without passing by the market. The oil price fall has challenged this policy built on public spending. This has induced a decline in revenues, affecting both the foreign exchange reserves which cover 22.2 months of imports and the public budget. The trade balance deficit reached 13.7 billion dollars in 2015. This reversal of unexpected circumstances produced a deep economic crisis. In this work, we will try in the first part to show that public spending resulted in not only low growth rates but very expensive for the national community. Also, these expenditures have inaugurated a return of government intervention when the Algerian economy began to open up the market. In the second part, we analyze the effects of the oil prices drop on economic balances.

Keywords: public finances - the budget policy - Economic growth - receipts – the public expenditure. Economic crisis.

1. INTRODUCTION

When the countries of the northern shore of the Mediterranean are forced to reduce their deficits by fiscal austerity measures, Algeria embarked on extensive growth programs mainly based on public spending. After the first plan to support economic recovery (PSER) in 2001, a second supplementary support program for economic recovery is implemented in 2005-2009. The financial allocations made available for both programs are 7 Billion Dollars (525 billion dinars) for the first and 55 Billion Dollars (4200 billion AD) for the second an increase of almost 800%. The aim of the first program is mitigating perverse effects of a deep crisis and creates the conditions for a genuine sustainable development strategy. In 2009, the Algerian government has a third stimulus plan in a difficult international context marked by the financial and economic crisis of 2007/2008 crisis affected almost all economies and has plunged the world into a prolonged recession. During that several countries were operating severe budget restrictions, Algeria launched for 2010-2014, his third five-year program. Ambitious in its objectives by significant financial resources mobilized, the program is an extension of the previous two stimulus programs (2001-2009). At the end of 2014, the level of public funding be around 700 billion dollars after the respective revaluations in each sector. The GDP growth rate was positive during all these years, but it did not exceed an average of 3%. Overall, the performance of the Algerian economy as measured by GDP growth rate is real but modest or low. Growth is mainly driven by oil that continues to weigh, either in GDP or in taxation. In this work, we try to show that public spending resulted in not only low growth rates but very expensive for the national community. Also, these expenditures have inaugurated a return of government intervention when the Algerian economy began to open up the market.

2. PUBLIC EXPENDITURE AND BOOSTING ECONOMIC GROWTH

Following an acute financial crisis, Algeria, launched in 1990 in a process of economic liberalization that was to make the move from a centrally planned economy to a market

economy. The Algeria begins to structural adjustment that the IMF and the World Bank recommend it. The state contractor begins its withdrawal from the economic sphere in a difficult economic and social context marked in particular by the reduction of financial resources on the one hand and the other radical Islamism. The combination of these phenomena strengthens the sovereign state, but to the detriment of the liberalization of the economy. The state threatened as a public authority should maintain its hegemony over the economy. This stranglehold on the national economy allowed him to control the financial resources to quell social discontent. The 90s were marked by a pervasive state remains the largest employer in the country with 2 million employees, when the oil sector accounts for a third of GDP, 98% of exports and over 70% of government revenue. The early 2000s, and following a fragile economic situation has resulted in a very low growth rate, the state is committed to closing the various delays during the 1980s and 1980. For this purpose, a policy of public spending was launched three economic stimulus programs aimed especially to revitalize the economy and make the structural changes as expected. Changes which should lead the country out of oil dependency and thus help diversify the economy and build a productive economy. These programs were launched in 2001 and cover the period 2000 to 2015. The aim is to revitalize the national economy. After the first plan to support economic recovery (PSER) in 2001, the second supplementary support program for economic recovery is implemented in 2005-2009, while the third, it covers the period from 2010 to 2014. Budgetary expenditures provided for these three programs are 7 Billion Dollars (525 billion dinars) for the first and 55 Billion Dollars (4200 billion AD) for the second an increase of almost 800%, and 268 billion dollars for the third is an increase of 387% compared to the second plane. These three planes funded targeted a recovery by the application based on large public investments supposed to provide the country with infrastructure and create a dynamic and a ripple effect throughout the economy. The aim of the first program is mitigating "perverse effects of a deep crisis and create the conditions for a genuine sustainable development strategy." This ambition has four goals including:

- 1 / catering managers and living environments;
- 2 / IT territorial disparities and imbalances;
- 3 / rehabilitation of rural areas in their triple dimension economic, social and environmental;
- 4 / mitigation of mass migrations and especially painful in the last decade and job creation.

The second plan is more ambitious. It is more important goals, given the importance of the program to achieve. In this plan, it is:

- 1 / improving the living conditions of the population
- 2 / The development of basic infrastructure
- 3 / The development and modernization of public services
- 4 / Support to Economic Development

The third plan is the continuation of two previous stimulus programs (2001-2009). It has two main objectives:

- The completion of major projects already initiated (roads, rail, water.) Amounting to 130 billion US dollars;
- New project commitments amounting to 156 billion US dollars. The program provides a set of projects that it expects to achieve:
 - a) Over 40% of resources will be reserved for the improvement of human development (2 million units),
 - b) 40% of the resources will be allocated to basic infrastructure and public services,

c) Support to develop the national economy with over 1,500 billion dinars, including 1,000 millibars to support the agricultural develop et150 billion for the promotion of SMEs through the realization of industrial zones, upgraded and reclamation bank loans (300 billion dinars)

d) Develop industrial mobilizes over 2000milliards dinars, including 350 billion for job creation.

e) The development of the knowledge economy that mobilizes more than 250 billion dinars.

The latter program as we see an important place for the improvement of living conditions and develop the human and basic infrastructure projects, described as major projects. The objectives always relate to the revitalization of the economy to build a diversified and productive economy to get the country out of its dependence on hydrocarbons.

2.1. Nature of state spending

Over the period 2000-2009, public spending accounted for in Algeria averaged 13% of GDP (19% in 2009 against 7.8% in 2000), the highest rate among the emerging and developing countries.

Table 1: Structure of budget revenues and expenditures from 2001 to 2012

	budget revenue	budgetary expenditures
2001	1 389,70	1321,00
2002	1576,70	1550,60
2003	1525,50	1690,20
2004	1606,40	1891,80
2005	1714,00	2052,00
2006	1841,90	2453,00
2007	1949,10	3108,60
2008	2902,40	4191,10
2009	3275,30	4246,30
2010	3074,60	4466,90
2011	3489,80	5853,60

Source: Ministry of Finance, General Directorate of Policies and Forecasts: Economic situation in Algeria, Year 2011, August 2013

Here, we observe that the presence of oil revenues releases the budget constraint. Rising world oil prices has transformed the budgetary situation in Algeria. The share of revenues generated by oil and that of capital expenditure in the budget prepared by the government, have increased. In a Keynesian perspective, public spending is considered a growth factor of aggregate demand, stimulating the production is economic growth.

2.2. Growth rates

The financial upturn fueled by oil revenues, supported by soaring world prices over the last decade has not been without positive impact on the Algerian economy, certainly. economic growth rate today revolves around 3% per year. The unemployment rate fell by 30% in 2000 to

less than 10% in 2014 while the ratio of debt to GDP, which peaked at more than 116% in 1996, has been falling in the years 2000 to 8.8% in 2008 and 9.2% in 2013, one of the lowest in the world. The same economic growth rate if positive, remains modest compared to other oil-exporting countries, such as Qatar, Kuwait and Saudi Arabia. Between 2006 and 2013, the Algerian growth did not exceed 3.6%, even declining to 1.6% in 2009. The massive injection of public money through the various stimulus packages, the growth rate was low.

Table 2: Growth rate of GDP for the period 2004-2012

Years	2004	2005	2006	2007	2008	2009	2010	2011	2012
Rate of growth	5,2	5,1	2	3	2,4	2,4	3,5	3,4	2,4

Another negative impact of the high dependence on oil resources: the neglect of productive sectors such as industry and agriculture, may create jobs and reduce some exogenous risks. Poor relation of the Algerian economy, the agricultural sector now represents less than 10% of GDP, after reaching a low of 6.7% in 2008. This reduces Moreover, the country's food autonomy and 'exposed to fluctuations in the international market prices of food and agricultural commodities. If the country has made progress in 2013, public finance management remains a critical issue in the long term. The state must not only consolidate its current position, but also lay the foundation for a sustainable fiscal structure through increased revenue non-hydrocarbon, which would protect the country against the volatility associated with fluctuations in world prices of oil. The challenge also lies in external balances. The surplus in the balance of payments had jumped to \$ 34 billion in 2008, the year the price of oil reached a record high, before falling to zero next year. Two years later, a 20 billion surplus was recorded, before falling again to 1 billion in 2013. This evolution sawtooth perfectly illustrates the volatility problem, sometimes extreme, linked to the lack of economic diversification. Dependence vis-à-vis region of oil revenues led to a greater macroeconomic instability. Any reduction in oil prices led to a decrease in financial resources and thus budgetary expenditures that support economic growth.

3. The oil price fall

Oil prices, expressed in dollars, fell about 50% in the second half of 2014. The average price of oil rose from 109,55 dollars / barrel in the first quarter 2014 to 75.38 dollars / barrel in the last quarter 2014 (100.23 dollars in 2014) and only 54.31 dollars / barrel in the first quarter of the current year. This is not without effect on the Algerian economy. The drop in oil prices, is combined with a contraction of the quantities of oil exported in the first quarter 2015 (-8.99%). This situation will have negative effects on public finances, much of which is financed by oil revenues. Hydrocarbon exports account for 95% of total exports and about two-thirds of government revenue.

3.1. Impact on public finances

The Treasury deficit rose during the first two months of 2016 to nearly 1.404 billion dinars (DA billion) at the end of February 2016 (against nearly 413 billion DA at end-February 2015), an increase of nearly 240% indicate the statistics provided by the Ministry of Finance. As for the oil tax collected in January and February 2016, it stood at 321.67 billion against 405.7 billion DA DA in the same period of 2015 (-20.7%), according to preliminary data from the Ministry. On ordinary Treasury resources, they declined to 391.91 billion DA at end February 2016

(against 488.73 billion DA at end of February 2015). Budget revenues actually collected (oil and ordinary) decreased to 713.6 billion against 894.43 billion DA in both periods of comparison (-20.2%), knowing that the LF 2016 expects revenues of 4.747, DA 43 billion on the year. As for budget expenditures, they increased to almost 2,040 billion DA on the first 2 months 2016, against 1222.6 billion DA in the same period 2015, an increase of 66.85% (LF 2016 provides for spending total of 7984.1 billion DA for the current year). Thus, operating expenses rose to 1256.5 billion against 937.64 billion DA DA (+ 34%), while those of equipment are mounted to 783.5 billion against 284.96 billion DA DA (+ 175%). Which gave a deficit budget balance of 1326.36 billion DA on the first 2 months against 328.17 billion DA to the same period of 2015 (+ 304.2%). The balance of the trust accounts is displayed down to 22 billion dinars (25.3%) while the balance of other Treasury operations declined by 12.8% to \$ 99, DA 5 billion at end-February 2016. the overall deficit of the Treasury has reached 1403.86 billion DA at end February 2016.

3.2. Impact on economic growth

The fall in world oil prices since mid-2014 led to a deterioration of macroeconomic balances. In 2015, growth has slowed down again to 2.9% in 2014, due to lower average price of oil, which went from \$ 100 a barrel in 2014 to \$ 40 per barrel in 2016. because initially it was expected that this decline is short, lack of sanitation of public finances led to a doubling of the budget deficit, which stood at 15.9% of GDP in 2015 . Because disbursements are very important, the oil stabilization fund has seen its resources decline, from 25.6% of GDP in 2014 to 16.2% of GDP. International reserves remain high, at 28 months of imports, but they are dwindling rapidly. Despite tight monetary policy, inflation reached 4.8% mainly because of the impact effect of a depreciation in nominal value of 20% dinar, which was to correct the external imbalance. The unemployment rate rose to double digits and was more pronounced among women and youth.

Table 3: Economic Indicators

Indicators of growth	2012	2013	2014	2015	2016 (e)
GDP (billion USD)	209,01	209,70	213,52e	175,08e	181,71
GDP (annual%, constant prices)	2,6	2,8	3,8e	3,0e	3,9
GDP per capita (USD)	5.574	5.533	5.406e	4.345e	4.426
Government debt (% of GDP)	9,944	8,278	8,788	10,188e	13,586
Inflation rate (%)	8,9	3,3	2,9	4,2e	4,1
Current account balance (USD billion)	12,29	0,84	-9,64	-30,96e	-29,40
Current account balance (% of GDP)	5,9	0,4	-4,5e	-17,7e	-16,2
Source: IMF - World Economic Outlook Database - 2016. e : Estimated data					

Inflation is expected to increase from 4.2% in 2015 to 4.1% in 2016, against a rate of 2.9% in 2014. In April, it had estimated that inflation is expected to rise to 4% in 2015 and in 2016. The IMF report also provides a breakdown of the labor market in the country for 2015 and 2016. Unemployment will experience a negative trend, with rates of 11.6% and 11.7% of the workforce, respectively. This rate was 10.6% in 2014.

Table 4: Unemployment rate

Socio-economic indicators	2014	2015	2016 (e)
Unemployment rate (%)	10,6	11,6	11,7
<i>Source: IMF - World Economic Outlook Database - 2016.</i> <i>e : Estimated data</i>			

World Bank provides, in effect, a growth of 3.1% in 2017, before falling to 2.7% in 2018. Algeria also faces the same way that most oil exporters, a situation complicated budget. The financial institution refers, in fact, a deficit for the current account balance for both the budget balance of payments. This is also the case in many countries in the Mena region. Foreign exchange reserves have shrunk rapidly, according to BM, without giving figures of indications. She mentioned, however, the increased use of foreign exchange reserves due to inflation, currency devaluation and financing of fiscal deficits. The institution explained that the budget problems are driven by the level of expenditure and lower revenue rates. Moreover, the financial institution has reduced its global growth forecast for 2016 to 2.4%, from 2.9% announced in January. This decision reflects the anemic growth rates in the advanced economies, the continued weakness in prices of commodities, the sluggishness of world trade and the decline in capital flows, said the institution.

4. CONCLUSION

If Algeria does not undertake urgently an alternative economic development strategy, it may face a worsening of these underlying weaknesses, even the origin of the uprisings in other Arab countries. In this context, the support of strong growth, based on the development of a strong and independent private sector, is essential to reduce the dependence of the economy on oil and help create jobs. The authorities should thus improve the business climate, reduce constraints to foreign investment and promote integration into international trade, according to the International Monetary Fund (IMF). The Algeria will also invest in the development of non-oil sectors and create a favorable legal and financial environment for the emergence of a culture of entrepreneurship, especially on innovative niche and high value. The establishment of such a climate the pass, among others, the development of the financial sector, whose current size is a real obstacle to private sector growth. By way of illustration, only one new IPO took place in 2013 (bringing to four the number of listed companies) while the market has a total of two corporate bonds. Furthermore, the access of SMEs to bank loans is limited.

LITERATURE :

1. Banque mondiale, *Revue des Dépenses Publiques* 2007
2. Benachenhou, A ; « KEYNES est mort », dans *el-watan* du 20 /01/2009
3. Belmioub, MC, « Gouvernance et rôle économique et Social de l'Etat : Entre exigences et résistances », in revue IDARA, N° 21, 2002.

4. Benabdallah Y ; « Le développement des infrastructures en Algérie : quels effets sur la croissance économique et l'environnement de l'investissement ? », Article disponibles sur le site « www.gate.cnrs.fr/unecaomc »
5. Chabou M.C , « Gouvernance publique : de la mauvaise gestion à la tragédie managériale », El-watan du 20/06/2012
6. Dahmani A. , l'expérience algérienne des réformes : problématique d'une transition à l'économie de marché, Annuaire de l'Afrique du Nord .XXXVII, CNRS, 2000
7. El Khoury G . « Typologie de réformes de l'Etat : Un moyen de changement garantissant la souveraineté étatique » www.fgm.usg.edu.lb/files/a12011/PDF?
8. Groupe de Banque Africaine de Développement, Note de Dialogue, 2011/2012, Alger, Mai, 2011
9. Hedir M. « Autres expériences de développement à travers le monde : quelques éléments chiffrés de comparaison », Symposium du FCE, 14-15 Mars 2012
10. Lamiri, A, L'Algérie s'est trompée de diagnostic et de thérapie" AU FORUM Alegria Invest , repris par le quotidien Liberté du 04 /10/ 2011.
11. Mebtoul, A. (2011). Bilan des Politiques Economiques de 1963 à 2010, in « le Développement Economique de l'Algérie : expériences et perspectives » ouvrage collectif sous la direction de Hafsi, T, Editions Casbah. Alger, 2011
12. Mebtoul A , « Le paradoxe de l'aisance financière : loi de finances 2008, incolore et toujours sans rapport avec la réalité, Liberté économie, n° 456, Novembre 2007
13. Mebtoul, A, « Pour la première fois depuis dix ans , l'inflation en Algérie est de 10% en 2012 : risque de frein à l'investissement productif et des tensions sociales, « www.Reflexionsdz.net » quotidien national, consulté le 26/01/2012
14. Ministère de l'industrie et la promotion de la pme, Revue n°1, janvier 2011, disponible sur le site « www.mipmepi.gov.dz/IMG/PDF/001.pdf »
15. Williamson J. « Le consensus de Washington : Un train de réformes devenu un label galvaudé », Finances et développement » Septembre 2003

SECTOR VARIATION IN THE USE OF CRM SYSTEMS FOR ENTERPRISE LOGISTICS

Agata Mesjasz-Lech

Czestochowa University of Technology, Poland
agata.mesjasz@poczta.fm

ABSTRACT

The article focuses on the use of CRM systems in enterprise logistics, in relation to customer service. Maximizing customer service quality is the chief goal of logistics which can be achieved through automation of customer service processes. Hence the objective of the paper is to compare the change in the number of companies using CRM systems in the economic sectors in Poland in the 2012-2015 period with the changes in the number of businesses using computers. The shift-share analysis was used. The following elements were specified: Analyzed area potential, Enterprises structure, and Analyzed area competitiveness. Additionally the average rate of change for the number of companies using CRM software in Poland in years 2010-2015 was analysed in order to determine the trends in the development of implementation information technologies supporting the enterprise logistics in the field of customer lifetime value and profit.

Keywords: *Customer Relationship Management, Information Technologies, Logistics, Shift-share analysis.*

1. INTRODUCTION

The task of logistics is to shape an efficient and effective flow of all kinds of resources within businesses and between them. Customer service is one of the key aspects of logistic processes (Skowronek, Sarjusz-Wolski, 2003, p. 19; Kadłubek, 2012, p. 927), but the idea of customer here encompasses the producer, supplier, seller as well as the end customer. Customers play an important role in the improvement of logistic systems of enterprises because their expectations determine the quality of customer service. Therefore, identifying the needs of clients and establishing long-term relationships with them is a challenge for contemporary businesses (Kadłubek, 2010, p. 155). It is also crucial to seek new solutions leading to better quality of products (Kott, Skibińska, Sukiennik and Szczepanik, 2015, p. 88). Customer - the key link of a logistic system - has become the central aspect of CRM (*Customer Relationship Management*). Through information resources they provide, CRM systems help find clients and establish long-term relationships with them. The common area of CRM systems and customer service is the management of marketing and sales campaigns with the use of feedback in communication (Bojanowska, 2013, p. 72). The basic goal of CRM systems is to establish lasting relationships with customers (Wang, 2011, p. 225; Oba, 2001, p. 604) and to adjust the marketing strategies of building those relationships to specific customer needs in order to deliver the right product at the right moment (Thearling, 2009, p. 1181). Logistic customer service also deals with the criteria of product type and delivery time, and thus embraces the aspects of quality, place and cost. That is why the analysis of the use of CRM systems seems relevant and important. The goal of the article is to evaluate the development and dynamics of CRM systems use in the individual sectors of Polish economy against the development of the use of computers in the whole country. Our assumption is that the development of information infrastructure is crucial for the implementation of systems supporting decision-making processes in customer service.

2. THE ROLE OF CRM SYSTEMS IN AN ENTERPRISE

CRM systems are comprehensive tools at the interface of customers and businesses. CRM systems are categorized as systems which “enable organizations to contact customers and collect, store and analyze customer data to provide a comprehensive view of their customers” (Khodakarami and Chan, 2014, p. 27). Subject literature emphasizes that using CRM systems contributes to the maximization of customer lifetime value, organization’s efficiency and profit (Persson and Ryals, 2014, Chang et al., 2014, Chuang and Lin, 2013, Josiassen et al., 2014, Li and Mao, 2012, Johnson et al., 2012; Wu and Lu, 2012, Milovic, 2012, Keramati et al., 2013). Not only do they guarantee an increased profit, but also the development of an enterprise (Heidemann, Klier, Landherr and Zimmermann, 2013, p. 73). The implementation of CRM systems, therefore, should constitute a value for both the customer and the enterprise. A successful implementation of a CRM system increases the number of customers by entering new sales channels (Olaszak, Bartuś, Billewicz, 2015, p. 190). Yet contrary, research shows that although they used CRM systems, many enterprises did not achieve profitable growth or even lost or worsened their long-term customer relations (Qi et al., 2014, p. 295). The success of their implementation dwells in the proper management of the enterprise's resources such as: human resources, organizational resources and technological resources (Santouridis, Tsachtani, 2015, pp. 307-308). Human resources play a crucial role in the use of CRM systems, especially when it comes to worker commitment in finding customer information, establishing and maintaining relationships. A proper implementation of CRM systems also requires organizational resources such as culture, structure, knowledge management and support of the company’s top management. Technological resources are determined by three fundamental elements of a CRM system: analytic (analysis of customer behaviour), operational (registering orders, running customer database, customizing offers, sales management) and communication (contact with customers). For some authors the basic areas determining a successful CRM system implementation are: strategy, people, processes, and technology (Singh, Singh, 2011, p. 102). Table 1 presents factors which determine the implementation of a CRM system in a company in relation to identified resources.

Table following on the next page

Table 1: Factors determining the implementation of CRM systems in enterprises.

Author	Factors	Description
Salloum, Ajaka, 2013, p. 17	Institution specificities	Country, owners, local implication in the country Juridical status, size of the company, strategic factor encouraging the investment, clients' origins, type of clients, etc.
	System specificities	Existence of a CRM system, type of CRM (transactional, operational, decision-making), frequency of updates, source (internal, external)
	Use of the CRM system	Cross-selling, ad-hoc relationship, reactivity, knowledge of customer, integration of several communication Channels, work process, human constraints, presence of multi-players, presence of multi-sources, employees skills and experience, legal regulations, complexity of the products
Steel, Dubelaar and Ewing, 2013, pp. 1329-1330	Industry context	Range of collaboration, self-regulation, or the independent adoption of business processes to meet legislative or customer needs, cultural norms, strategy development (link of the CRM strategy with the development of value for the customer and the organisation), types of outcomes achievable from CRM
	Organisational context	Organisational structure, information technology, organisational culture (adaptive, customer-oriented), complexity
	Customer context	The type of organization engagement in environment (business-to-consumer, business-to-business, not-for-profit)
Šebjan, Bobek and Tominc, 2014, pp. 464-465	Process-oriented factors	Number of dimensions of process-oriented organization: organizational structure, language, documentation, utilization, information systems, performance measurement, customer requirements, process view, process jobs, process management and measurement
	Technology-oriented factors	The development of new products using new technologies in and outside organizations, investing profits back into research and development, industry standards, etc.
	Innovation-oriented factors	The organisation culture, innovative management, the support for searching for new ideas, innovation, research-based innovation, involvement in projects and programs

The necessity and success of a CRM system implementation have a lot to do with the company's economy sector. Belonging to a specific sector determines the resources and the kind of processes realized in a company as well as the type and complexity of the relations with customers. For this reason the analysis concentrates on the economic sectors with reference to CRM systems for gathering and storing customer information and for marketing purposes.

3. METHODOLOGY

The development of the use of CRM systems was examined through the shift-share analysis to evaluate the development of individual sectors with reference to the development level of the benchmark area. This enabled an evaluation of sector changes in the context of the analysis of

the structure of economic and social phenomena. It was, therefore, an attempt to determine differences between sectors in the development rate of an examined phenomenon. In a shift-share analysis the following elements were specified:

1. Analyzed area potential (AAP), which determines the changes of the use of CRM systems in sectors with the assumption that they develop in a tempo which is similar to the whole country (Poland) in the field of the level of the use of computers.
2. Enterprises structure (ES), which characterizes the portion of changes which comes from the general tendency with the use of CRM systems, and where a positive value means a better structure in the examined sector than in Poland.
3. Analyzed area competitiveness (AAC), which describes changes in terms of the use of CRM systems caused by a competitive position of sectors and, thereby, indicates the difference between the increase index in the analyzed area compared to Poland.

The formulas (1)-(3) were used:

$$AAP_{ib} = \sum E_{ib}^{t-1} \cdot \left(\frac{E_{ib}^t}{E_{ir}^{t-1}} - 1 \right) \quad (1), \quad ES_{ib} = \sum E_{ib}^{t-1} \cdot \left(\frac{E_{ib}^t}{E_{ir}^{t-1}} - \frac{E_{ir}^t}{E_{ir}^{t-1}} \right) \quad (2), \quad AAC_{ib} = \sum E_{ib}^{t-1} \cdot \left(\frac{E_{ib}^t}{E_{ir}^{t-1}} - \frac{E_{ir}^t}{E_{ir}^{t-1}} \right) \quad (3).$$

E_r – number of enterprises using computers in their activity in the reference area r (Poland), E_{ir} – number of enterprises using CRM systems in the reference area r in the group i according to the cross-sectional division, E_{ib} – number of enterprises using CRM systems in the reference area b (individual sectors) in the group i according to the cross-sectional division, $t-1$ – the first year in the analyzed period, t – the last year in the analyzed period.

The division is consistent with the classical shift-share model (Knudsen 2000, p. 178, Zaccomer 2006, p. 2014). The sum of the components AAP, ES and AAC is the so called total shift (TS). TS represents the actual change of the number of enterprises using CRM systems in the year t compared to the year $t-1$.

The dynamics were analysed with the annual average change ratio estimated through the formula (4):

$$ACR = (\bar{i}_g - 1) \cdot 100\% \quad (4), \quad \text{where: } ACR - \text{average rate of change, } \bar{i}_g = \sqrt[n-1]{\frac{y_n}{y_1}} - \text{geometric}$$

mean, n – the number of analyzed numbers, y_n – the value of variable in the last analyzed number, y_1 – the value of variable in the first analyzed number.

The value of the ACR indicates an annual average increase (positive ACR) or an annual average decrease (negative ACR) of the examined phenomenon in the analysed period.

4. RESULTS OF THE EMPIRICAL RESEARCH

4.1. Sectorial structure of the use of CRM systems in Poland

The scale of the use of CRM systems in Poland is determined by the size of an enterprise and belonging to individual sectors. Figures 1-3 present the structure of businesses which used CRM systems in 2015 by size and sector.

Figure following on the next page

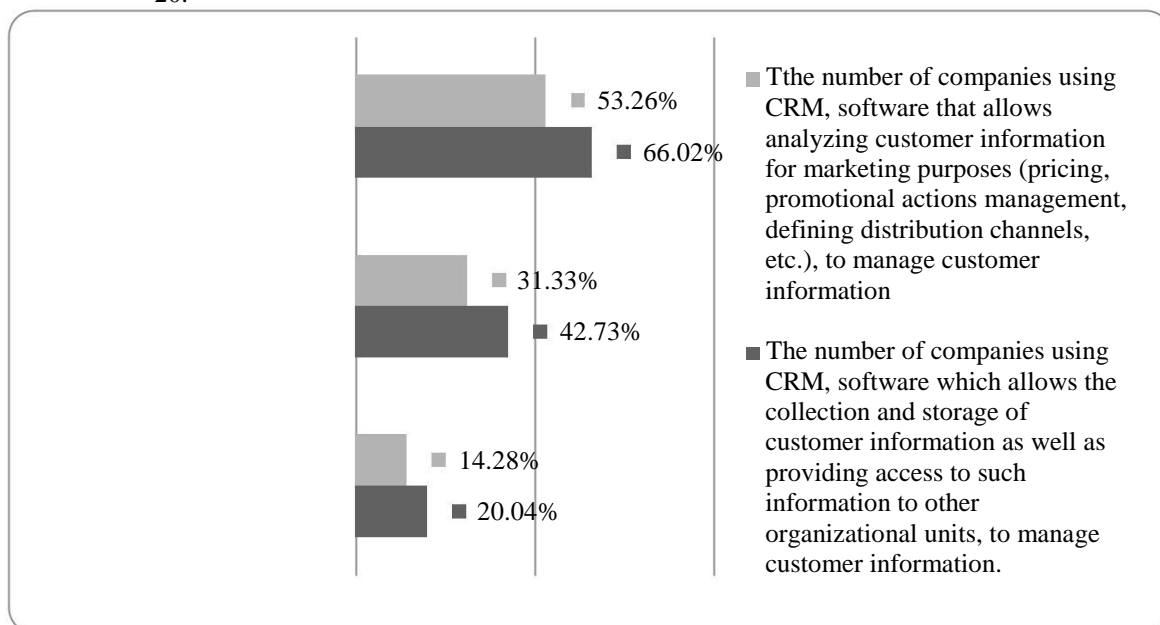


Fig. 1. The structure of enterprises using CRM systems by size in Poland in 2015

In Poland CRM systems are mainly used in big enterprises which stems from the complexity and intensity of processes realized there. They also have bigger financial resources for the implementation of IT solutions. In Poland, however, the use of ERP and CRM systems is generally limited as only 25% of enterprises use them for gathering and storing customer information, and 18% of businesses have implemented CRM systems for marketing purposes. The modest level of CRM systems use is a result of the structure of enterprises in terms of size - small and medium sized businesses make up as much as 97% of all enterprises in Poland.

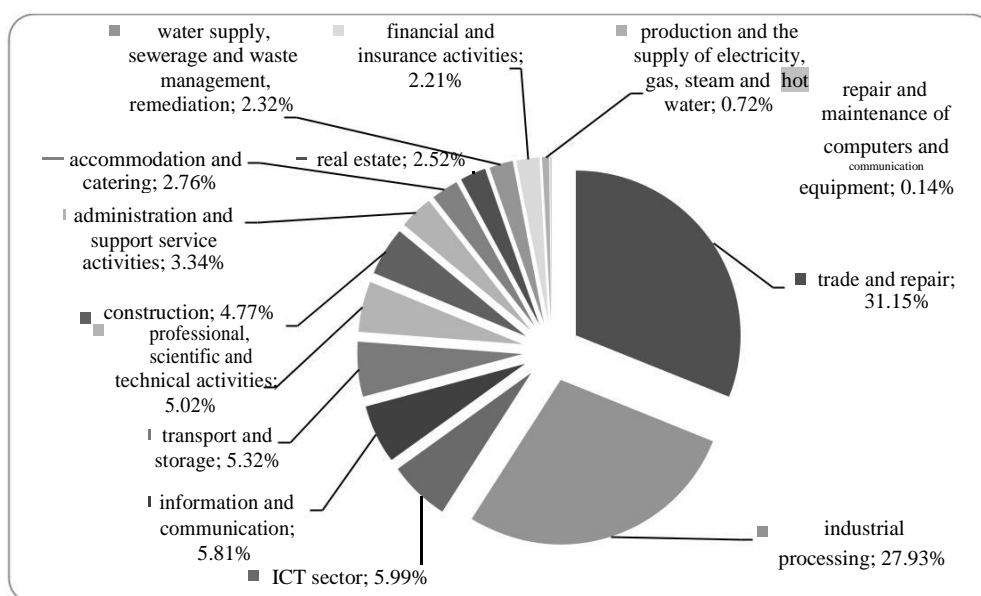


Fig. 2. The sectoral structure of the number of companies using CRM, software which allows the collection and storage of customer information as well as providing access to such information to other organizational units, to manage customer information in Poland in 2015

In the case of companies using CRM, software which allows the collection and storage of customer information as well as providing access to such information to other organizational units, to manage customer information enterprises from trade and repair sectors and industrial processing are the main users (59.08%).

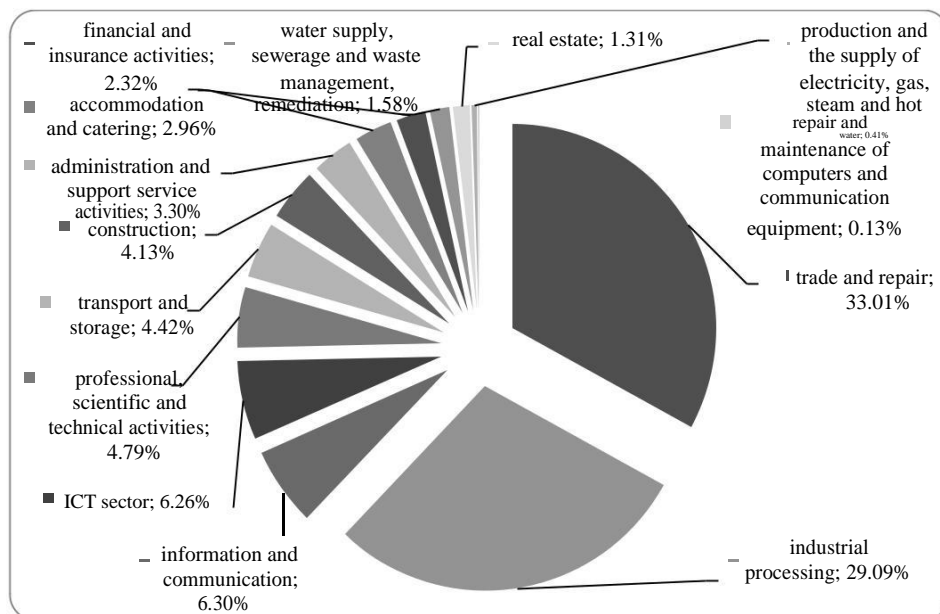


Fig. 3. The sectoral structure of the number of companies using CRM, software that allows analyzing customer information for marketing purposes, to manage customer information in Poland in 2015

When it comes to managing customer information, 62.10% of companies using CRM, software that allows analyzing customer information for marketing purposes (pricing, promotional actions management, defining distribution channels, etc.), to manage customer information belong to industrial processing and trade and repair sectors which seem to have a dominant position in the sector structure.

4.2. Structural and sectorial analysis of the use of CRM systems in the individual sectors of Polish economy

The benchmark area of the structural and sectorial analysis is Poland. Through the analysis we determined changes in the number of enterprises using CRM systems in management in individual sectors in comparison to the level of the use of computers in the whole country. The years 2012-2015 were analysed. The data come from database of the Central Statistical Office (GUS database, 2016). The shift-share analysis pointed the sectors where the CRM use tendencies were caused by the tendencies in the use of computers in the whole country. The results of the shift-share analysis are shown in table 2.

Table following on the next page

Table 2: Components of shift-share analysis for the number of companies using CRM in Poland in the period 2012-2015

Sector	Companies using CRM, software which allows the collection and storage of customer information as well as providing access to such information to other organizational units, to manage customer information				Companies using CRM, software that allows analyzing customer information for marketing purposes (pricing, promotional actions management, defining distribution channels, etc.), to manage customer information			
	The level of components			Real change	The level of components			Real change
	AAP	ES	AAC	TS	AAP	ES	AAC	TS
Industrial processing	388.35	2385.57	159.08	2933.00	312.93	1533.78	155.29	2002.00
Production and the supply of electricity, gas, steam and hot water	12.19	74.89	-38.08	49.00	7.15	35.03	-47.17	-5.00
Water supply, sewerage and waste management, remediation	30.52	187.48	45.00	263.00	14.38	70.47	55.16	140.00
Construction	94.42	579.99	-506.41	168.00	70.37	344.91	-439.29	-24.00
Trade and repair	470.82	2892.23	-542.05	2821.00	411.05	2014.68	-819.73	1606.00
Transport and storage	72.56	445.71	57.73	576.00	45.23	221.70	64.07	331.00
Accommodation and catering	20.93	128.60	346.46	496.00	19.67	96.43	231.90	348.00
Information and communication	64.15	394.07	350.78	809.00	46.66	228.71	408.63	684.00
Financial and insurance activities	46.33	284.57	-284.90	46.00	31.44	154.12	-102.56	83.00
real estate	34.81	213.82	19.37	268.00	9.67	47.39	84.94	142.00
Professional, scientific and technical activities	68.61	421.44	51.96	542.00	46.16	226.23	121.61	394.00
Administration and support service activities	44.90	275.79	48.31	369.00	36.57	179.26	-1.83	214.00
Repair and maintenance of computers and communication equipment	2.19	13.43	-2.61	13.00	1.77	8.65	-6.42	4.00
ICT sector	69.53	427.12	295.35	792.00	52.63	257.96	295.40	606.00
Total	1420.29	8724.71	0.00	10145.00	1105.68	5419.32	0.00	6525.00

Source: own calculations

The shift-share analysis concerning the number of companies using CRM, software which allows the collection and storage of customer information as well as providing access to such information to other organizational units, to manage customer information and for the number of companies using CRM, software that allows analyzing customer information for marketing purposes (pricing, promotional actions management, defining distribution channels, etc.), to manage customer information yielded similar results. In terms of systems for gathering and storing customer information, the number of businesses using CRM software in 2015 was

bigger than in 2012 by 10145, and similarly bigger by 6525 in the case of systems for managing information about customers in terms of customer information analysis for marketing goals, and the value of the actual shift was positive for all sectors in reference to enterprises using CRM software for gathering and storing customer information. Relatively speaking, according to the TS component value, the greatest potential of the increase of the number of enterprises using CRM systems was found in the sectors: industrial processing and trade and repair. The positive TS value was mainly due to the ES component whose highest values were observed in the sectors: industrial processing and trade and repair, and lowest in the sectors repair and maintenance of computers and communication equipment. The positive AAP value suggests that CRM systems use has a growing tendency by assuming the similar tempo of increase of the national development of computer use in enterprises. In fact, this increase was over seven times smaller than the increase in the use of CRM systems for gathering and storing customer information and almost six times smaller than the increase in the use of CRM systems for managing information about customers in terms of customer information analysis for marketing goals. The best developing sectors in terms of the number of companies using CRM systems at the same time had the least competitive position compared to the other sectors and to the country in terms of the analyzed variable. This situation is caused by the existence of sectors where the use of CRM systems is more advisable in the context of their characteristic processes.

4.3. Dynamics of change in the use of CRM systems in individual sectors of Polish economy

Enterprises strive to translate the potential of IT into specific areas of their activity to increase efficiency. Undoubtedly, CRM systems are critical for an efficient operation of companies. The dynamics of change in the use of CRM systems in individual sectors were analysed. Table 3 shows the average rate of change for different groups of enterprises divided according to their size and sector in the years 2010-2015.

Table 3: The average rate of change for the number of companies using CRM systems by size and sectors in Poland in the period 2010-2015

Specification	CRM systems for gathering and storing customer information	CRM systems for marketing purposes
Total	12.36%	10.37%
Small-sized companies	14.81%	11.99%
Medium-sized companies	8.52%	7.14%
Large-sized companies	7.38%	8.94%
Industrial processing	13.56%	12.23%
Production and the supply of electricity, gas, steam and hot water	5.14%	13.75%
Water supply, sewerage and waste management, remediation	18.23%	17.48%
Construction	6.73%	8.73%
Trade and repair	11.38%	7.19%
Transport and storage	17.45%	19.47%
Accommodation and catering	25.96%	18.60%
Information and communication	13.49%	13.19%
Financial and insurance activities	4.16%	8.35%
real estate	13.82%	15.14%
Professional, scientific and technical activities	9.80%	10.44%
Administration and support service activities	12.82%	7.89%
Repair and maintenance of computers and communication equipment	14.47%	5.98%
ICT sector	25.10%	25.32%

* The average rate of change was calculated for the period 2012-2015

Source: own calculations

The whole analysed period shows an annual average increase in the number of enterprises, classified both by size and sector, which supported their decision making processes with CRM systems. In the years 2010-2015 we observe a faster annual increase in the number of enterprises using CRM systems for gathering and storing customer information in comparison with the number of enterprises using CRM system for marketing purposes. As far as the change dynamics in enterprises according to size is concerned, the number of businesses using CRM systems grew fastest among small businesses. Annual average change rate for the medium and large enterprises using both systems was similar. When it comes to the CRM systems for gathering and storing customer information, the biggest increase was observed in the sectors: accommodation and catering and ICT, the smallest in the sectors: financial and insurance activities, production and the supply of electricity, gas, steam and hot water and construction. The biggest increase dynamics (measured with annual average change rate) of the number of enterprises using CRM systems for marketing purposes were observed in the sectors: ICT and transport and storage, the smallest on the other hand in the sectors: trade and repair and administration and support service activities. Sectors characterized by the biggest annual average rate of change are the ones connected with services and logistics. Surely, the type of activity positively influences the necessity for CRM systems in businesses and leads to the increase in the number of enterprises using IT systems for customer service management.

5. CONSLUSION

Information technology in enterprises helps adjust quickly to changing environment. Computer systems for decision-making make enterprises more flexible to market challenges. The need for the implementation of CRM systems supporting logistic processes, especially in terms of customer service, stems directly from the activity of the enterprise. The sector the company functions in determines the realized logistic processes, their level and advancement, and thus also the complexity and intensity of customer service. In the years 2010-2015 we observed an annual average increase in the number of enterprises using CRM systems. The biggest annual average increase took place among small enterprises and enterprises belonging to sectors rendering services, including logistic services. It is small businesses, therefore, that are developing fastest in this respect. Yet in Poland both systems are implemented mainly by medium and large enterprises. The size of an enterprise undoubtedly translates into the necessity and ability to implement CRM systems, and into the relation between the level of CRM use and the results of an enterprise. The scale and complexity of customer service in large and medium entities is much bigger than in small ones.

The results of the shift-share analysis indicate increasing trends in the number of companies using CRM software which allows the collection and storage of customer information as well as providing access to such information to other organizational units, to manage customer information and the number of companies using CRM software that allows analyzing customer information for marketing purposes (pricing, promotional actions management, defining distribution channels, etc.), to manage customer information. Relatively speaking, the sectors: industrial processing and trade and repair, which have the biggest number of enterprises using CRM systems, showed the best potential in terms of the analysed variables. These sectors, however, are characterised by smaller development in terms of the use of CRM systems compared to the development in terms of computer use in the whole country. This means the increase in the use of computer infrastructure in these sectors does not translate into an increase in the number of enterprises using CRM systems. And the need for CRM systems in these sectors is high. They are connected with the transformation of materials into new products, wholesale and retail sale which is the final stage of distribution, and rendering sale services including repairs. Therefore, automation and simplification of the dialogue with the customer will result in his increased satisfaction and loyalty.

LITERATURE:

1. Bojanowska, A. (2013). *Wpływ koncepcji CRM na działania marketingowe firmy*. Polityki Europejskie, Finanse i Marketing, Nr 9 (58), pp. 66-75.
2. Chang, H.H., Wong, K.H., Fang, P.W. (2014). *The effects of customer relationship management relational information processes on customer-based performance*. Decision Support Systems, vol. 66, pp. 146–159.
3. Chuang, S.-H., Lin, H.-N. (2013). *The roles of infrastructure capability and customer orientation in enhancing customer-information quality in CRM systems: Empirical evidence from Taiwan*. International Journal of Information Management, Vol. 33, pp. 271– 281.
4. Johnson, D.S., Clark, B.H., Barczak, G. (2012). *Customer relationship management processes: How faithful are business-to-business firms to customer profitability?* Industrial Marketing Management, Vol. 41, pp. 1094–1105.
5. Josiassen, A., Assaf, A.G., Cvelbar, L.K. (2014). *CRM and the bottom line: Do all CRM dimensions affect firm performance?* International Journal of Hospitality Management, Vol. 36, pp. 130– 136.
6. GUS database. (2016). Retrieved 11.07.2016 from <http://stat.gov.pl/obszary-tematyczne/nauka-i-technika-spoleczenstwo-informacyjne/spoleczenstwo-informacyjne/wykorzystanie-technologii-informacyjno-telekomunikacyjnych-w-przedsiębiorstwach-i-gospodarstwach-domowych-w-2015-r-3,13.html>.
7. Heidemann, J., Klier, M., Landherr, A., Zimmermann, S. (2013). *The optimal level of CRM IT investment. An economic model and its application at a financial services provider*. Electronic Markets, Vol. 23, pp. 73–84.
8. Kadłubek, M. (2012). *Polityka obsługi klienta w logistyce cz. 1*. Logistyka, Nr 3.
9. Kadłubek, M. (2010). *Logistyczna obsługa klienta w przedsiębiorstwach transportowo-spedycyjno-logistycznych (TSL)*. Logistyka, Nr 2.
10. Keramati, A., Nazari-Shirkouhi, S., Moshki, H., Afshari-Mofrad, M., Maleki-Berneti, E. (2013). *A novel methodology for evaluating the risk of CRM projects in fuzzy environment*. Neural Computing and Applications, Vol. 23, Suppl. 1, pp. S29–S53.
11. Khodakarami, F., Chan, Y.E. (2014). *Exploring the role of customer relationship management (CRM) systems in customer knowledge creation*. Information & Management, Vol. 51, pp. 27–42.
12. Knudsen, B.C. (2000). *Shift-share analysis: further examination of models for the description of economic change*. Socio-Economic Planning Sciences, Vol. 34, pp. 177-198.
13. Kott, I., Skibińska, W., Sukiennik K., Szczepanik T. (2015). *The use of computer systems tools for supporting innovation companies*. In B. Skowron-Grabowska (ed.), *Logistics and marketing determinants of enterprises management*, (pp. 88–97). Ostrava: Technical University of Ostrava.
14. Li, L., Mao, J.-Y. (2012). *The effect of CRM use on internal sales management control: An alternative mechanism to realize CRM benefits*. Information & Management, Vol. 49, pp. 269–277.
15. Milovic, B. (2012). *Application of customer relationship management (CRM) in agriculture*. Polish Journal of Management Studies, Vol. 6, pp.151-161.

16. Oba, T. (2001). *Competency of set analysis in CRM closed loop marketing*. Conceptual Modeling — ER 2001, Vol. 2224, pp. 604–606.
17. Olaszak, C., Bartuś, K., Billewicz, G. (2015). *Wykorzystanie systemów klasy CRM w działalności biznesowej przedsiębiorstw – wybrane wyniki badań*. Studia Ekonomiczne. Zeszyty Naukowe Uniwersytetu Ekonomicznego w Katowicach, Nr 232, pp. 178–192.
18. Persson, A., Ryals, L. (2014). *Making customer relationship decisions: Analytics v rules of thumb*. Journal of Business Research, Vol. 67, pp. 1725–1732.
19. Qi, J.-Y., Qu, Q.-X., Zhou, Y.-P. (2014). *How does customer self-construal moderate CRM value creation chain?* Electronic Commerce Research and Applications, Vol. 13, pp. 295–304.
20. Salloum, C., Ajaka, J. (2013). *CRM Failure to Apply Optimal Management Information Systems: Case of Lebanese Financial Sector*. Arab Economic And Business Journal, Vol. 8, pp. 16–20.
21. Santouridis, I., Tsachtani, E. (2015). *Investigating the Impact of CRM Resources on CRM Processes: a Customer Life-Cycle Based Approach in the Case of a Greek Bank*. Procedia Economics and Finance, Vol. 19, pp. 304–313.
22. Singh, S., Singh, S.K. (2011). *Creating value for businesses by providing CRM solutions: a case of Oracle CRM on demand*. Information Intelligence, Systems, Technology and Management, Vol. 141, pp. 101–109.
23. Skowronek, C., Sarjusz-Wolski, Z. (2003). *Logistyka w przedsiębiorstwie*. Warszawa: Polskie Wydawnictwo Ekonomiczne.
24. Steel, M., Dubelaar, C., Ewing, M.T. (2013). *Developing customised CRM projects: The role of industry norms, organisational context and customer expectations on CRM implementation*. Industrial Marketing Management, Vol. 42, pp. 1328–1344.
25. Šebjan, U., Bobek, S., Tominc, P. (2014). *Organizational factors influencing effective use of CRM solutions*. Procedia Technology, Vol. 16, pp. 459–470.
26. Thearling, K. (2009). *Data Mining for CRM*. Data Mining and Knowledge Discovery Handbook. Springer, pp. 1181–1188.
27. Wang, H. (2011). *How to stick to online consumers: CRM perspective*. In Y. Wu (ed.), *Computing and Intelligent Systems: International Conference, ICCIC 2011*. Wuhan, China, September 17-18 (pp. 224-231). Berlin Heidelberg: Springer-Verlag.
28. Wu, S.-I., Lu, C.-L. (2012). *The relationship between CRM, RM, and business performance: A study of the hotel industry in Taiwan*. International Journal of Hospitality Management, Vol. 31, pp. 276–285.
29. Zaccomer, G.P. (2006). *Shift-Share Analysis with Spatial Structure: an Application to Italian Industrial Districts*. Transition Studies Review, Vol. 13 (1), pp. 213–227.

CONCEPTUALIZATION OF GREEN HUMAN RESOURCE MANAGEMENT

Agnieszka Leszczynska

Maria Skłodowska Curie University

Lublin, Poland

agnieszka.leszczynska@poczta.umcs.lublin.pl

ABSTRACT

The objective of this paper is to explore green human resource management practices of organisations based on the existent literature. A survey of literature allowed the specification of functions that are realized within the GHRM framework as well as the dominant practices in this area. Furthermore, the article below discusses the conceptual model of GHRM based on the functions of “traditional” HR and the concept of a company’s “black box. The contribution of this paper lies in presenting the role of HRM function towards creating a green organisation as well as the current trends of green HRM practices.

Keywords: *green human resource management.*

1. INTRODUCTION: GHRM – scope and meaning

Papers on green marketing (Peattie 1992), green accounting (Bebbington 2001; Owen 1992), green retailing (Kee-hung *et al.* 2010), green supply chain (Brío, Fernández, Junquera, 2007), green finance (Watson, D’Annunzio, 1996), and green management in general are already a well established trend in literature but analyses of human resources management in the context of green management remain few and far between. With increasing numbers of studies on organisational greening (Marcus, Fremeth, 2009), it became clear that organisations needed the support of human resource practices, such as training, performance evaluation, and rewards, to implement greening (Daily, Huang, 2001; Govindarajulu, Daily, 2004). It is significant because the human resource plays a key role in the success or failure of an organisation’s efforts towards going green. HR function (HRM function) enables to align the policies of the organisation to the green goals and drives green practices to be ingrained in the organisation’s culture.

Green human resource management (GHRM) is defined as the HRM aspects of environmental management (EM). Another definition suggests that GHRM is the contribution of HRM policies and practices towards the broader corporate environmental agenda of protection and preservation of natural resources Prasad (2013). It is referred to all the activities involved in development, implementation and on-going maintenance of a system that aims at making employees of an organisation green (Opatha, Arulrajah, 2014). GHRM is therefore a practice aimed at transforming normal employees into green i.e. environment-friendly employees (Zoogah, 2011). The quoted definitions indicate that the area refers to the policies, practices and systems that make employees of the organisation green for the benefit of the individual, society, natural environment, and the business. The purpose of green HRM is to create, enhance and retain greening within each employee of the organisation so that he or she gives a maximum individual contribution. The foundation of GHRM lies in the assumption that HRM is critical to the success of environmental management and HRM concepts and practices can support its implementation. The significance of GHRM results from the fact that HRM plays a critical role in embedding environmental strategy, creating the skills, motivation, values and trust to achieve an environmental goals. Distinguished policies in the field of HR (recruitment, performance management and appraisal, training and development, employment relations and pay and reward) are considered as powerful tools for aligning employees with an organisation’s environmental strategy. One can hardly discuss green management without taking the employees into account. Daily and Huang (2001) state that each of the phases of an

environmental management system (from environmental policy to analysis of the results) requires the specific support of a human resource practice. Similarly Jabbour and Santos (2008) also stated that superior environmental performance outcome requires human resource practices that support the whole implementation and maintenance of environmental management systems in the organisations. The employees are the foundation in which the implementation of the more advanced green practices is grounded; they condition the improvement of environmental performance and development of green innovations. The readiness on the part of HR to champion sustainability at a strategic level may be lacking, as HR managers may not see themselves as strategic drivers of environmental initiatives. The positioning of “green” functions is the key to improving environmental management. In this context, it is necessary to associate systematic HR practices with the area of environmental management. The high level of inclusion with regard to environmental factors in the area of HR has a beneficial effect on the organisational culture, team formation and learning. It ensures long term health and sustainability of organisation’s internal and external stakeholders (Zoogah, 2011).

2. METHODOLOGY

Our analysis process includes categorizing and classifying the existing literature in GHRM (across the full range of HRM practices), using papers published in international journals. In the review we focus on those papers that report empirical findings or develop theoretical arguments for the environmental management–HRM relationship.

To ensure the required methodological rigor, this literature review employs the systematic process of content analysis (Lage Junior, Godinho Filho, 2010) that consists of four iteratively executed steps (Mayring, 2008):

- Step 1. Material collection: The material to be collected and the unit of analysis are defined and delimited. Our literature sample comprises English-speaking, peer-reviewed case-study papers on GHRM.
- Step 2. Descriptive analysis: Formal aspects of the material are assessed.
- Step 3. Category selection: Structural dimensions including the major topics of analysis and related analytic categories with detailed classifications of each structural dimension are selected to be applied to the collected material.
- Step 4. Material evaluation: The content of the papers is analyzed according to the structural dimensions and analytic categories to identify relevant issues and to interpret the results.

3. GREENING HRM PRACTICES

GHRM practices pertain to the program, processes and techniques implemented in the area of HRM with the view of limiting harmful and strengthening beneficial environmental impacts of the organisation. GHRM entails the performance of HRM tasks while also fostering environmental awareness, developing skill and promoting desirable pro-environmental attitudes. Making a HRM function green involves inclusion of policies, procedures, and practices which ensure right employee green inputs and right employee green performance of job. It involves both traditional human resource practices (recruitment, selection, performance evaluation, training, and rewards) (Jabbour et al., 2010) and new forms such as organisational culture (Gupta, Kumar, 2013), teamwork (Jabbour et al., 2013), and employee empowerment (Daily et al., 2012).

The point of reference for GHRM is definition of requirements in terms of green competencies, green attitude, green behaviors and green results, with the view of achieving environmental goals (Opatha, Arulrajah, 2014). The necessary competences relate to environmental knowledge and skills and their significance has been emphasized by numerous authors, e.g. Collier, Esteban (2007); Garavan et al. (2010); Sudin (2011). The right attitude entails positive

predisposition, approach to environmental problems in general. Green behaviour comprises voluntary pro-environmental actions of the employee (eg. shut down computer when not working instead of hibernating it, use natural light when working, buy organic food for parties) as well as obligatory behaviour - official requirement to be met by the employee. Such duties may include specific procedures to be followed by the employee to reduce wastage and remove wastes. Green results relate to pro-environmental performance, and specifically the employee's contribution to the same.

Job descriptions are the basis for human resource management in a company. Green job design is a specification of a number of environmental protection related task, duties and responsibilities (Wehrmeyer, 1996). Job descriptions or person (job) specifications may include technical, personal, environmental or social requirements. At times, companies will create specialist positions related directly to environmental protection. In that case the same concentrate exclusively on environmental management aspects of the organisations, whereas green competencies, environmental knowledge constitutes a special component in job specification. In the case of other positions, environmental aspects are simply added to the relevant job descriptions. Attracting talented personnel is one of the key challenges in HR. In creating environmental oriented workforce, companies are faced with two possible paths: 1) adapting the recruitment process, 2) providing required environmental protection related awareness, education, training and development to the existing workforce. In terms of cost efficiency, green recruitment proves more beneficial to the company. Enherd concludes that in terms of this process, companies tend to take advantage of their image of environmentally-friendly organisations and thus attract more environmentally aware candidates. Some companies integrate corporate environmental policy and strategies with the recruitment policy of the company. They emphasize the importance of the candidates' environmental awareness or express their preferences to recruit candidates who have competency and attitudes to participate in corporate environmental management initiatives. On the other hand, graduates and other job applicants pay attention to the environmental management practices and performance of companies and use such information when deciding where to apply. According to the 2007 poll on green employment conducted by MonsterTRAK.com⁵, 80% of young professionals were interested in working at a job that contributed positively to the environment and 92% of students and entry-level applicants showed preference to work for a sustainable firm (Odell, 2014). Another survey by the Carbon Trust also emphasizes the importance of green policies of a company as an important criterion for prospective employees. Findings of CIPD/KPMG⁸ survey of 1000 respondents show that 47% of HR professionals feel that strong green approach of firms will make employees prefer working for them and also 46% stated that having a green approach would help attract potential employees (Phillips, 2007). In an organisation active in the area of sustainable development, CSR will be viewed as more attractive and will hence be preferred by potential employees. Such developments are in line with signalling theory in recruitment and selection where, because of incomplete information in the recruitment process, candidates use organisational attributes, such as environmental image and reputation, to find clues about the firms' future intentions and actions. The perceived attractiveness is higher in the case of better qualified employees. As revealed in a 2007 research, high-achieving graduates judge the environmental performance and reputation of a company as a criterion for decision making when applying for jobs (Chartered Institute of Personnel and Development (CIPD). Environmental reputation will also matter more when recruiting younger staff employees. In the process of selection, the environmental concern and interest may provide additional criteria of evaluation (Renwick, 2013). When interviewing candidates environmental-related questions are asked by company. Green HRM also focuses on individual learning and the personal environmental competences of employees by setting up specific trainings and further education programs. Training is the primary source of information about

the company's carbon footprint, the implemented and planned environmental initiatives, and environmental management procedures. In the US, £300m has been invested in training for green jobs under the Obama administration (Barton, 2009). In some instances, certain organisations do specific green induction to their new recruits. They induct new employees about environmental orientation programs specific to their jobs. Zoogah (2011) suggests training new employees for systems and processes in place to enable waste reduction and energy conservation. Opatha adds incentivising green interpersonal citizenship behaviour of employees. In the case of already employed staff members, training need analysis by assessing the environmental knowledge and skills can help identify the training required in environmental management and thereby devise focused training modules. An analysis of training needs is the basis for developing a training program suited to the respective individual needs. Training goals include: learning or adapting environmental friendly best practices, providing environmental awareness, providing environmental education to employees. The main effectiveness indicator with respect to training is the acquisition of environmental knowledge, which combines more than one category of knowledge. Training may pertain to both theoretical and practical issues related to waste management, energy efficiency, consumption of natural resources, environmental laws, and codes of conduct. Jackson, Renwick, Jabbour, and Muller-Camen (2011) identify three green HRM training perspectives, from the basic premise of compliance, enabling the conformance in the areas of regulations and technicality, to raising employee awareness in relation to the corporate agenda and, finally, creating a shift in organisational culture. Absence of such training may hinder the performance of environmental goals. The training should also be addressed to the managerial staff. Indeed, environmental management is already an important part of management training at universities and MBA courses. At the same time, studies confirm that managerial attitudes and norms are seen to act as strong drivers for undertaking active EM behaviours (Marschal, 2005). Building the awareness of the managerial staff through supplementary training will result in more active involvement and readiness to propose new initiatives. Green performance appraisal (PA) covers topics such as environmental incidents, use of environmental responsibilities and the communication of environmental concerns and policy. Issues involved in environmental PA concern the need for managers to be held accountable for environmental management performance in addition to wider performance objectives. The main purpose of green reward is to incentivise and stimulate employee involvement. Compensation mechanism can be leveraged to drive employees to change their behaviour towards green performance. A variable pay element can be added to the compensation system for rewarding employees who portray green and environment-friendly behaviour linked to work performance. Snape provides the example of a British company whose ICI included environmental targets as part of their performance related pay assessment for senior managers (Snape *et al.*, 1994). Berrone and Gomez-Mejia's (2009) study on links between environmental performance and executive compensation in 469 US firms reveals stronger support for environmental performance being positively associated with CEO total pay. Tying remuneration to environmental performance means that the level of the same is dependent on this performance. It may be applied in managerial and specialist positions which require knowledge in the areas of environmental engineering, environmental laws, etc. The same is uncommon in the case of other personnel where a reward system usually proves more effective. Rewards may consist of e.g. paid vacations, time off and gift certificates (Govindarajulu, Daily, 2004), excellence awards, annual awards dinners to recognize exemplary behaviour in environmental management (Simms, 2007). In some companies, employees are non-financially rewarded (awards/special recognitions/honours/prizes) for their good environmental performance. The primary condition for the effectiveness of a reward system is that it is publicised and valued in the organisation, the rewards must also be attainable by any employee.

Ramus (2002) confirms that recognitions and financial incentives can be effective in motivating employees to generate eco-initiatives. The use of environmental rewards and recognition (such as daily praise and company awards) are seen to have a significant impact on employee willingness to generate eco-initiatives. It is therefore justified to introduce new rewards for originating and participating in environmental innovations. Rewards also provide incentives to encourage environmentally friendly behaviours. Employees will be more willing to partake in pro-environmental initiatives, which is important as pressure may in fact originate from this direction. Henriques and Sadorsky (1999) find organisations with more proactive environmental commitment profiles being positively associated with employees as a pressure source. Rothenberg (2003) points out two mechanisms which stimulate employee involvement in environmental management: a suggestion programme and problem solving circles. Encouraging employees to make suggestions for environmental management improvements boosts their involvement. The management's conscious efforts can help increase employee participation in decision making. On the other hand, employees will also be influenced by negative stimulation. Negative stimuli (warning, criticism or suspension) are likely to affect behaviour. It should be mentioned, however, that improvement in terms of practices is not guaranteed while involvement is inevitably bound to plummet. The evaluation of environmental performance attributable to a given employee poses a considerable challenge. Green results have the following two dimensions:

- 1) green innovations: new environmental initiatives (Ramus, Steger, 2000; Ramus, 2002).
- 2) green outcomes: number of hours of working with natural light or amount of reduction of electricity consumption and degree of achievement of specific environmental performance targets (Russo, Fouts, 1997; Rothenberg, 2003; Daily et al., 2009).

This requires relating the evaluation criteria to the environmental goals or performance of the organisation. It is also necessary to establish a system of environmental information to collect environmental performance data. The system may be integrated with performance appraisals of managers, employees. Calia et al. (2009) state that adequate evaluation based on the results of environmental projects (for example, reducing pollution) are critical to companies becoming more environmentally proactive. Other evaluation criteria may include the number of environmental incidents, involvement in eco-programmes, communication of the environmental programme. A good practice is to provide regular feedback to the employees to achieve environmental goals or improve their environmental performance. Another GHRM function entails shaping green employee relations. Renwick et al. (2008 and 2013) emphasises in this context the importance of union support. The support of trade unions for pro-environmental initiatives is secured through consultation and distribution of responsibility. Mentioned authors suggested certain green employee relations and union management practices. They include employee involvement and participation in green suggestion schemes and problem-solving circles, staff independence to form and experiment with green ideas, integrating employee involvement and participation into maintenance, employee help-line for guidance in green matters, tailoring green employee involvement schemes to industry/company standards, increasing line/supervisory support behaviours in environmental management, union-management negotiating to reach green workplace agreements, training of union representatives in respect of environmental management aspects, providing opportunities to the unions to negotiate with management about green workplace agreement.

Table 1. Selected GHRM practices

Recruitment and selection	Development	Remuneration	Evaluation	Employee relations
Environmental dimension as a duty in job description	Training needs analysis to identify green training needs of employees	Financial incentives to employees for their good green performance of job	Evaluate employee's job performance according to green-related criteria	Facilitating employee participation in green suggestion schemes
Green competencies as a special component in job specification	Familiarising new employees with greening efforts of the organisation	Non-financial rewards (recognitions praises)	Including environmental aspects in feedback information	Conducting a debate on possible solutions to the environmental problems of the organisation
The job descriptions specify the environmental reporting role and other environmental impact related roles	Training on environmental knowledge and skills			Acknowledging the unions as stakeholders in environmental management and parties to environmental negotiations
Communicate the employer's concern about greening through recruitment efforts	Induction programs showing green citizenship behaviour of current employees			
Selection of candidates based on environmental criteria				
The interview gauge the potential compatibility of the candidate with the company's green goals				

Prepared by the author on the basis of Opatha, Arulrajah (2014)

A separate category is constituted by solutions aimed at stimulating pro-environmental behaviours within the organisation. These rely primarily on the assumption that behaviour can be shaped both at the workplace and beyond it. The consumption model and lifestyle of an individual will significantly impact one's personal carbon footprint. Employees' private environmental performance is closely attached to their individual ways of living and their everyday behaviour (Reusswig, 1994; Söderholm, 2010). In this respect, green HRM policies that only focus on peoples' role as employees and their work-related behaviour are insufficient. In order to successfully promote an environmentally friendly and responsible use of resources at the workplace, green HRM needs to set up activities that support environmentally friendly behaviour at the workplace and in private life. Rashid, Wahid and Saad (2006) have documented that employees' participation in environmental management systems can spill over and influence environmentally responsible attitudes and behaviour in employees' private life.

Similar results can be achieved by:

- promoting environmentally friendly consumer behaviour,
- encouraging employees to bring in green ideas and experiences.

GHRM is not possible without a greener organisational culture (Gupta, Kumar, 2013; Jabbour, Santos, 2008), the environmental empowerment of employees (Daily et al., 2012) and the encouragement to form environmental teams (Jabbour et al., 2013; Daily et al., 2012). The cultural change should be directed towards deepening the values which facilitate long-term sustainability. The pro-environmental sentiments of employees ought to be strengthened by the organisational culture (Fernandez, Junquera, Ordiz, 2003; Harris, Crane, 2002) which ought to initiate pro-environmental activities and encourage innovations in this area. Green teams are used to solve environmental problems that can be used to generate ideas, resolve environmental management conflicts and foster environmental learning. Environmental teams may involve employees from the same department/area, different departments/ areas, or different companies both to analyze complex problems in environmental management and to implement more advanced environmental practices (Jabbour et al., 2013). Meanwhile, environmental empowerment is to strengthen participatory readiness by delegating powers and involving employees in decision making.

The solutions described above are only several examples of various available instruments capable of stimulating the employee's pro-environmental behaviour. Although directly related to human resources, the same are implemented within the framework of environmental management. The same confirms that focusing solely on HRM functions proves insufficient; GHRM requires a broader perspective.

4. GHRM Model

The presented GHRM practices can be grouped under five distinct categories (Yusliza, 2015): e-HRM, Work-life Balance (WLB), Corporate Social Responsibility (CSR), Green Policies, and Extra Care Program (Table 2). In turn, Muster and Schrader (2011) divide them into 4 groups je: information-based, service-based, finance-based and time-based instruments. Information based instruments are to facilitate dissemination of information through the use of leaflets, online blogs, suggestion schemes, problem solving groups, newsletter, Intranet. Additionally it is possible to arrange events and lectures on environmental issues. Service based instruments are to promote environmentally friendly consumption models. E.g. arrange centralized shopping for organic products, vegetable boxes, coffee or textiles. Finance-based instruments include special discounts for all services. An example of time-based reduction is the reduction of working time (reduced average hours per job, reduced average hours per person, year, reduced total hours per working life. As they tend to limit consumption expenditures, time-based instruments are seen as contributing to environmental protection.

Table 2. Selected GHRM practices

e-HRM	WLB	CSR	Green Policy	Extra Care
Sending online applications	Work from home	Making internal company	Organisational green policies	Discounts for green company offers
Creating recruitment templates	Time off for allowances	documentation online	Environmental management system	Parking spots for mothers with children
Management of circulation of HR documents	Day off for "overtime" done	Use of public transport and bikes		
Employee evaluation via a web browser	Bonuses for employees supporting families	Centralized orders of green products		
E-learning		Green cafeteria Green canteen		

GHRM is undoubtedly an organisational challenge. In order to make sure that the organisation gets right employee green inputs and right employee green performance of job, it is indispensable that HRM functions are adapted or modified to be green. Making a HRM function green involves inclusion of policies, procedures, and practices which ensure right employee green inputs and right employee green performance of job. Ideally it is possible to make each function green. The result will be an improvement in terms of individual performance, and consequently the environmental performance of the entire organisation (Figure 1).

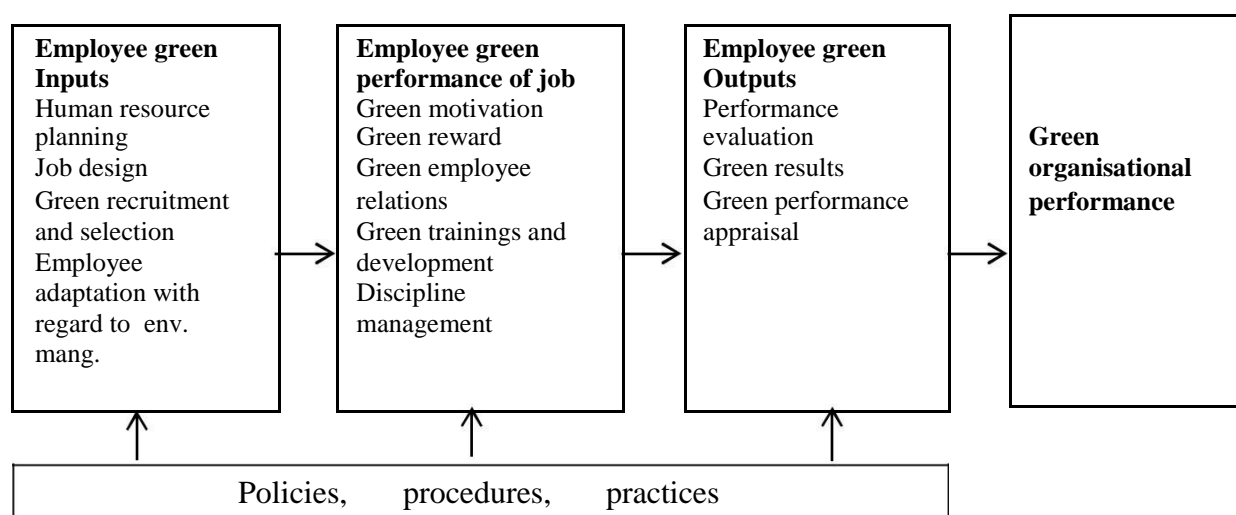


Figure 1. GHRM model

5. CONCLUSION

HRM has a considerable potential with regard to greening an organisation. Creating, practicing and maintaining environmental related innovative behaviours of employees coupled with right attitude of greening, requires the use of GHRM practices. The key challenge in front of HR professionals is to understand the scope and depth of green HRM in transforming their organisations as green entities. Understanding and implementing GHRM practices allow an organisation to shape the behaviours and beliefs of its employees, and consequently garner desirable environmental results. GHRM helps companies' sustainable performance. It is necessary to analyze how the proposed model could contribute to truly sustainable organisations.

LITERATURE:

1. Barton, R. (2009). Is the grass any greener? *The Independent on Sunday*, 15 November, 8–13.
2. Bebbington, J. (2001). Sustainable development: a review of the international development, business and accounting literature. *Accounting Forum*, 25, 128–157.
3. Brío, J.A., Fernández, E., Junquera, B. (2007). Management and employee involvement in achieving an environmental action-based competitive advantage: an empirical study. *The International Journal of Human Resource Management*, 18(4), 491-522.
4. Calia, R.C., Guerrini, F.M., de Castro, M. (2009). The impact of Six Sigma in the performance of a Pollution Prevention program. *J. Clean. Prod.* 17 (15), 1303-1310.
5. Carbon Trust (2006). Office Based Companies: Maximising Energy Savings in an Office Environment. Report No. CT007. London: Carbon Trust, 1–19.

6. Chartered Institute of Personnel and Development (CIPD) (2007). The environment and people management, Discussion web page.
7. Daily, B. F., Huang, S. C. (2001). Achieving Sustainability through Attention to Human Resource Factors in Environmental Management. *International Journal of Operations and Production Management*, 21, 1539-1552.
8. Daily, B.F., Bishop, J. W., Govindarajulu, N. (2009). Conceptual model for organisational citizenship behavior directed toward the environment. *Business & Society*, 48(2), 243–256.
9. Daily, B.F., Bishop, J.W., Massoud, J.A. (2012). The role of training and empowerment in environmental performance: a study of the Mexican maquiladora industry. *Int. J. Oper. Prod. Manag*, 32 (5), 631-647.
10. Douglas, W.S., Renwick, T.R., Maguire, S. (2013). Green Human Resource Management: A Review and Research Agenda, *International Journal of Management Reviews*, 15, 1–14.
11. Ehnert, I. (2009). *Sustainable HRM*. Heidelberg: Physica Verlag.
12. Fernandez, E., Junquera, B., Ordiz, M. (2003). Organisational Culture and Human Resources in the Environmental Issue: A Review of the Literature. *The International Journal of HRM*, 14(4), 634-656.
13. Garavan, T.N., Heraty, N., Rock, A., Dalton, E. (2010). Conceptualizing the Behavioral Barriers to CSR and CS in Organisations: A Typology of HRD Interventions. *Advances in Developing Human Resources*, 12(5), 587–613.
14. Govindarajulu, N., Daily, B. F. (2004). Motivating Employees for Environmental Improvement. *Industrial Management & Data Systems*, 104(4), 364-372.
15. Gupta, S., Kumar, V. (2013). Sustainability as corporate culture of a brand for superior performance. *J. World Bus.*, 48 (3), 311-320.
16. Haddock-Millar, J., Sanyal, Ch., Müller-Camen, M. (2015). Green human resource management: a comparative qualitative case study of a United States multinational corporation, *The International Journal of Human Resource Management*.
17. Harris, L., Crane, A. (2002). The Greening of Organisational Culture: Management Views on the Depth, Degree and Diffusion of Change. *Journal of Organisational Change Management*, 15(3), 214-234.
18. Jabbour, C.J.C. (2013). Environmental training in organisations: from a literature review to a framework for future research. *Resour. Conserv. Recycl.* 74 (1), 144-155.
19. Jabbour, C.J.C., Almada Santos, F.C., Fonseca, S.A., Nagano, M.S. (2013). Green teams: understanding their roles in the environmental management of companies located in Brazil. *J. Clean. Prod.*, 46, 58-66.
20. Jabbour, C.J.C., Santos, F.C.A. (2008). The central role of human resource management in the search for sustainable organisations. *The International Journal of Human Resource Management*, 19(12), 2133–2154.
21. Jackson, S. L. (1997). *The ISO 14001 Implementation Guide: Creating an Integrated Management System*. Hoboken: John Wiley & Sons.
22. Jackson, S.E., Renwick, W.S., Jabbour, C.J.C., Muller-Camen, M. (2011). State-of-the-Art and Future Directions for Green Human Resource Management: Introduction to the

- Special Issue. *German Journal of Research in Human Resource Management*, 25(2), 99–116.
23. Kee-hung, L., Cheng, T. Tang, A. (2010). Green retailing: factors for success. *California Management Review*, 52, 6–31.
24. Marcus, A., Fremeth, R. (2009). Green management matters regardless. *Acad. Manag. Perspect.* 23 (3), 17-26.
25. Marshall, M.E., Mayer, D.W. (1992). Environmental training: it's good business. *Bus. Horiz.* 2, 54-57.
26. Muster, V., Schrader, U. (2011). Green Work-Life Balance: A New Perspective for Green HRM, *Zeitschrift für Pers.*, 25(2), 140–156.
27. Odell, A.M. (2007). Working for the Earth: Green Companies and Green Jobs Attract Employees. <http://www.greenbiz.com>:
<http://www.greenbiz.com/news/2007/10/16/working-earth-green-companies-and-green-jobs-attract-employees>
28. Opatha, H.H. (2013), Green Human Resource Management: A Simplified Introduction, HR Dialogue, Department of HRM, Faculty of Management Studies and Commerce, University of Sri Jayewardenepura, 22-41.
29. Opatha, H.H.D.N.P., Arulrajah, A. (2014). Green Human Resource Management: A Simplified General Reflections, *International Business Research*, 7(8), 101-112.
30. Owen, D. (ed.) (1992). *Green Reporting: Accountancy and the Challenge of the Nineties*. London: Chapman & Hall.
31. Peattie, K. (1992). *Green Marketing*. London: Pitman.
32. Phillips, L. (2007). Go green to gain the edge over rivals. *People Management*, 13 (17), 9-23.
33. Prasad, R.S. (2013). Green HRM - Partner in sustainable competitive growth. *Journal of Management Sciences and Technology*, 1(1), 15-18.
34. Ramus, C. A. (2002). Encouraging Innovative Environmental Actions: What Companies and Managers Must Do. *Journal of World Business*, 37, 151-164.
35. Ramus, C.A., Steger, U. (2000). The roles of supervisory support behaviours and environmental policy in employee 'ecoinitiatives' at leading-edge European companies. *Academy of Management Journal*, 43(4), 605–626.
36. Rashid, N. R. N. A., Wahid, N. A., Saad, N. M. (2006). Employees Involvement in EMS, ISO 14001 and its Spillover Effects in Consumer Environmentally Responsible Behaviour. International Conference on Environment Proceedings (ICENV 2006), 13th-15th November 2006. Penang, Malaysia.
37. Renwick, D. (2008). Green HRM: A Review, Process Model, and Research Agenda. Discussion Paper Series. The University of Sheffield. from <http://www.shef.ac.uk/content/1/c6/08/70/89/2008-01.pdf>
38. Renwick, D., Redman, T., Maguire, S. (2008). Green HRM: A Review, Process Model, and Research Agenda. University of Sheffield Working Paper.
39. Reusswig, F. (1994). Lebensstile und Ökologie. Gesellschaftliche Pluralisierung und alltagsökologische Entwicklung unter besonderer Berücksichtigung des Energiebereichs. Frankfurt a.M.: IKO.

40. Rothenberg, S. (2003). Knowledge Content and Worker Participation in Environmental Management at NUMMI. *Journal of Management Studies*, 40(7), 1783–1802.
41. Russo, M.V., Fouts, P. A. (1997). A resource based perspective on corporate environmental performance and profitability. *Academy of Management Journal*, 40(3), 534–559.
42. Söderholm, P. (2010). *Environmental Policy and Household Behaviour: Sustainability and Everyday Life*. London: Earthscan.
43. Sudin, S. (2011). Strategic Green HRM: A proposed model that supports Corporate Environmental Citizenship. Paper presented at the International Conference on Sociality and Economics Development, IPEDR (10), IACSIT Press, Singapore.
44. Watson, S., D’Annunzio-Green, N. (1996). Implementing cultural change through human resources: the elusive organisation alchemy? *International Journal of Contemporary Hospitality Management*, 8(2), 25-30.
45. Wehrmeyer, W. (1996). *Greening People. Human Resources and Environmental Management*. Sheffield: Greenleaf Publishing.
46. Yusliza, M.Y., Othman, N.Z., Fernando, Y., Amran, A. (2015). Conceptualization of Green Human Resource Management: An Exploratory Study from Malaysian-based Multinational Companies, *International Journal of Business Management and Economic Research*, 6(3), 158-166.
47. Zoogah, D.B. (2011). The dynamics of green HRM behaviors: A cognitive social information processing approach. *Zeitschrift für Personalforschung*, 25(2), 117-139.

FACTORS AFFECTING ROAD TRANSPORT CARBON DIOXIDE EMISSIONS IN THE VISEGRAD GROUP: A PANEL COINTEGRATION APPROACH

Aneta Włodarczyk

Czestochowa University of Technology, Poland
ul. Dabrowskiego 69, 42-201 Czestochowa
Email aneta.w@interia.pl

ABSTRACT

This paper investigates the existence of the long-run relationship between transport carbon dioxide (CO₂) emissions and road transport energy consumption, economic growth, trade openness in the Visegrad Group countries over the period of 1992- 2012. The background of empirical research constitutes the Environmental Kuznets Curve (EKC) approach. Panel cointegration tests confirm the existence of the long-run relationship between CO₂ emissions in the transport sector and economic growth, but the results concerning the verification of the Environmental Kuznets Curve Hypothesis are inconclusive in the Visegrad Group countries. Moreover, the panel cointegration tests show the robustness of the EKC results on the inclusion of two important factors of transportation development, namely road transport-related energy consumption and trade openness, into the carbon dioxide emissions model.

Keywords: carbon dioxide emissions, energy consumption, Environmental Kuznets Curve, road transport, trade openness.

1. INTRODUCTION

Transport contributes to the increase of social, economic and spatial integrity of the country and strengthening given country's competitiveness on the international scene. Direct and indirect effects of transport's influence on economy include inter alia: increased efficiency of logistics processes in enterprises, increased spatial range of markets for the goods, creating conditions aiming at decreasing prices through mitigating negative impact of space on the cost level of goods manufacturing and services, mobilizing innovative activities in the scope of renewable energy sources use and an increase of fuel efficiency in the transport sector, satisfying communication needs of people (Neider, 2008, p. 33; Rydzikowski, Wojewódzka-Król, 2009, p.3). In other words transport enables efficient allocation of raw materials, natural resources and produced goods, as well as supports citizens' mobility. A growing demand for transport services may be caused among others by the growing activity of economic entities, rapid urbanization, the change of people's standard of life connected with the increase of disposable income and rapid growth in the number of private vehicles (Skowron-Grabowska, Sukiennik, Szczepanik, 2015, pp.1-4). The increase of transport activities leads to the energy consumption rising, what truly means the increase in both fossil fuel consumption and greenhouse gases (GHG) emissions into the atmosphere (Saboori, Sapri, Baba, 2014, pp. 150-155). Eurostat indicates that transport sector was responsible for 60% of all oil consumption in 2013. Even gradual increase of bio-fuels share as compared to conventional fuels has not changed the fact that a serious problem of transport development is its dependence on fossil fuels and its harmful impact on the environment. According to the Eurostat transport sector accounts for around a quarter of the GHG emissions, what makes it the second biggest greenhouse gas emitting sector after energy in the European Union. Since 2008 GHG emissions from transport sector have started to decrease, however in 2012 it still was 20.5% above 1990 levels. This means that harmful air emissions from transport sector would have to significantly fall by 2050 in order to fulfill the principal target GHG reduction for transport sector of 60% compared to 1990 baseline (EU Transport in Figures – Statistical Pocketbook 2015).

Taking above into consideration the aim of this study is to identify the common macroeconomic factors affecting carbon dioxide emissions from transport sector in the Visegrad Group countries over the period 1992 - 2012. The Visegrad Group was constituted by the Czech Republic, Hungary, Poland and Slovakia in 1991 in order to encourage the development of democratic rules and free-market economy in post-Soviet European countries. The cooperation among the Visegrad Group countries concerns inter alia the internal EU politics, energy security, environmental protection and sustainable economic development in this region. The process of gradual liberalization of foreign trade associated with the flexibility increase of the exchange rate regime, which began after the fall of the Iron Curtain, contributed to the development of transport activity in these countries. The inflow of the EU funds that were intended for the expansion and modernization of the transport infrastructure, constituted another positive impulse for the transport development. Moreover, the accession to the European Union and trade openness have caused the changes in the structure of fleet of passenger cars and lorries in these countries (Ministry of Foreign Affairs Republic of Poland, 2016). This shows the importance of analyzing the dynamic linkages among CO₂ emissions, energy consumption in transport sector, economic growth and trade openness effect for the Visegrad Group countries. The empirical research concerns the investigation of the long-run relationship between carbon dioxide emissions from transport sector and GDP in accordance with the Environmental Kuznets Curve (EKC) hypothesis by means of panel cointegration method. Additionally, the robustness of the results is studied by incorporation into the EKC equation two exogenous variables: road transport-related energy consumption and trade openness. It is worth stressing that papers devoted to analyzing of dynamic linkages among income, energy consumption and carbon dioxide emissions in transport sector in the sense of the EKC hypothesis are scarce. Most frequently analyses of the EKC hypothesis validity for transport sector are carried out for individual countries (Abdallah, Belloumi, Wolf, 2013, pp. 34-43; Azlina, Law, Hashim, Mustapha, 2014, pp. 598-606; Mraihi, Abid, 2014, 109-126; Xu, Lin, 2015, 311-322).

2. PANEL EKC MODEL

The basis of this paper constitutes the EKC hypothesis which assumes the non-linear nature of the relationships between environmental degradation and economic growth (Dinda, 2004, pp. 431–455). To be more precise, according to this hypothesis there is an inverted U-shaped relationship between carbon dioxide emissions from the transport sector and the GDP per capita. This means that carbon dioxide emissions grows in case of developing countries, but after achieving a certain level of economic growth CO₂ emissions decreases despite the fact that the GDP per capita still grows. In the classical approach the long-run relationship between CO₂ emissions from transportation activity and economic growth is described according to the Environmental Kuznets Curve Hypothesis as follows (Papież, 2013, p. 697; Piłatowska, Włodarczyk, Zawada, 2014, p. 52):

$$\ln(CO_2) = \alpha_0 + \alpha_1 GDP + \alpha_2 GDP^2 + u_{it} \quad (1)$$

where: CO₂ – carbon dioxide emissions from transport sector (per capita), GDP – real gross domestic product (per capita), $i = 1, \dots, 4$ denotes the country and $t = 1, 2, \dots, T$ denotes the time, α_0 – fixed country effect, α_1 , α_2 – the long-run elasticities of CO₂ emissions with respect to income and squared income, u_{it} – error term.

It is worth stressing that the expected sign of α_1 parameter is positive, whereas the sign of α_2 parameter is expected to be negative in order to confirm positive verification of the EKC hypothesis. This means that the inverted U-shaped curve with the turning point ($=$

In the EKC literature the more sophisticated functional form, which enables to capture the impact of both energy consumption and trade openness on environmental degradation, is also taken into consideration (Halicioglu, 2009, p.1158):

$$\ln(CO_2) = \alpha_0 + \alpha_1 E + \alpha_2 TO + \alpha_3 \ln(E) + \alpha_4 \ln(TO) + \dots \quad (2)$$

where: E – road transport energy consumption (per capita), TO – trade openness indicator, α_3 , α_4 – the long-run elasticities of CO₂ emissions relative to energy consumption and trade openness respectively.

According to literature studies, the increase of energy consumption may cause the increase of scale of economy and consequently CO₂ emissions increase, so the expected sign of α_3 is positive. The expected sign of α_4 is mixed depending on the country's attitude to the environmental protection issues. The increase in trade openness may be conducive to the increase in transportation activity which coupled with aging means of transport, unresolved "empty runs" issues, congestion problem cause the increase of air pollution by exhaust fumes in case of lower income countries (positive sign of α_4 parameter). For the case of countries with restrictive environmental protection laws and higher income level, α_4 sign is expected to be negative as these countries invest in modernization of transport infrastructure and introduce technological innovations in cars' industry (Halicioglu, 2009, pp.1156-1158; Farhani, Shahbaz, Arouri, 2013, pp. 2-4).

Panel cointegration methodology is often used for the EKC hypothesis verification due to the lack of sufficiently long time series data. The empirical study begins with the investigation of stationarity properties of individual series in panel datasets. For this purpose panel unit root tests are employed, which differ one from another by the assumption about cross-section dependence or independence, heterogeneous or homogeneous unit roots. Namely, Levin-Lin-Chu (LLC) and Breitung tests assume that there is a common unit root process so that the persistence parameters are common across cross-sections. In turn, Im, Pesaran and Shin (IPS) and Fisher-type tests using both Augmented Dickey-Fuller specification and Phillips-Perron specification (Fisher-ADF, Fisher-PP) enable the persistence parameters varying freely across cross-sections, so all of these tests allow for individual unit root processes. The null hypothesis in each test assumes the nonstationarity of panel variables (Maddala, Wu, 1999, pp. 631–652; Choi, 2001, pp. 249–272; Im, Pesaran, Shin, 2003, pp. 53–74; Levin, Lin, Chu, 2002, pp. 1-24). In case of confirmation that each of the variables contains a panel unit root, the existence of the long-run relationship (1) or (2) is examined by means of the Pedroni panel cointegration tests (Pedroni, 2004, pp. 597- 625). The null hypothesis of no cointegration is verified based on both panel cointegration tests and group mean panel cointegration tests. The first set of tests contains 'the within dimension statistics' that pool the autoregressive coefficients across different countries in order to conduct residuals unit root tests. The second set of tests contains

'the between dimension statistics' which are based on averages of the individual autoregressive coefficients associated with the unit root tests of the residuals for each country (Farhani, Shahbaz, Arouri, 2013, pp. 8-10).

3. EMPIRICAL RESULTS

Annual data for this analysis was collected from World Development Indicators (WDI)¹ and for the reason of the time series availability for the Visegrad Group countries, the sample period ranges from 1992 to 2012. Following Sabori, Sapri, Baba (2014), the data used in this study consist of CO₂ emissions from transport sector (CO_{2t}; in metric tons per capita)², real gross domestic product (GDP_t; constant 2005 US dollars per capita), road transport energy

¹ <http://data.worldbank.org/indicator> (accessed 03.02.2016).

² CO₂ emissions from transport contain emissions from combustion of fuel for all transport activity, regardless of the sector, except for international marine bunkers and international aviation.

consumption (E_t ; in kg of oil equivalent per capita)³, trade openness which is used as a proxy for foreign trade (in %)⁴. All variables are expressed in natural logarithms in order to stabilize variance and to obtain the carbon dioxide emissions elasticities of income, energy consumption and trade openness for transport sector. The results of the most of unit root tests presented in Table 1 indicate at the non-stationarity of logarithmic times series data and stationarity of their first differences, so one may conclude that each variable is integrated of order one (I(1)).

Table1: Panel unit root tests – results for the Visegrad Group countries (own calculation)

Type of test	lnCO2	lnGDP	ln ² GDP	lnE	lnTO
Levels of the variables					
LLC	-0.251	0.962	0.720	1.020	-0.121
Breitung	-0.941	1.631	1.529	-0.446	1.124
IPS	1.673	-0.343	-0.668	0.1694	1.090
Fisher-ADF	2.050	12.158	14.233	6.514	4.473
Fisher - PP	1.871	1.908	2.085	4.239	4.432
First differences of the variables					
LLC	-5.295	-4.140	-4.174	-0.784	-7.412
Breitung	-1.893	-1.657	-1.635	0.278	-4.678
IPS	-6.378	-3.372	-3.457	-2.514	-5.778
Fisher-ADF	48.556	25.040	25.668	29.432	39.978
Fisher - PP	85.592	20.742	21.455	297.146	47.601
Decision	I(1)	I(1)	I(1)	I(1)	I(1)

Note: *, **, *** denote statistical significance respectively at the 10%, 5%, 1% level. Schwarz Information Criterion (SIC) is used for lag selection.

Given that each variable is integrated of order one, in other words contains a panel unit root, the Pedroni panel cointegration tests are computed in order to confirm the existence of the long-run relationship (1) or (2). The estimates for the within and between dimension panel cointegration test statistics are reported in Table 2.

Table2: Panel cointegration tests for the EKC model – results for the Visegrad Group countries(own calculation)

Group countries(own calculation)			
Type of test	I EKC model –test statistic		II EKC model – test statistics
Pedroni tests - within dimension panel cointegration test			
Panel ν -statistic	0.918	(0.179)	0.406 (0.342)
Panel rho- statistic	-1.442	(0.075)	-0.298 (0.383)
Panel PP- statistic	-2.566	(0.005)	-2.585 ... (0.005)
Panel ADF- statistic	-3.132	(0.001)	-2.635 ... (0.004)
Pedroni test - between dimension panel cointegration test			
Group rho- statistic	-0.591	(0.277)	0.466 (0.679)
Group PP - statistic	-2.699	(0.003)	-2.757 ... (0.003)
Group ADF - statistic	-3.907	(0.000)	-4.023 ... (0.000)

Note: p-value in parentheses.

For both specifications of the long-run relationship the results of Pedroni cointegration tests are similar. In most cases, the null hypothesis of no cointegration is rejected at the 5% significance level, except for the tests based on the panel ν -statistic, panel rho-statistic and group rho-statistic. Taking into account Pedroni's remark that these three test statistics are negligible for short periods (Papież, 2013, p. 699), the general conclusion is that there is a long-run

³ Road transport energy consumption is the total energy used in the road sector including petroleum products, natural gas, electricity, combustible renewable and waste.

⁴ Trade openness is measured as the percentage share of the total value of real exports and imports of goods and services in real GDP (constant 2005 US dollars).

equilibrium relationship between carbon dioxide emissions and economic growth as well as between carbon dioxide emissions and economic growth, energy consumption, trade openness in transport sector.

Having confirmed the existence of cointegrating relationship according to the specification (1) and (2), the EKC parameters' estimates, which are obtained with the use of the FMOLS method, are the subject of further analysis (see Table 3 and 4).

Table 3: FMOLS estimation results – I EKC model for the Visegrad Group countries (own calculation)

Country	Constant	lnGDP	ln ² GDP	Adjusted R-squared
Czech Republic	-267.076 (0.000)	55.469 (0.000)	-2.875 (0.000)	0.908
Hungary	0.881 (0.966)	-1.628 (0.718)	0.167 (0.501)	0.963
Poland	35.637 (0.003)	-9.151 (0.001)	0.575 (0.000)	0.950
Slovakia	-68.509 (0.005)	13.769 (0.008)	-0.688 (0.013)	0.912
Panel	-74.767	14.615 (0.000)	-0.705 (0.000)	

The estimates of the long-run parameters are statistically significant at the 5% level for each country, except Hungary, but their signs allow the positive verification of the existence of the inverted U-shaped relationship between carbon dioxide emissions and income only in case of the transport sector in the Czech Republic and Slovakia ($\alpha_{1i} > 0$ and $\alpha_{2i} < 0$). For the Czech Republic the elasticity of transport related CO₂ emissions per capita with respect to the real GDP per capita in the long-run is 55.469 – 5.75lnGDP with the threshold income value of 15471.93 USD. It is rather a high value of income compared to the sample range of real GDP per capita which ranged from 9094.61 up to 15170.15 USD. The above mentioned elasticity for Slovakia amounts 13.769-1.376lnGDP, implying the threshold income of 22171.01 USD, which is significantly higher than the maximum income of 15222.69 USD, which was reached by Slovakia during the analyzed period. The case of Poland shows that the development of the long-run relationship between air pollutions emissions from the transport sector and economic development is not consistent with the Environmental Kuznets Curve Hypothesis. It is worth stressing that for two of the Visegrad Group countries where the EKC hypothesis is not rejected, the problem of the location of the threshold income value appears. Moreover, the FMOLS estimation results presented in Table 3 are supportive of the EKC hypothesis in the Visegrad Group region, which means that carbon dioxide emissions increased with the economic development at the beginning, then CO₂ emissions started to decrease after the threshold value of income had been reached. All the panel coefficients are significant and have the expected signs. The elasticity of transport related CO₂ emissions per capita with respect to the real GDP per capita in the long-run is 14.615 – 1.41lnGDP with the threshold income value of 31737.31 USD. It appears to be an inverted U-shaped relationship between transport-related carbon dioxide emissions per capita and the real GDP per capita in Visegrad Group treated as a whole. It is worth emphasizing that although panel cointegration tests confirm the existence of the long-run relationship between CO₂ emissions in transport sector and economic growth, the results concerning the verification of the Environmental Kuznets Curve Hypothesis are inconclusive in the Visegrad Group countries. It is caused by the problem of the position of the threshold income value compared to the level of real GDP reached by each country or the inappropriate signs of parameters in the model (1).

Table 4: FMOLS estimation results –II EKC model for Visegrad Group countries (own calculation)

Country	Constant	lnGDP	ln ² GDP	lnE	lnTO	Adjusted R-squared
Czech Republic	-224.962 (0.000)	46.242 (0.000)	-2.377 (0.000)	0.334 (0.004)	-0.306 (0.033)	0.907
Hungary	23.872 (0.230)	-6.443 (0.141)	0.393 (0.101)	0.307 (0.003)	0.080 (0.029)	0.965
Poland	15.337 (0.057)	-4.653 (0.014)	0.255 (0.013)	0.866 (0.000)	0.199 (0.018)	0.998
Slovakia	-75.357 (0.000)	14.724 (0.000)	-0.818 (0.000)	1.060 (0.000)	0.656 (0.000)	0.960
Panel	-75.080	12.470 (0.000)	-0.637 (0.000)	0.646 (0.000)	0.158 (0.000)	

The FMOLS estimation results for the second specification of the long-run equilibrium model are robust to the inclusion of two additional variables, namely road transport energy consumption and trade openness. The signs and significance level of the coefficients related to income or squared income are rather the same as in the first specification of the long-run equilibrium model. Thus, the EKC model is positively verified in case of the Czech Republic, Slovakia and the Visegrad Group. It is worth stressing that the inclusion of road transport energy consumption and trade openness into carbon dioxide emissions function caused the decrease of the income threshold value in case of Slovakia and the panel of countries, so it became more realistic compared to the level of the real GDP reached in the analyzed period. The new threshold value for the Czech Republic, Slovakia and the Visegrad Group as a whole amounts to 16763.63 USD, 8103.084 USD, 17819.86 USD respectively. Regarding the influence of energy consumption on carbon dioxide emission in transportation activity, the FMOLS estimates are not unexpected. The results in Table 4 shows that a 1% increase in road transport related energy consumption per capita increases carbon dioxide emissions per capita, derived from transportation activity, approximately by 0.334% in the Czech Republic, by 0.307% in Hungary, by 0.866% in Poland, by 1.060% in Slovakia and by 0.646% in the Visegrad Group. For each country and for the panel of countries the elasticity parameter of transport CO₂ emissions related to road transport energy consumption is positive and statistical significant at 1% level. In general, the long-run energy consumption by road transport leads to an increase in scale of economy and stimulates transport related CO₂ emissions. Additionally, it has been found that a 1% increase in foreign trade caused the increase of carbon dioxide emissions from transport sector in each country, except the Czech Republic, and in the Visegrad Group as a whole. All of the elasticity coefficients of CO₂ emissions related to trade openness are statistically significant at 5% level. It may mean that the opening to the world of Hungary, Poland and Slovakia after the disintegration of the socialist bloc and in particular their accession to the EU was conducive to the increase in import of used cars and trucks from the richer EU countries (see Figures 1 and 2). Out of all analyzed Visegrad Group countries, Poland was characterized by the highest share of passenger cars older than 10 years (70.7% in 2012), while the same indicator equaled to 54.2% in case of the Czech Republic. Poland occupied the similar place in the ranking of the Visegrad Group in terms of the age of lorries and road tractors, because 61.6% of them in 2012 were older than 10 years. The Czech Republic was placed in the best position in this ranking due to the value of aging lorries indicator of 34.6%.

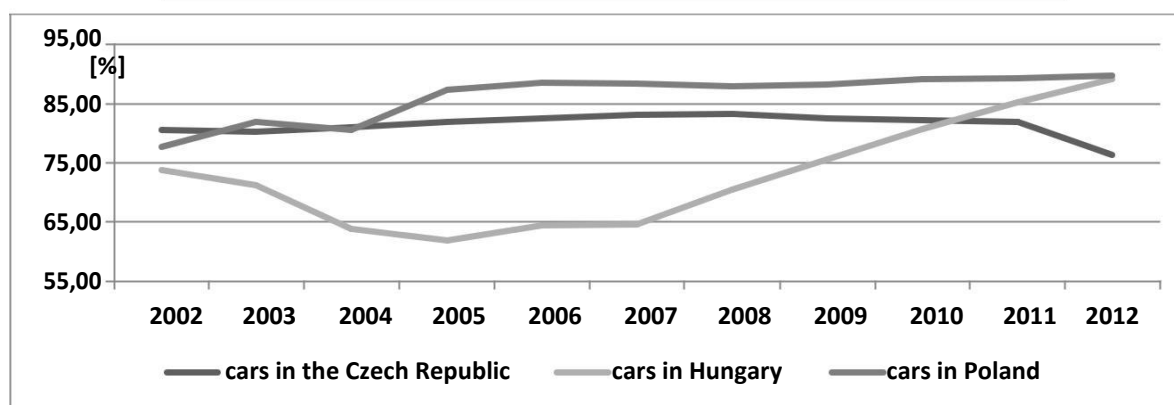


Figure 1: Share of over 5 years old vehicles in total number of passenger cars in the Visegrad Group countries (own work based on Eurostat, <http://ec.europa.eu/eurostat/web/transport/data/database> (accessed 12.04.2016))

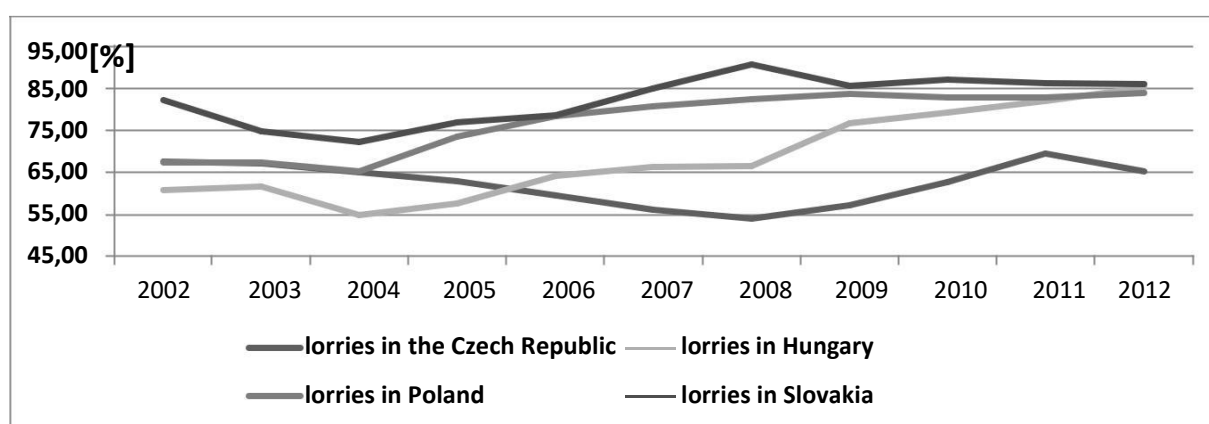


Figure 2: Share of over 5 years old vehicles in total number of lorries and road tractors in the Visegrad Group countries (own work based on Eurostat, <http://ec.europa.eu/eurostat/web/transport/data/database> (accessed 12.04.2016))

The ageing of transport means, which was accompanied by the growth of transportation needs as a consequence of fast economic development, undoubtedly contributed to the increase of carbon dioxide emission in the transport sector. This effect was additionally strengthened by weak environmental regulations.

In other words, Hungary, Poland, Slovakia were characterized by rather dirty transportation activity, with significant share of GHG emissions in total emissions at the country level, which may be indirectly explained by the comparative advantage theory under trade liberalization conditions (Jayanthakumaran, Verma, Liu, 2012, pp. 450-460). The growth of second-hand cars import from Western Europe, which was perceived as more luxurious and better equipped than domestically produced ones, caused that car markets in these countries became filled with second hand-cars of well-known global brands, which had not been available to the citizens of these countries due to the economic policy of the former communist bloc. A side effect of this process was a drop in the number of new cars registrations.

4. CONCLUSION

In this study, the EKC hypothesis in relation to the transportation activity has been verified for the Visegrad Group countries over the period 1992-2012, by employing panel data approach. Panel cointegration tests confirm the existence of the long-run relationship between CO₂ emissions from the transport sector and economic growth, but the results concerning the verification of the Environmental Kuznets Curve Hypothesis are inconclusive in the Visegrad

Group countries. The FMOLS estimates of the long-run parameters allow to conclude about existence of the inverted U-shaped relationship between carbon dioxide emissions and income only in case of the transport sector in the Czech Republic, Slovakia and the Visegrad Group treated as a whole. Although the estimated long-run coefficients of real GDP per capita and its square have the expected signs, the income turning points are very high in comparison to income level in the sample range, and therefore, poor evidence in support of the EKC hypothesis was found. Moreover, the panel cointegration tests show the robustness of the EKC results on the inclusion of two important factors of transportation development, namely road transport-related energy consumption and trade openness, into the carbon dioxide emissions model. It is worth stressing that adding these two exogenous variables into the environmental function caused the decrease of the income threshold value in case of Slovakia and the Visegrad Group countries. In each case, the elasticity parameter of carbon dioxide emissions related to energy consumption is statistically significant and positive, which means that an increase in transport energy consumption leads to an increase in economy scale and to enlarged environmental degradation on account of transportation activity. Additionally, the empirical results provided evidence on the increase of carbon dioxide emissions from transport sector in Hungary, Poland and Slovakia under the influence of the increase in foreign trade connected with the disintegration of the socialist bloc and liberalization of international trade conditions. Therefore, in order to limit a negative impact of the transport sector on the environment in the Visegrad Group a variety of government incentives to mitigate carbon dioxide emissions might be recommended (Mesjasz-Lech, 2016, pp. 623-630; Skowron-Grabowska, 2014, pp. 25-27; Kowalik, 2014, pp. 12220-12225): an increase of energy efficiency in the transport sector through development of intermodal transport in cargo transport, an increase of the share of environmentally-friendly means of transport (vehicles and buses using fuel cells and hydrogen and the ones propelled by electricity, gas, hybrid, compressed air), implementing innovative systems of traffic and transport management in particular branches of transport (ITS – road transport, ERTMS – rail transport, SESAR – air transport, VTMS – sea transport, RIS – inland waterway transport), decarbonisation of fuels and supporting purchases of more environmentally-friendly vehicles by public subjects, organizational and system solutions which aim at decrease of transport congestion, particularly in urban areas.

LITERATURE:

1. Abdallah, K. E., Belloumi, M., Wolf, D. D. (2013). Indicators for sustainable energy development: A multivariate cointegration and causality analysis from Tunisian road transport sector. *Renewable and Sustainable Energy Reviews*, 25, 34-43.
2. Azlina, A. A., Law, S.H., Hashim, N., Mustapha, N. (2014). Dynamic linkages among transport energy consumption, income and CO₂ emission in Malaysia. *Energy Policy*, 73, 598-606.
3. Breitung, J. (2000). The Local Power of Some Unit Root Tests for Panel Data. *Advances in Econometrics*. 15. Nonstationary Panels. Panel Cointegration and Dynamic Panels. Amsterdam: JAI Press. 2000. pp. 161-178.
4. Choi, I. (2001). Unit root tests for panel data. *Journal of International Money and Finance*, 20, 249-272.
5. Dinda, D. (2004). Environmental Kuznets Curve Hypothesis: a Survey. *Ecological Economics*, 49, 431-455.

6. European Commission (2015): *EU Transport in Figures –Statistical Pocketbook 2015*. Retrieved 22.05.2016 from <http://ec.europa.eu/transport/facts-fundings/statistics/doc/2015/pocketbook2015.pdf>.
7. Farhani, S., Shahbaz, M., Arouri, M.E.H. (2013). *Panel analysis of CO2 emissions, GDP, energy consumption, trade openness and urbanization for MENA countries*. MPRA Paper no. 49258. Retrieved 22.05.2016 from <http://www.mpra.ub.uni-muenchen.de/49258>.
8. Halicioglu, F. (2009). An Econometric Study of CO₂ Emissions. Energy consumption. income and Foreign Trade in Turkey. *Energy Policy*, 37, 1156–1164.
9. Im, K. S., Pesaran, M. H., Shin, Y. (2003). Testing for unit roots in heterogeneous panels. *Journal of Econometrics*, 115, 53–74.
10. Jayanthakumaran, K., Verma, R., Liu, Y. (2012). CO₂ emissions. energy consumption. trade and income: a comparative analysis of China and India. *Energy Policy*, 42, 450-460.
11. Kowalik, J. (2014). Logistyczne uwarunkowania rozwoju transportu drogowego w Polsce (Logistics conditions of the development of road transport in Poland). *Logistyka*, 6, 12220-12225.
12. Levin, A., Lin, C. F., Chu, C. S. J. (2002). Unit root tests in panel data: asymptotic and finite-sample properties. *Journal of Econometrics*, 108, 1–24.
13. Maddala, G. S., Wu, S. (1999). A comparative study of unit root tests with panel data and a new simple test. *Oxford Bulletin of Economics and Statistics*, 61, 631–652.
14. Mesjasz-Lech, A. (2016). *Directions of Changes in the Sustainable Development of Transport in Poland in the Context of European Integration*. Ostrava: 3rd International Conference on European Integration 2016, 623-630.
15. Ministry of Foreign Affairs Republic of Poland. Retrieved 22.05.2016 from http://www.ms.gov.pl/en/foreign_policy/europe/visegrad_group.
16. Mraihi, R., Abid, M. (2014). Energy and CO₂ emissions efficiency: evidence for the Tunisian transport sector. *World Review of Science. Technology and Sustainable Development*, 2. vol. 11, 109-126.
17. Neider, J. (2008). *Transport międzynarodowy* (International transport). Warsaw: PWE.
18. Papież, M. (2013). *CO₂ emissions, energy consumption and economic growth in the Visegrad Group countries: a panel data analysis*. Retrieved 10.03.2016 from <http://www.katstat.uek.krakow.pl/wp-content/uploads/2014/06/C0-2-emissions-energy-consumption-and-economic-growth.pdf>.
19. Pedroni, P. (2004). Panel cointegration: Asymptotic and finite sample properties of pooled time series tests with an application to the PPP hypothesis. *Econometric Theory*, 20, 597- 625.
20. Piłatowska, M., Włodarczyk, A., Zawada, M. (2014). The Environmental Kuznets Curve in Poland: Evidence From Threshold Cointegration Analysis. *Dynamic Econometric Models*, 14, 51-70.
21. Rydzikowski, W., Wojewódzka-Król, K. (2009). *Transport: Problemy transportu w rozszerzonej Unii Europejskiej* (Transport: Problems of transport in the enlarged European Union). Warsaw: PWN.

22. Saboori, B., Sapri, M., Baba, M. (2014). Economic growth, energy consumption and CO₂ emissions in OECD (Organization for Economic Co-operation and Development)'s transport sector: A fully modified bi-directional relationship approach. *Energy*, 66, 150-161.
23. Skowron-Grabowska, B. (2014). Problems of Managing Transportation Systems in Urban Areas. *Logistyka*, 5, 25-27.
24. Skowron-Grabowska, B., Sukiennik, K., Szczepanik, T. (2015). *Growth of Transport Industry and Economic Development in Poland*. Miskolc: The Publications of the MultiScience –XXIX MicroCAD International Multidisciplinary Scientific Conference (CD-ROM).
25. Xu, B., Lin, B. (2015). Factors affecting carbon dioxide (CO₂) emissions in China's transport sector: a dynamic nonparametric additive regression model. *Journal of Cleaner Production*, 101, 311-322.

IMPACT INVESTING – OPPORTUNITY FOR CREATIVE INVESTMENT

Daniela Majercakova

*Faculty of management, Comenius University in Bratislava,
Slovakia daniela.majercakova@fm.uniba.sk*

Lucia Kocisova

*Faculty of management, Comenius University in Bratislava,
Slovakia lucia.kocisova@fm.uniba.sk*

ABSTRACT

Innovative financing instruments complement traditional international resources flows such as aid, foreign direct investments and remittances to mobilize additional resources for development and address specific market failures and institutional barriers. Innovative financing is essential tool as the development of the community drives to eliminate poverty, raise living standards and protect the environment. The impact investment community has been expanding rapidly. Given the breadth of the impact investing market, there are significant and varied opportunities for investors working across asset classes and with a wide range of risk/return expectations to address some of the world's most pressing problems through their investment activities. Some individuals and organizations have already embarked on impact investing. Others are just starting out. Eager to learn more and start their impact investing journey, they want to find new ways to put their money to work for the things they care about. As for individual investors, the reasons for making impact investments vary widely, for many, the opportunity to make a difference locally is a strong motivating force. For the other individuals, impact investing is a logical extension of goals they have pursued in other aspects of their lives. Some investors are drawn to impact investing by the idea of helping to get an innovative start-up off the ground in a developing country and others are drawn to impact investing by its emphasis on innovation. The aim of this paper is to describe and analyse impact investing from the perspective of creativity in development of social behaviour of investors combined with new ways of investing opportunities.

Keywords: *creativity, development, impact investing, opportunity, resources.*

1. INTRODUCTION

Innovative financing mean different things to different people. Innovative financing is the manifestation of two important trends in international development. (1) an increased focus on programs that deliver results

(2) a desire to support collaboration between the public and private sector.

Within the vision, innovative financing provides resources that are stable, predictable and supplemental to official development assistance from donor countries. Innovative financing is not a financial innovation. It encompasses a broad range of financial instruments and assets including securities and derivatives, result-based financing and voluntary contributions. Established financial instruments, such as guarantees and bonds, constitute nearly 65% of the innovative financing market; while new products dominate in many conversations about innovative financing, most resources mobilized through innovative financing use existing products in new markets or involving new investors. From this, we can argue, that our definition of innovation of financial market is not about bringing a new market space, but bringing new products and opportunities for a wide range of investors to financial markets. Successful innovative financing instruments address a specific market failure, catalyse political momentum

to increase and coordinate the resources of multiple governments and offer contractual certainty to investors.

Innovative financing is critical for creating opportunities for public-private sector collaboration that will help address global challenges. However, we can argue that governments, international institutions and private actors recognize the magnitude of this challenge. They have begun to understand the limitations of existing approaches to international assistance and have made efforts to improve aid effectiveness and engage the private sector through agreements such as the 2005 Paris Declaration on Aid Effectiveness or 2011 Busan Partnership for Effective Development Cooperation.

2. INNOVATIVE FINANCING

The innovative financing landscape is showing a shift from basic resource mobilization tools to a diverse range of solution-driven financing instruments. Description of the market considers three dimensions of existing innovative financing instruments:

- (1) Type of instruments
- (2) Characteristics of the innovation
- (3) Financial function.

14 different types of the innovative instruments are frequently classified as innovative finance instruments. From this perspective we should introduce products in categories:

- a) Securities and derivatives – such a Bonds and Notes, Guarantees, Loans, Microfinance Investment Funds, other Investment Funds and other Derivative products;
- b) Result-based Financing, such an Advanced market commitments, Award and Prizes, Development Impact Bonds, Performance-based contracts and Dept-swaps and buy-downs;
- c) Voluntary contribution – such a Carbon Auctions (voluntary) and Consumer Donations;
- d) Compulsory charges –taxes

All of these types of innovative instruments meet two basic needs – innovative element (new product, new market or new participant) and development support element (mobilize resources, financial intermediations or deliver resources). From this perspective we should conclude that innovation is in the eye of the beholder. Innovative financing is innovative when it deploys proved approaches to new markets, introduces novel approaches to establish problems or attracts new participants to the market. Innovative financial market is still evolving. Some models have proven to be successful, some are ripe for scaling and others are still new ideas in the testing stage, for example as a start-up. Proven models, such as guarantees and bonds, have easily replicated and scaled structures benefiting from clear standards for assessing risk and determining payment terms, many have established track records. Models that are ripe for scaling such as performance-based contracts are also easily to create, but do not have enough performance data to establish a mature asset class. Newer ideas, such a Development Impact Bonds, are still being developed and will require substantial support from concessional donors before they can attract private capital and scale beyond the pilot stage.

3. IMPACT INVESTMENTS

Impact investments are intended to deliver financial returns together with social and environmental benefits. Although investing directly in socially motivated companies or projects, they might require experience and knowledge. The existence of funds and other intermediary vehicles that pool investments in underlying companies means that anyone can

engage in this form of investing. The rise of impact investing comes in a critical moment. Catastrophic environmental trends have created an imperative to mitigate the effects of climate change. Alarming levels of global youth unemployment demand heavy investment to help vulnerable individuals to launch careers or become entrepreneurs. A new way of young professionals is entering workforce, bringing with them alternative ideas about the role of business in the world. In fact, in recent years, more and more questions have been arising about the nature of capitalism itself and whether its current practice really serves our society and the planet. It is hardly surprising that impact investing is attracting the interest of everyone from bankers to philanthropists and to private individuals. Here is a new way of deploying capital that can combine the demand for profitability with a desire to solve social and environmental problems. The question of investment impact is of obvious importance for investors who want to make a difference. Although we do not reject the possibility of earning market-rate financial returns while achieving social impact, we are sceptical about how much of impact investing market actually fits this description. Having impact implies causation, it depends on the idea of the counterfactual – on what would have happened if a particular investment or activity had not occurred. The enterprise itself has impact only if it produces social outcomes that would not otherwise have occurred. And for an investment or nonmonetary activity to have impact, it must increase the quantity of the enterprise's social outcomes beyond what would otherwise have occurred. Perhaps the oldest form of impact investing itself is microfinance. For more than 30 years, the practice of making small loans to the world's poorest people has proved a powerful tool in the battle to eradicate poverty. Meanwhile, in the United States, the Community Reinvestment Act in 1977 created a network of community development financial institutions (CDFIs) to provide mortgages and other financial services to communities underserved by mainstream banks. Alongside these seeds of the impact investing industry, the philanthropic sector has been looking to business for way of making a greater impact. Part of this has meant embracing some of the outcome-oriented principles and practices of the business sector, as in the case of venture philanthropy. In 2007 the Rockefeller Foundation convened a group of investors, entrepreneurs and philanthropists at its Bellagio Conference Centre in Italy. Participants were asked what would enable them and others to put more capital to work for social and environmental benefit. By the end of the meeting, the term impact investing had been coined. Impact investors are members of a diverse community of individuals and organizations, all of which want to tap into the power of business models to provide new solutions to social and environmental problems. So how exactly does impact investing differ from other investments and models that seek to make a positive impact on people and the planet? Generally speaking, impact investing sits on a continuum with Socially Responsible Investing on one side and venture philanthropy on the other one. Socially responsible investing (SRI) is a form of capital deployment in which a financial return is expected but that incorporates social or environmental values into investment decisions. SRI investors and fund managers have traditionally excluded companies or sectors that are too risky, but more recently SRI has expanded to embrace positive performance by integrating environmental, social or governance factors into the long-term financial analysis of a company.

4. INVESTMENT IMPACT

While impact investing shares some ground with form of capital deployment, it represents a powerful additional tool in the battle to improve lives and solve some of the world's biggest problems. However, the distinctions between impact investing and other types of social investments are not always clear. The Impact Reporting and Investment Standards (IRIS), Global Impact Investment Rating System (GIIRS) provide standardized metrics for assessing some common output criteria. However, these focus more on an enterprise's operations than on its products. With rare exceptions – most notably, the field of microfinance – there have been

few efforts to evaluate the actual outcomes of market based social enterprises. The absence of data and analysis makes it difficult for impact investors to assess the social impact of the enterprises they invest in.

We should use classification of six P's for summarized kinds of capital benefits that impact investors can provide:

- (1) Price;
- (2) Pledge;
- (3) Position;
- (4) Patience;
- (5) Purpose;
- (6) Perspicacity.

The first five are particularly relevant to investments that expect below-market returns. The sixth may hold the key to achieving both market returns and social impact.

For the investors interested and searching for opportunity to impact investing it is mostly important that, at the heart of impact investing there is a presence of dual objectives – the desire to achieve actively the positive social or environmental results as well as financial ones. On the other hand, impact investing may creatively complement philanthropy and be used by philanthropists, but it is not philanthropy – unlike grants impact investments are made with an expectations of financial return. Impact from impact investments should be seen as a positive investment made in an enterprise that has the potential to solve a specific problem or deliver a particular service while also turning a profit or at least becoming financially self-sustaining. Working group established under the UK's presidency of the G8 calls on all participant in the impact investing to measure the ecosystem to:

- (1) Embrace impact accountability as a common value that lies at the heart of all impact
- (2) Apply measurement best practices across impact portfolios, deals, and investee organizations
- (3) Establish an “impact language” and data infrastructure that enables the application of these practices
- (4) Evolve the field through continued learning and the advancement of a shared impact measurement agenda.

In a world where this vision for a robust impact measurement convention has become a reality, the value that is generated through impact measurement is clear and undisputed. The integrity of the impact investing market will be well understood, signalling the promise for a new level of accountability that transparency in global capital markets.

Because impact measurement demonstrates an investor's true intent to have a positive impact, it is central to the practice of impact investing. Without it, effective impact investing cannot occur. Done, right, impact measurement can:

- (1) Generate intrinsic value for all stakeholders in the impact investing ecosystem.
- (2) Mobilize greater capital to increase the amount of aggregate impact delivered by impact investing
- (3) Increase transparency and accountability for delivering on intended impact.

An impact investment must constantly balance the dual imperative of generating positive social impact and profit. Some impact investment business models, especially those employing high-volume, low-cost approaches are able to drive financial return and social impact together with impact and profit correlation as the business expands. However, it would be naive to believe that these two imperatives have never been in tension. Indeed, within the microfinance sector, some concerns about mission drift are already beginning to appear. In addition to having different reasons for measuring impact participants in the impact investing, the industry will use the measured data in different ways. Companies want to understand, track and report their social performance, and compare their performance with that of their peers. Fund managers also need a system for managing the variety of social performance information they receive from their portfolio companies. In defining measures of social impact, these standards must find the line between the level of detail that is too onerous to collect and one that is too superficial to be useful. A common language for social performance metrics will encourage transparency, credibility and comparability, just as the International Financial Reporting Standards provide transparency and comparability across financial performance reports. The standards included metrics related to the social aspects of business operational practices as well as of its products and services. The standards are overseen by an independent governance body that provides guidance towards the ongoing advancement of the framework and ensure its alignment with existing best practices.

5. IMPACT INVESTING ECOSYSTEM

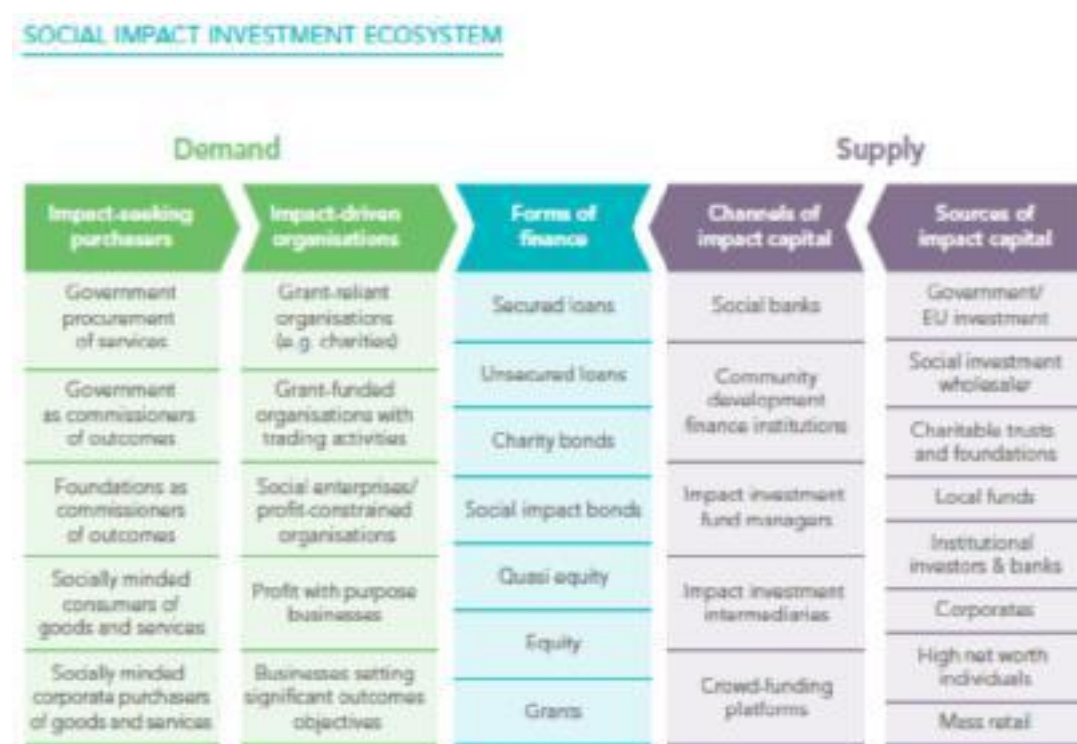


Figure: Social impact investment ecosystem (*Impact investment: The invisible Heart of Markets*, 2014)

From the perspective of schematic overview of the ecosystem related to the policy options available to governments some areas are outlined into the Social impact investment ecosystem's diagram (diagram 1 at next page). The principal components are:

- Impact-seeking purchasers: those provide the sources of revenue that underpin investment in impact-driven organizations. Such purchasers can include governments, consumers, corporations or foundations.
- Impact-driven organizations: all types of organizations which have a long-term social mission, set outcome objectives and measure their achievement, whether they are social sector organizations or impact-driven businesses.
- Forms of finance: which are needed to address a range of different investment requirements
- Channels of impact capital: to connect investors to impact-driven organizations in situations where the sources of impact capital do not invest directly in impact-driven organizations.
- Sources of impact capital: to provide the investment flows needed.

6. IMPACT INVESTORS

With large as well as small investors participating, it is becoming clear that impact investing is no longer a minor actor on the stage of asset management or social impact.

As an impact investor, you are part of a diverse and dynamic community made up of individuals and organizations with varying degrees of financial resources and experience, a diversity of goals and objectives and differences in their approaches to investing.

For individual investors, the reasons for making impact investments vary widely. For many, the opportunity to make a difference locally – in the place where they live, work, have accumulated their wealth or are already active as philanthropists - is a strong motivating force. If supporting your local community is high in your agenda, you may proactively identify and craft local investment opportunities as nobody else did. Before other individuals, impact investing is a logical extension of goals they have pursued in other aspects of their lives.

Some investors are drawn to impact investing by the idea of helping to get an innovative start-up off the ground in a developing country. With enterprises scattered across the globe and often tiny in scale, doing this alone is extremely difficult for an individual investor or family office. Navigating the relevant legal issue and identifying terms that meet the needs of both investors and entrepreneurs can be particularly challenging. In this case, investors can might turn to a network or wealth advisers for help or may seek actively to raise additional capital in order to defray administrative costs.

7. CONCLUSION

Many of investors are drawn to impact investing by its emphasis on innovation. Individuals and family offices are diverse in their approaches to impact investing for some, this is a new tool helping them to achieve a social or environmental goal, and often it may be built many years on philanthropy, volunteer service or civic engagement in that area. For others impact investing is a way of using their wealth and to contribute to positive change in the world while generating the income they are looking for. Innovation often results in ideas that are applied by company in order to further satisfy the needs and expectations of the customers. Even when companies focus on tackling a single issue, the complex nature of poverty and social change may mean that their impact is multifaceted. The range of investment opportunities available to impact investors is broad and growing. Such opportunities are diverse by impact objective, asset class and return expectations, and by many other parameters. With the growth of the community of

impact investors new questions come. Are there enough impact enterprises out there to absorb this new mission-driven investment capital? The danger, which we can see is that if the supply is insufficient, money might find its way into too many enterprises that ultimately fail and in turn create the risk that impact investing itself might be deemed a failure. Alternatively, investors might become frustrated and give up when they do not find a ready supply of investable opportunities.

While impact investors provide the capital, it is these enterprises that can turn that capital into innovative products or create financially sustainable business models that deliver everything from health care and education to clean energy and forest conservation. Assessing the social and environmental performance of these investments can be complex. To advance impact investing, therefore, robust measurement system is essential. After all, smart investors would demand detailed feedback on the for-profit companies in which they invested – as impact investor. To be the part of this exciting new investment ecosystem, investors will need a range of resources and creativity for combine them together with their needs and preferences.

LITERATURE:

1. Rodin, J. – Brandenburg, M. (2014) *The power of impact investing*. Philadelphia: The Rockefeller Foundation.
2. J. P. Morgan Global Research (2010). Impact Investments. An emerging asset class.
3. Majerčáková, D. (2015). Social entrepreneurship as challenge for Slovak social system. In: ACRN Journal of Finance and Risk Perspectives 4(1).
4. Majerčáková, D. (2015) The impact of social enterprises in the terms of social innovations, Proceedings of 25th IBIMA conference, Madrid.
5. Westley, F., & Antazde, N. (2010). Making a difference: Strategies for scaling social innovation for greater impact. *The Innovation Journal: The Public Sector Innovation Journal*, 15, 3-20
6. Philips, W., Lee, H., Ghobadian, A., O'Regan, N. & James, P. (2014). Social Innovation and Social Entrepreneurship: A Systematic Review. doi: 10.1177/1059601114560063. Retrieved February 20, 2015, from <http://gom.sagepub.com/content/early/2014/12/05/1059601114560063.full.pdf+html>.

THE TAX SYSTEM AS A GENERATOR OF ECONOMIC INEQUALITY IN CROATIA

Dunja Skalamera - Alilovic

*Faculty of Economics, University of Rijeka, Croatia
skalamer@efri.hr*

Ivan Rubinic

*Faculty of Law, University of Rijeka, Croatia
irubinic1@pravri.hr*

ABSTRACT

A tax system stands out as the vital instrument in a contemporary economy. Apart from being the medium for fulfillment of fiscal goals, taxes can be used for a wide spectrum of non-fiscal goals, of which the most relevant is influence on income redistribution and the creation of a righteous society. Despite this importance, the system faces a problem which arises from an economic reality and manifests in the fact that, contrary to theory, practice knows not of optimal taxation. The aforementioned generates significant implications and creates practical limitations for achieving economic growth in a modern country and, consequently, society as whole. The aim of this paper is to perceive, detect and alter the characteristics of a tax system which create income and wealth inequality. An analysis had been conducted on the Croatian tax system, which was used to show how structure can provide incentive for creating and maintaining the persistent inequality. The results have shown that the effects of negative tax practices on inequality, in recent history, are still existent and untackled. The organization of tax rates is not working toward the direction of a “positive” distribution of the tax burden.

High shares of regressive taxes in Croatian budget are proof of the system’s departure from the equality principle. From the taxation aspect, capital income enjoys a privileged status when being compared to labor income. An obligation to pay lower corporate tax, instead of higher income tax, is being forced by lawmakers. The system suffers from loopholes that can be used for tax evasion and many categories are either not a subject of taxation, or their status is inadequate. Acknowledging theory and using empirical analysis of economic practice, it can be concluded that the Croatian tax system creates and deepens inequality and acts in favor of preserving a wide gap between contradictory societal structures. The latter confirms the necessity of tax system reform, taking into account the aims of curbing inequality and carrying out a righteous distribution of the tax burden with a simultaneous, efficient redistribution of collected assets.

In order to achieve stability and create a base for future growth, the fulfillment of goals recognized under the scope of this paper need to be considered in the context of a societal priority.

Keywords: *Croatia, inequality, regressive taxation, tax system.*

1. INTRODUCTION

The Great Recession brought to the surface what was seemingly an outdated but, relevant economic problem. The market failure sparked daily debates regarding the justification of a wide wealth gap, management of the poorest members of society, and the government’s role in curbing the negative effects of the market.

The rising economic inequality threatened to confirm the thesis that the capitalistic society is inherently unstable. In addition, it created the need to find adequate models of governance, with final aim to obstruct the overgrowth of the “seed of destruction”, or the inequality that can threaten stability and question the efficiency of the capitalist society.

Recognizing economic inequality¹ as an ominous and destabilizing factor of economic activity is the focus of this paper, where the key determinant of the fiscal apparatus, the tax system, will be analyzed regarding the creation of economic inequality.

The research will be conducted using the Croatian tax system within the research question “Does the existing system lead to generating, expanding, and sustaining inequality?”

The aim of the paper is to confirm the hypothesis that the Croatian tax system does not follow principles of horizontal and vertical equality, but it creates, widens, and maintains inequality. Therefore, this tax system is *de facto*, working in favor of economic inequality, which makes its social role highly questionable.

This paper uses normative approach, providing a synthesis of existing literature and its applications to this specific case. Using conventional methods, a series of supporting hypotheses will be confirmed through induction, and will defend the central hypothesis.

The research is structured in six sections. After the INTRODUCTION, the foundation of the paper (which provides information on existing conditions and reviews of past research) is covered in the sections TRENDS AND STRUCTURE OF INEQUALITY IN CROATIA and TAX SYSTEM AND INEQUALITY. The fourth section, IMPACT OF THE CROATIAN TAX SYSTEM ON INEQUALITY, deals with the analysis of the tax rate structure, distribution of the tax burden, regressive taxation, taxation of labor, capital, assets, as well as other categories relevant to the hypothesis. The fifth section, TAX SYSTEM IMPROVEMENTS AND LIMITATIONS IMPOSED BY GLOBALIZATION, covers the advancement of the tax system towards decreasing inequality, as well as globalization that, as an exogenous factor, limits the creators of national policies and forces them to an international convergence toward high levels of inequality. The sixth and final section, CONCLUSION, provides a synthesis of this research, in which the central hypothesis is defended.

2. TRENDS AND STRUCTURE OF INEQUALITY IN CROATIA

A review of inequality, due to the multidimensional nature of the matter, needs to be conducted beyond the frame of conventional quantitative indicators. Such an approach is necessary in order to distance oneself from measurements of conventionally accepted methods, whose outcome is potentially dubious. Therefore, the authors approach the problem from two aspects. The first is a restricted analysis of conventional methods and the second introduces various indicators which will build on the aforementioned methods and point out the magnitude of economic inequalities within Croatia.

According to Poverty Measurements for 2014 (DSZ, 2015), the “at risk of poverty” rate in Croatia was 19%, the quintile share ratio (S80/S20) was 5.1, and the Gini coefficient was 30.2%². These categories show an identical pattern in the period 2009-2014. It is reflected in rising inequality from 2009-2010, after which a gradual downsizing of inequality occurs. Regarding inequality, compared to the countries of the European Union, Croatia reflects the European average and, due to the minimum deviation throughout the analyzed period, it can be described as stagnating inequality.

Eurostat (2016) data shows that Croatian unemployment rate in 2015 was 16.3%, long term unemployment was 10.3%, youth unemployment surpassed 40%, and the share of recipients working for minimum wage was 9.2% of the total economically active population.

¹ The stand of the authors is that certain levels of inequality are desirable, from the aspect of creating incentive as a catalyst for economic activity. However, the existence of extremely high levels of inequality, which is the current practice in many countries, cannot be justified using economic reasoning.

² Until 2009, inequality and poverty measurements were conducted on the basis of the Household Consumption Survey. Following that, the Citizens Income Survey was implemented. The methodological difference prevents a detailed analysis of inequality trends and limits research to short-term analysis.

On September 5, 2015, 7,706 physical entities had debt higher than 100,000 HRK, 3,729 legal entities had debt higher than 300,000 HRK, 71,824 other tax payers had debt higher than 15,000 HRK (Tax Administration, 2015), and 328,532 citizens, or 7.67% of population, had frozen accounts (FINA, 2016).

Deposits are highly concentrated and 20% of investors have 94% (163 billion HRK) in deposits, while 13% of savings account holders possess 67% of all deposits (60% of time deposits). The former indicates a significant inequality, which is supported by the Gini coefficient, showing index values above 0.8 (Croatian National Bank, 2016).

Forbes (2014) examination shows that the richest quintile of Croatian citizens has, at their disposal, 96% of the wealth. Croatia had three billionaires and 250 millionaires, while at the same time more than 10,000 people were recipients of the Guaranteed Minimum Compensation provided by the Ministry of Social Politics and Youth (2014). The source of 95% of the total assets (2.7 billion HRK) intended for social care in 2014 was provided by the State Budget. This amount equates to 80% of the estimated net worth of the richest Croatian citizen, not taking into account his two most profitable enterprises. According to the Tax Administration, 156 people collect a monthly income above 100,000 HRK. In 2014, the highest income, based on tax returns, was 7.7 million HRK. A report from FINA (2013) states that the top 20 entrepreneurs, according to their highest paid average net monthly salary, were paying salaries above 21,400 HRK. In first place was the company ADRIS GRUPA, paying the immense amount of 52,533 HRK.

Based on the preceding information, if Croatia wants to accomplish secure, harmonized growth and development, and achieve an acceptable life standard for the average citizen, the importance of curbing economic inequality becomes indisputable.

3. TAX SYSTEM AND INEQUALITY

Taxes, as the price of a civilized society³, are the main income of the state apparatus responsible for the functioning of contemporary countries and, precisely for this reason its necessity is not being questioned. From the beginning of economics as a science, questions regarding taxes preoccupied the minds of lead economists. Hence, the founder of economics, Adam Smith (1776) states, “The subject of every state ought to contribute toward the support of the government, as nearly as possible, in proportion to their respective abilities; that is in proportion to the revenue, which they respectively enjoy under the protection of the state.”

Following the same logic, Article 51 of the Croatian Constitution states⁴, “Everyone shall participate in the defrayment of public expenses, in accordance with their economic capability. The tax system shall be based upon the principles of equality and equity.” Fulfillment of the taxation principle, with a simultaneous impact of curbing and limiting the expansion of inequality, is possible by enforcing taxation according to the Ability-to-Pay Principle.

Considering that the fundamental task of the capitalistic state is protection of private property rights, it is logical that an individual who has higher economic power enjoys greater protection and consumes a higher quantity of services. Therefore, it is only natural that a wealthy individual bears a higher tax burden, e.g. a share proportional to the consumed services and finances public expenditures which allow them the enjoyment and protection of their status. In order to conduct taxation according to the Ability-to-Pay Principle, the following conditions have to be fulfilled (Musgrave, 1989, 223):

- a) Horizontal equity: tax payers who are in the same position have to participate equally; and
- b) Vertical equity: tax payers who are in different positions (wealthier) have to participate differently (pay more).

³ This is a quote that is attributed to O.W. Holmes.

⁴ This is in accordance with the practice of the majority of European Union countries.

These principles formally call upon all citizens, and their implementation works toward diminishing inequality.

Finding a correlation between categories of taxation and inequality is of the utmost complexity. This vast and complicated task is represented in the models of taxation of various incomes, progressivity of tax rates, and taxation of real-estate and capital gains, as well as a great number of seemingly less focal issues, which are being marginalized, due to the size constraint of the paper.

In the writing that follows, the authors will introduce to the reader a short literature review including research that supports the main hypothesis and is connected to the impact of taxation on economic inequality.

Burman (2013, 563-592) supports the thought that progressive taxation will result in reducing economic inequality. He states that when determining the level of progressivity, the lawmaker must take into account the level of income necessary for sufficient functioning of the country, the span of the tax exemptions, and the distribution of the tax burden. In the article *Taxes and Inequality*, using the USA as an example, Burman highlights problems represented by the fact that countries gravitate toward the usage of regressive taxes as a source of collecting budget assets, which has a severe impact and violates the horizontal principle of taxation. He also recognizes the unequal treatment of taxation of capital gains and labor incomes, and recommends that the optimal solution would be the integration of capital and labor incomes and taxation with progressive income tax rates.

Wijtvliet (2014) argues that unequal and preferential treatment of capital gains taxation, comparing to labor income, from the Ability-to-Pay aspect, is not justifiable. He holds that differences in classifying labor income and capital gains are a result of an obvious and deliberate lack of reasoning in the implementation of the wider concept of income, leading to inequality. The sustainable solution, he argues, deals with the problem at its source, in a way that the above mentioned components must be taxed using the same underlying logic.

Avi-Yonah (2014) states that the purpose of progressivity of the tax system is in collecting assets for redistribution, which would then be used for fulfillment of social goals⁵, hence, the creation of a more equal society. Moss (2004) holds that the institute of progressive taxation is an important aspect of risk management (inequality insurance), which protects individuals from an unfortunate economic situation, and is compensated for by those with high incomes.

Affirmation of the thought that the tax system has a direct influence on inequality is also found within work of Thomas Piketty (2015) who, on multiple occasions, confirms the relationship between taxation and inequality. Piketty identified progressive taxation of income (first used in France in 1914) and real-estate taxation (first used in 1901) as key variables which, due to their impact on accumulation and concentration of wealth, prevented the return of Rentier capitalism of the 19th century. Piketty considers redistribution as a necessary task of a country, and takes the stand that economic inequality requires collective efforts regarding the achievement of an efficient level of redistribution. The latter is of importance, not exclusively due to the fact that inequality defies the public idea of social justice, but because it implies a significant waste of human resources which otherwise could be allocated more efficiently and work in favor of society as a whole.

Some authors (e.g. Burman, L., Rohaly, J., Shiller, R) who consider that adequate use of the tax system can raise the level of welfare, are focusing on ways to minimize negative effects of

⁵ The focus has been shifted from the level of progressivity to the way assets collected by taxation are being allocated toward helping those in need.

taxation, and are suggesting inventive solutions such as indexation of levels of tax progressivity in respect to targeted inequality rate⁶.

Other authors have different, yet equally innovative solutions. Rakowski (1999) writes about the utility of periodical taxation of wealth, with the goal of protecting political and economic institutions. He argues that periodical taxation should be used within a small percentage of the population, the highest percentage of the wealthiest individuals within a society.

Such a principle is relevant within the period of economic contractions and, due to its nature (passing the burden of the crisis on wealthier individuals), the principles of equity are supported⁷.

Ending this literature review without noting contrary opinion, including the thought that taxes are not a relevant or determining factor, would be far from objective.

There are numerous credible authors who hold the opinions that economists should focus on factors other than just the tax system when curbing inequality but, unfortunately, due to the constraints of the paper, the focus will stay on the aforementioned economic thoughts.

Nevertheless, the well informed reader can oppose, using the argument that, regarding the creation of inequality, more importance should be attributed to the allocation of the budget expenditures, rather than the organization of tax system. Despite this, the authors hold that the mere organization of the tax system reveals much more than what can be seen at first glance. From one side, it reveals the preferences of the creators of economic policies while, from the other side, it shows limited possibility for activism in the wider population.

4. IMPACT OF CROATIAN TAX SYSTEM ON INEQUALITY

After the presentation of the theoretical underpinnings of the paper, the authors will lay out arguments that work toward defending the main hypothesis. Arguments are structured in five sections, which are the most relevant, but not the only connections between tax system organization and economic inequality.

4.1. The organization of tax rates and positive distribution of the tax burden

Organizing tax rates such that the effects of their implementation go in favor of a positive distribution of the tax burden signifies that the creators of the tax system should make decisions using the equality and equity principles, as well as the Ability-to-Pay principle (applied both relatively and absolutely).

In order to show that the Croatian tax system, formally and practically, does not follow the abovementioned principles, a comparison to other EU countries will be displayed and conclusions will be drawn.

Table following on the next page

⁶ The lawmaker sets a targeted rate of inequality and adjusts the rate of progressivity of the taxation accordingly.

⁷ This is the principle that should have been followed when the Crisis Tax was introduced in Croatia.

No.	Member State	VAT	Income Tax	Corporate Tax ⁸	Inheritance and Gifts tax
1	Austria	20	50	25	30
2	Belgium	21	50	33	80
3	Bulgaria*	20	10	10	6.6
4	Cyprus	19	35	12.5	0
5	Czech Republic*	21	15	19	15
6	Denmark	25	55.8	23.5	36.3
7	Estonia*	20	20	20	0
8	Finland	24	48.3	20	36
9	France	20	45	33.3	40
10	Greece	23	42	29	40
11	Ireland	23	40	25	33
12	Italy	22	43	27.5	8
13	Latvia*	21	23	15	0
14	Lithuania*	21	15	15	10
15	Luxembourg	17	40	21	48
16	Hungary*	27	16	19	18
17	Malta	18	35	35	0
18	Netherlands	21	52	25	40
19	Germany	19	45	15	50
20	Poland	23	32	19	20
21	Portugal	23	48	21	10
22	Romania*	24	16	16	0
23	Slovakia	20	25	22	0
24	Slovenia	22	50	17	39
25	Spain	21	49	28	34
26	Sweden	25	59	22	0
27	UK	20	45	20	40
28	Croatia	25	40	20	5
EU average		21.6	37.3	21.7	22.8

* = EU member states which exercise proportional, instead of progressive, taxation of income

Table 1: Comparative analysis of chosen tax categories within the EU in 2015 in % (Authors' calculations based on Deloitte (2015))

When calculating the VAT (value added tax), only the highest tax rates of each member state were taken into consideration. If we compare the average VAT rate of the EU with Croatia we will see that Croatian rate is 16% higher. A direct connection between the average VAT rate

⁸ Corporate Income tax or Profit tax

and inequality is confirmed through the fact that VAT is a regressive tax, in practice (Blažić, 1999; Škarica, 2009; Urban, 2011).

Income tax is analyzed according to the tax rates that apply when an agent falls within the highest tax bracket. According to this criteria, Croatia seems to obtain positive results (a rate is 7% lower), but if a small correction is made and an analysis is done only for member states with progressive tax rates, the reality will be considerably different. Progressive tax rates are present in 21 EU countries and their average tax rate is 44.2%. This confirms that the richest citizens of those EU countries that utilize progressive taxation are, on average, according to the income category, taxed 10% more than their colleagues in Croatia.

The rate of corporate income tax is third in a series of negative indicators of economic inequality, when tax systems are being compared. The table shows that the average corporate tax rate within the EU is higher than in Croatia by 8.5%. Causality between inequality and lower corporate tax rates is quite obvious if we recognize that profit is not appropriated by the most vulnerable (economically) part of the society.

The last category, the tax rate on inheritance and gifts, whose highest rates were analyzed, can end up as the responsibility of the recipient (in most cases, the highest rates occur in cases where the testator is not a blood relative of the successor). Such an indicator is useful when reconsidering the actions that motivated the lawmakers in designing the system, when they created the regulations and served the interests of those they wanted to protect. The share of the most vulnerable individuals, within the total amount of inherited assets is negligible, and because of that, it is worrisome to conclude that average EU rate is more than 3.6 times higher than Croatian rate. This problem is also brought to light by Jelčić (2011), who emphasizes the necessity of tax system reform and supports the initiative that instead of paying taxes on inheritance and gifts using the proportional rate of 5%, a taxation using double progression should be introduced. Double progression, when forming tax rates, should be determined cumulatively, by both the inherited assets and the relationship between testator and recipient (a practice used in several EU countries).

It needs to be stated that the existence of high tax rates does not necessarily mean that the Croatian tax system creates an unequal society. An individual with such a claim would come to the conclusion that, in comparing the member states used as a benchmark (with lower tax rates) inequality is lower, which is not necessarily true. Therefore, a comparison serves only as an indicator of the worldview of the creators of the Croatian tax system, as well as an indicator that there is an opportunity for creating a system which would generate a decline in inequality.

The result of this comparison is that tax rates in Croatia are organized in a way which does not follow the Ability-to-Pay principle. Croatia has a high rate of regressive VAT (16% higher than the average). The highest incomes are taxed using rates 10% lower than other EU countries with progressive taxation and corporate tax and tax on inheritance and gifts, categories which target wealthy societal structures, are being taxed using a rate below the EU average.

4.2. High shares of regressive taxes in the Croatian budget as a proof of the system's departure from the equality principle

Taxes are the most important category within budget revenue. According to Ministry of Finance (2014, 24), it can be calculated that in 2014 taxes made 55.54% of total revenue of the Croatian government or 87.56% of revenue if the component of social insurance is excluded.

Analysis of the share of regressive taxes within tax revenue and total revenue of the Croatian government was conducted under the assumption that indirect taxes are regressive if luxury goods are excluded or neglected.

Significance of this limitation is minimal because strictly regressive taxes, or taxes that have an indirect regressive effect, such as VAT, excise duty⁹ (Urban, 2011; Kesner-Škreb, 1999) and customs duty (Jelčić, 2011), represent a major part of the total Croatian tax revenues.

Under the category of regressive taxes, indirect taxes will be considered. Various types of taxes will be sorted according to Jelčić (2008, 105) who, under the category of direct taxes, considers taxes which are paid before spending income.

Using data from the Croatian Ministry of Finance Annual Report, the available tax categories are classified and analyzed as follows:

Category		Amount	Share in Total Tax
	Income tax	1,401,942	12.9%
	Corporate income tax and withholding tax	5,657,765	
	Taxes on property	385,981	
	Taxes on use of goods, permission to use goods or perform activities	728,216	
	Total	8,173,904	
	Value added tax	40,923,449	86.64%
	The consumption tax	153,166	
	Excise duty	12,846,449	
	Taxes on specific services	117,470	
	Other taxes on goods and	423,015	
	Tax on international trade and transactions	424,501	
	Total	54,888,050	
III. Other	Unclassified Total	287,860	0.45%
Total tax (I. + II. + III.)		63,349,864	

Table 2: Classification of the tax categories of tax revenues in Croatia in 2014 in thousands of HRK (Authors' calculations based on the Annual Report from the Croatian Ministry of Finance (2014, 24))

The total tax revenues in 2014 were 63.35 billion HRK, of which a staggering 86.64% was comprised of indirect taxes. Hence, more than four fifths of the Croatian tax revenues were regressive. If the comparison is expanded to the total revenues for the same year (114.04 billion

⁹ Excise duty can be progressive if it is imposed on luxury goods. However, considering that excises on luxury goods were terminated in 2013, their progressive nature is not being used as a tool of economic policy. According to the Tax Administration (2015, 101), the tax object (excises) includes alcohol and alcoholic drinks, tobacco and its derivatives, energy sources, and electric energy. These items are consumed by individuals regardless of income level and, therefore, from a taxation aspect, their effect is regressive.

HRK), it is concluded that 48.12% (or 75.87% if we exclude social contributions) of total revenue was regressive. Using the same logic, the share of direct taxes was 12.9% of tax revenue i.e. 7.1% of total revenue, while the category of unclassified taxes, due to its marginal share, is of no significance.¹⁰

The substantial share of regressive taxes in the budget revenue represents, contrary to the convergent logic of the free market, the force of divergence that widens the wealth gap and, thus, creates a more unequal nation.

4.3. Taxation of capital income vs. taxation of labor income

The third section of the analysis, with respect to how the Croatian tax system creates and potentiates inequality, is focused on the contrasting taxation treatment of the labor and capital incomes.

Prior to computation, it should be stated that the comparison of these types of taxation is highly complex. However, if we take into consideration that the final goal of economic activity is to reap the benefits, there is no valid reason that would make it inappropriate to compare two seemingly different types of income, that received on the basis of labor and that received on the basis of capital.

The difference in taxation is evaluated using a model which operates under the following assumptions:

- The calculation was conducted in accordance with tax regulations valid on 21 September 2015;
- Both labor income and profit from capital are shown as annual values;
- Workers gross salary withholdings, as well as uncollected capital claims of the owner, are neglected;
- The computation of the surtax was done using the rate of the city of Zagreb; and
- The capital owner withdraws the entire profit (there is no reinvestment).

Labor Income			Capital Income		
Category		Amount	Category		Amount
I. Tax base		400,000	I. Tax base		400,000
	12%	3,168	Corporate income tax	20%	80,000
	25%	33,000	After-Tax income		320,000
	40%	96,640	Withholding tax ¹¹	12%	38,400
II. Total tax		132,808	II. Total tax		118,400
Surtax	18%	23,905	Surtax	18%	21,312
III. Tax and surtax total		156,713	III. Tax and surtax total		139,712
Share III. in I.		39.18%	Share III. in I.		34.93%

Table 3: Share of taxes in labor and capital income in HRK (Authors' calculations based on Income Tax Act and Profit Tax Act)

¹⁰ Eurostat (2014, 59) came to the same conclusion, using different methodology.

¹¹ For the tax rate on withholding tax, the authors took into consideration the rate for taxing the yield from dividends and shares in corporate income.

The table clearly shows that the structure of taxation favors capital income in comparison to labor income. The share of the total tax burden, with regard to income from labor, is 39.18%, while the same share within income from capital equates to the smaller portion of 34.93%. The agent who receives income from capital is taxed 4.25 percentage points lower than the worker and pays 17,000 HRK less tax annually (see Table 3). The fact that the worker has to pay 17,000 HRK more in taxes is not negligible (keeping in mind that his monthly salary is 20,000 HRK).

While analyzing the importance of taxation, regarding inequality, one has to note that agents frequently obtain capital income in addition to labor income. With that in mind, the effect on economic segregation grows proportionately.

At the same time, the owners of the capital can preserve that capital within their company and avoid paying withholding tax (12%) as well as surtax (18%), or reinvest profits and, ideally, completely avoid paying taxes. The creators of tax policies justify said practices by providing incentives for investment and charging higher taxes on future profits of the legal entity. However, the underlying question is whether the economic reality supports the logic of the creator of the tax system, or whether the logic of the creator supports only certain subgroups of society. Such a practice surely violates the principle of equality since it neglects the possibility of bankruptcy for a legal entity that reinvested its profits, inflation that diminishes the tax burden on future profits, the higher net present value of future budget revenues, as well as other various factors. Furthermore, there is no explanation as to why investment in human capital for individuals does not have the same tax status as reinvestment in the legal entity i.e., why reinvestment in a company decreases the tax burden, while investment in human capital does not.

It is not easy to answer the question of who, *de facto*, bears the burden of corporate income tax¹². Does it fall on the shareholders, consumers or workers backs? In accordance with the principle of profit maximization, corporate income tax can be seen as the basic cost of the production process. Hence, it can be expected that the owner of the company, having that in mind, will include the tax burden in the final price of the good or service. In other words, they transfer the tax burden to the consumer.

Concerning the latter, it can be concluded that individuals within society are enjoying protection from the state, embodied in favorable tax treatment. The tax burden is unequally distributed and it does not take into consideration economic status, does not follow the principles of equality and equity and, consequently, creates inequality.

In addition, adoption of the Profit Tax Act (2014) introduced a variety of controversies and questions for which a concise answer cannot be provided. The reason for this is the fact that some taxpayers are, through the Profit tax Act, forced to abandon the former practice of paying income tax and are now forced to pay lower corporate income tax (profit tax)¹³. Such an “innovation”, without a doubt, is a clear example of negative redistribution of the tax burden.

The above mentioned practice, in the middle run, can result in a significant widening of the income and wealth gaps between the poorest and the richest individuals within the same country.

Turković-Jarža (2014, 201) points out that according to Article 2 of the Profit Tax Act, any person involved in an economic activity, according to the Crafts Act, as well as activities that are, from the taxation aspect, equalized with craft activities, are obliged to pay corporate income tax/profit tax (instead of income tax) at the beginning of the following tax year. Criterion for

¹²See Auerbach, A. (2006).

¹³See table 3

the transfer of tax treatment exists if the agent, in the current period, earns more than 3,000,000 HRK (VAT excluded) in revenue, or if at least two of three following conditions are satisfied:

- a) Income is higher than 400,000 HRK;
- b) Value of long-term assets is higher than 2,000,000 HRK;
- c) On average, more than 15 workers are employed.

Implications of the Profit Tax Act and the consequential impact on unequal tax treatment can be analyzed using Table 3.

Namely, the status of a person who falls under the jurisdiction of the Crafts Act (before implementation of the Profit Tax Act), was the same as taxpayers who paid income tax. This is precisely the reason why, when calculating shares of tax in labor and capital income, the authors assume an income of 400,000 HRK. Before the Profit Tax Act, a taxpayer paid 156,713 HRK in taxes (income 400,000 HRK), while after the adoption of the Act¹⁴, they paid the lower amount of 139,712 HRK. When tax policy is revised, the logic of the lawmaker is not reasonable, since it forces the results of both: lost tax revenues and higher inequality.

This issue was, on multiple occasions, raised by Jelčić (2007; 2011), who questioned justification, efficiency and constitutionality of the Act. He pointed out the possibility that the Profit Tax Act was created in favor of persons involved in independent professional activities, and derisively names the situation “the pearl of the Croatian tax system”.

Taking into account that some groups are in a position to avoid progressive income taxation, and that as a result of the new tax status, they obtain numerous benefits¹⁵ and, in relative terms, they contribute less than other members; it can be concluded that the application of such policies works against both horizontal and vertical principles.

4.4. Tax evasion and other factors directly linked with the creation of inequality

The complex tax system that is subject to frequent changes (Bratić and Urban, 2006; Kesner - Škreb, 2011; Šimović, 2012), as well as compatibility of accounting and tax systems (Blažić, 2004), work in favor of wealthier members of society. They have access to information regarding modifications of the tax system, from which opportunities arise, as well as accumulated assets that can be used towards diminishing or avoiding payment of taxes. The previous statement will be confirmed using two simple models based on real life regulations. The first example will show how agents can change the headquarters of a legal entity with the aim of avoiding paying surtax, while the second will show how agents (independent professional activity) can use the transition from taxation of income to lump sum taxation and diminish their tax burden.

	Earnings Before tax	Profit Tax	Withholding Tax	Total Tax	Surtax	Share of Tax Burden
Legal Entity A	1,000,000	200,000	96,000	296,000	53,280	34.93%
Legal Entity B	1,000,000	200,000	96,000	296,000	0	29.60%

Table 4: The impact of surtax on business performance of legal entities in HRK (Authors' calculations)

¹⁴ This occurs assuming that the aforementioned conditions are satisfied.

¹⁵ Such as tax exemption when reinvesting

If we compare Legal Entity A with its headquarters in Zagreb (18% surtax rate) with Legal Entity B that has headquarters in municipalities which do not charge surtax, significant deviations from the horizontal principle of taxation will be seen. Legal Entity A will pay 53,280 HRK more in taxes and the share of the tax burden will be 5.33 percentage points higher than the entity that is not required to pay surtax. Legal Entity A, from initial earnings before tax, receives 650,720 HRK, while Legal Entity B receives 704,000 HRK.

Identical logic can be applied to labor income, as well as the consumption tax which, depending on strategies of municipalities, oscillates in intervals from 0-3%.

These examples are evidence of a paradoxical fact where lawmakers, using inadequate decisions within the sphere of the tax system, create rivalries between municipalities that would like to attract a higher number of residents. In this endeavor, they are encouraged to use the absence of surtax as competitive leverage.

The second example, which yields unequal tax treatment and creates the opportunity for manipulation of the system, with a goal of minimizing taxes paid, can be detected within lump sum taxes in particular.

Using the cases regarding taxation of renting apartments, rooms, and beds, a comparison using the agent who pays income tax and the agent who pays a lump sum tax, will be conducted.

Calculations are carried out under the following assumptions:

- The annual income of both agents is 200,000 HRK;
- The agent who pays income tax qualifies for a personal deduction (coefficient 1) and does not pay surtax;
- Annual lump sum income tax is calculated for 20 beds for an A Category tourist area, within a surtax free municipality.

	Income	Income Tax	Lump Sum Tax	Share of tax Burden
Agent A	230,000	-	6,000	2.61%
Agent B	230,000	52,328	-	22.75%

Table 5: Comparison of income and lump sum taxation, in renting apartments, rooms and beds in HRK (Authors' calculations based on Tax Administration (2015))

The share of the tax burden of the agent who pays lump sum tax is twenty percentage points lower than that of the agent who pays income tax. With an equal annual income of 230,000 HRK, the agent who pays income tax is being charged the considerable amount of 46,328 HRK. Taking into account that both agents are involved in the same activity and that one agent is being charged eight times more than the other, it can be concluded that, even within a theoretical model, this defies common sense.

When organization of the tax system allows colossal differences between certain categories, when the transfer from one category to another is relatively easy, and when the most vulnerable

individuals cannot achieve the same tax status as the wealthy, the existing tax system surely does not result in equality¹⁶.

The above topics are relevant, but are not the sole connection between the organization of the tax system and economic inequality. That being said, a few additional factors which represent the determinants of unequal tax treatment, the detailed explanation of which would require additional articles, will be presented briefly.

The first factor is an inefficient collection of taxes from the Croatian Tax Administration. This is verifiable through insight into the Tax Administration database, The List of Matured and Uncollected Claims, which was discussed earlier in this paper and dated September 5, 2015.

Since such a high portion of taxes are not collected, required participation from all citizens in covering the costs of the country is nothing more than a formal farce. All taxpayers who are not settling their obligations toward the country are creating an unrighteous and unequal society. The lawmaker, considering the high number of debtors, has a crucial impact on the unequal treatment of all citizens, whereby those citizens who are not able to manage as well as those who responsibly cover their tax obligations, bear the highest burden.

The second factor is preferential tax status of financial services and the financial sector. A high number of financial services are exempt from taxation (based on the Value Added Tax Act), exemptions are further expanded to include bank assets (contrary to Hungarian practice), as well as financial transactions. This is not an exclusive problem of the Croatian tax system since it occurs throughout the entire European Union. This causes the EU to involve a considerable amount of effort to design a package of measures with a goal of harmonizing the tax treatment of the financial sector, increasing transparency, and diminishing unequal distribution of the tax burden¹⁷.

The third factor has to do with problems dealing with the taxation of income based on independent professional activity. The domain, among other issues, includes the authors' fees. This potentially violates the principles of righteousness because such income (after deducting costs), according to the current legislation, is being taxed by 25%. When the fees are considered regular income, they fall under progressive taxation, which leads to a righteous outcome¹⁸. This problem is in direct connection to the partial termination of the obligation to file an annual tax report, which Šimović (2012) classifies as a key factor in the deviation from the principles of horizontal and vertical equality.

The fourth and last factor is taxation, or lack thereof, regarding personal income earned within virtual worlds¹⁹ or charged in virtual currency. It is, as the taxation of the financial sector, a factor which does not occur exclusively in Croatia, and which represents a problem with global implications. In this case, the lawmaker is bound by necessity to tax the income earned in virtual worlds and using virtual currencies, however, the application of such taxation is highly complex in practice. The technological innovations and modern economic activity are demanding up-to-date adjustments of the country's institutions and regulations, which are nearly impossible to provide. Such a situation results in the fact that, in Croatia, the income of this sort is either not being taxed, or it is not taxed adequately. The occurrence, in most cases, is that the Tax

¹⁶ Important forms of tax evasion, which will not be covered within the scope of this paper, such as usage of offshore tax havens and change of residence to foreign countries with lower or nonexistent tax rates, must be mentioned.

¹⁷ See European Commission (2015)

¹⁸ Similar treatment also stands for the status of the additional income taxation

¹⁹ See S. Gadžo, et al. (2014)

Administration formally recognizes the taxation of virtual transactions and taxation with virtual currencies, but they are most commonly used or initiated with tax evasion in mind.

4.5. Effects of past, negative tax practices on inequality

The inequality phenomenon is not bound to a certain time period and, due to that, when analyzing the impact of the tax system on its creation, the review of relevant, negative tax practices occurring in past periods, is necessary.

In order to defend the thesis in a clear and concise manner, only a few key cases from this category will be presented:

- a) Acceptable tax deductions from income tax – Insight into the practice of past periods shows the existence of prescribed personal deduction enlargement on the basis of expenditures for health services, acquiring healthcare supplies and real estate needs²⁰. These personal deductions could be claimed up to the amount of 12,000 HRK annually. They were used in a large number of services, which acted discriminatorily toward the poorest members of society. In order for an individual to be able to take advantage of rehabilitation, healthcare supplies, or alterations to their living environment, one must have accumulated assets in possession, with which all the above can be afforded. The individuals who have no assets cannot obtain a decrease in the tax burden i.e., they cannot take full advantage of the offerings of the tax system. Therefore, the application of the acceptable tax deductions of this sort violates the principle of vertical equality. Šimović (2012) states that from 2005-2009 the usage of tax deductions increased from 3.7 billion HRK to 5.1 billion HRK and concludes that such a relationship represents the significant impact on horizontal (in)equality. He clearly states that within the income tax system of the RC, the horizontal principle was violated. The synthesis here is that a line of deductions leaves the real tax burden below the level it should be, which results in deviation from both vertical and horizontal principles.
- b) The Crisis Tax – The duration was 17 months, ending in 2010. The Crisis Tax was imposed on income typically covered under income tax, under constraint, if 3,000 HRK is surpassed. From 3,000 – 6,000 HRK taxes were being paid at the rate of 2%, while at earnings surpassing 6,000 HRK, a rate of 6% was charged. As a result of questionable righteousness, the Crisis Tax experienced numerous critiques, among which the most notable was from the Croatian Constitutional Court. In the beginning, taxation was not imposed on independent professional activities, which meant that all citizens were not treated equally. The opinion of the authors, in accordance with Rakowsky (1999), and taking into consideration that the object of taxation included even pensions is that lower income classes should have been excluded from taxation with a simultaneous introduction of higher tax rates imposed on higher income classes. Tax rates should have been higher and applied only to those individuals who, regardless of economic contraction, enjoy a life standard far above the average.
- c) Tax and surtax exemption on income from capital – Tax and surtax exemption on capital income began March 1, 2012, according to Article 30 of The Income Tax Act. From the inequality aspect, the period before the Act was implemented was a period during which persons earning income from capital were exempt from taxation. It must be noted that from 2001-2004 capital income was taxed, although in a different form than the one that is currently implemented. After this Act was repealed in 2005, a new deviation from the

²⁰ The complete list of services is available on websites of the Tax Administration.

horizontal equality principle began (Šimović, 2012). Keeping in mind that income from capital is obtained by individuals from higher income classes, this specific case of tax exemption can be seen as yet another failure, or incentive of the tax system, depending on which class the individual belongs to²¹.

- d) Exemption of taxation from winnings in games of chance – From one side, high earnings from games of chance directly create inequality, while from the other side, exemption from taxation leads to the fact that income from games of chance create greater privileges compared to other types of income, which are taxed regularly.

Even though one may gain the impression that the results of the stated practices are trivial, it is important to keep in mind the existence of the multiplier effect which, in the long run, generates substantial differences.

Any practice that leaves the poorest members of society at the same level of utility (or lowers it), while at the same time increases utility to those individuals who can afford it, defies the Rawls max-min principle of justice and widens inequality.

The impact of these arguments on horizontal and vertical equality, as well as non-observance of the Ability-to-Pay principle, confirms the central hypothesis. Furthermore, this leads to the conclusion that the effects of the existing tax system in Croatia are working toward creation, expansion, and preservation of wealth and income inequality.

5. TAX SYSTEM IMPROVEMENTS AND LIMITATIONS IMPOSED BY GLOBALIZATION

If the Direct Tax Act from 1990 (Jelčić and Bejaković, 2012) is used as the foundation for the Croatian tax system, it can be seen that it is relatively young in comparison to the rest of Europe. A little more than a quarter of a century is not nearly enough time for establishment of a system which is consistently confronted with dynamic markets and the exponential rise of innovations in every sphere of economic activity. The immaturity of the system can justify smaller errors, however, it cannot be used as justification for the existence of fundamental defects.

Recently, Croatia has made a substantial effort in improving the system, which is manifested in the termination of multiple tax exemptions, in introduction of capital income taxation for individuals, in introduction of taxation on interest from savings, in the Fiscalization Act, in implementation of the new Tax Administration platform, and in various other, less significant activities. All of these should be recognized as positive steps in diminishing unequal tax treatment and will directly lead to a higher level of righteousness and a more equal society.

Besides these improvements in decision making (regarding the organization of the tax system), the importance of international surroundings needs to be emphasized. It is a contemporary topic which is the object of discussions among the world's leading economists, such as Stiglitz (2013) and Piketty (2014; 2015).

Piketty, besides his commitment to a higher wealth tax (in a broader sense), with the goal of achieving less inequality, emphasizes the need for harmonization of the tax system both in the EU and globally. The French economist states that the absence of unique tax policies leads to the usage of national tax policies, with an aim of attracting foreign capital and increasing competitiveness. In other words, the absence of common tax policies in the EU (and the world), on one hand, enables the member countries to lower tax rates in order to increase current welfare. On the other hand, it makes things more difficult for other member countries attempting to implement tax policies which are supportive of equality. Piketty sees a solution in execution of the flat tax, which would be used for taxation on all incomes earned on capital

²¹ The problem of taxation of capital income in Croatia was analyzed in detail by Orsag (2011).

investments and which would also be universal, with the purpose of avoiding negative effects of fiscal competition.

Within the international context, the organizers of national tax policies do not have much space for the creation of a more righteous system. The reason for this is because the shift in that direction (taxing in accordance with the Ability-to-Pay principle) would yield an outflow of capital toward member countries that enforce lower tax rates and do not make equality a priority.

All of the above leads to the conclusion that, even if designers of a national policy were to create a better system and remove the flaws, they would be limited by international competition and the outcome of such an undertaking would be uncertain at best.

The righteousness of the tax systems within the Single Market must be built on international foundations. This can be seen in the example of the EU, which strives to harmonize tax systems²². The tax adjustment on the level of the EU would, in addition to the enhancement of transparency, disallow differences in national tax systems in order to lower the tax burden on individual agents. Nevertheless, considering that the current direction of EU policies aims to obtain coordination focused on consumption taxation (regressive taxation), it is highly controversial as to whether such upgrades would serve the EU's most vulnerable citizens.

6. CONCLUSION

Throughout this paper, the impact of the Croatian tax system on the creation, preservation, and support of wealth and income inequality was analyzed.

The research was conducted using this underlying question, "Do lower income and low wealth groups bear a higher tax burden, or have policymakers taken into account relative shares of taxes and, subsequently, organized the system in accordance to the principles of equality and the Ability-to-Pay?"

The organization of the tax system and its impact on economic inequality was evaluated using the available tax categories and by taking into consideration whether they are designed in accordance with horizontal and vertical equality, as well as with the Ability-to-Pay principle.

Based on the presented material, the following can be concluded:

- a) The organization of the tax rates does not work toward distribution of the tax burden according to the Ability-to-Pay principle;
- b) The share of regressive taxes within budget revenues is extremely high;
- c) Capital income has a privileged taxation status when compared to labor income;
- d) An obligation to pay lower corporate tax, instead of higher income tax, is being forced by lawmakers;
- e) Tax evasion is possible and probable;
- f) Effects of negative tax practices on inequality, in recent history, are still existent; and
- g) The system suffers from an abundance of components that directly cause inequality.

The effects of these arguments on horizontal and vertical inequality, and deviation from the Ability-to-Pay principle, are in alignment with the central hypothesis and confirm that the existing Croatian tax system works toward widening and sustaining inequality within the society. It can be seen that Croatian citizens do not bear a tax burden in accordance with their economic status. Due to this, the principles of righteousness and equality are functioning exclusively as formal postulates and the tax system unambiguously represents one of the pillars of economic inequality.

²² See European Parliament (2015)

The lawmakers in the sphere of taxation need to conduct significant reform in order to adjust the system to the proclaimed principles and to create a system that benefits the society in its entirety. The trends of reform movements are in favor of improving the current reality but, on that path, they encounter obstacles of global fiscal competition and a consequential outflow of capital. Therefore, tax system reform, regardless of its complexity, must become a societal priority.

ACKNOWLEDGEMENT: *This work has been supported by the Croatian Science Foundation under the project 6558 Business and Personal Insolvency – the Ways to Overcome Excessive Indebtedness.*

LITERATURE:

1. Auerbach, J. A. (2006). Who Bears the Corporate Tax? A Review of What we Know, I. Poterba (ed.), *Tax Policy and the Economy* (pp. 1-40), Vol. 20, The National Bureau of Economic Research, Cambridge, MA.
2. Avi-Yonah, R. S. (2014). The Parallel March of the Gini: How Does Taxation Relate to Inequality and What Can Be Done About it?, *Public Law and Legal Theory*, University of Michigan, No. 385.
3. Blažić, H. (1999). Regresivnost poreza na dodatnu vrijednost u Hrvatskoj, *Financial Theory and Practice* (pp. 667-676), Zagreb, Vol. 33, No. 2.
4. Blažić, H. (2004). Tax Compliance Costs of Small Business in Croatia, *Financial Theory and Practice* (pp. 309-324), Zagreb, Vol. 28, No. 3.
5. Bratić, V., Urban, I. (2006). Tax expenditures in Croatia, *Financial Theory and Practice* (pp. 129-195), Zagreb, Vol. 30, No. 2.
6. Burman, L. (2013). Taxes and Inequality, *Tax Law Review* (pp. 563-593), New York, Vol. 66.
7. Constitution of the Republic of Croatia. (2014). Official Gazette of the Republic of Croatia, No. 56/90, 135/97, 8/98, 113/00, 124/00, 28/01, 41/01, 55/01, 76/10, 85/10, 05/14.
8. Crafts Act. (2013). Official Gazette of the Republic of Croatia, No. 143/13.
9. Deloitte (2015). *Corporate Tax Rates 2015*, Deloitte Touche Tohmatsu Limited, UK.
10. Deloitte (2015). *International Tax Country Highlights 2015*, Deloitte Touche Tohmatsu Limited, UK.
11. DSZ (2015). *Poverty Indicators 2014*, DSZ. Retrieved 07.02.2016 from <http://www.dzs.hr>
12. European Commission (2015). *Taxation of the Financial Sector*. Retrieved 12.03.2016 from <http://ec.europa.eu>.
13. European Parliament (2015). *Tax Policy in EU: Issues and challenges*. Retrieved 16.04.2016 from <http://www.europarl.europa.eu>.
14. Eurostat (2014). *Taxation trends in the European Union*, European Commission. Retrieved 24.03.2016 from <http://ec.europa.eu>.
15. Eurostat (2015). *Unemployment indicators*. Retrieved 24.03.2016 from <http://ec.europa.eu>.
16. FINA (2013). *Izješće o najvećoj prosječnoj mjesečnoj plaći u 2013. godini*. Retrieved 07.04.2016 from <http://www.fina.hr>.
17. FINA (2016). *Pregled stanja blokade građana po gradovima i županijama*. Retrieved 13.02.2016 from <http://www.fina.hr>.
18. Forbes (2014). *Hrvatskih top 50*. Retrieved 07.02.2016 from <http://forbes.hr/>.

19. Gadžo, S, Jengiđ, A, Jerđinoviđ, A. (2014). Primitci fiziđkih osoba ostvareni u virtualnim svjetovima i teorijski okvir oporezivanja dohotka, *Zbornik radova Pravnog fakulteta Sveučilišta u Rijeci* (pp. 291-319), Faculty of Law, University of Rijeka, Rijeka.
20. HNB (2016). *Financijska stabilnost* (No. 16). Retrieved 16.02.2016 from <https://www.hnb.hr/>.
21. HZMO (2016). *Statističke informacije HZMO-a*. Retrieved 05.03.2016 from <http://www.mirovinsko.hr/>.
22. Income Tax Act. (2014). Official Gazette of the Republic of Croatia. No. 177/04, 73/08, 80/10, 114/11, 22/12, 144/12, 43/13, 120/13, 125/13, 148/13, 83/14, 143/14.
23. Jelđić, B, Bejaković, P. (2012). *Porezi: opći dio*, Visoka poslovna škola Libertas, Zagreb.
24. Jelđić, B, Lončarić-Horvat, O, Šimović, J, Arbutina H, Mijatović, N. (2008). *Financijsko pravo i financijska znanost*, Official Gazette of the Republic of Croatia, Zagreb.
25. Jelđić, B. (2007). Zašto fizička osoba može, i/ili mora, umjesto poreza na dohodak plaćati porez na dobit?, *Informator* (p. 1), Zagreb, Vol. 55, No. 5538.
26. Kesner-Škreb, M, Kuliš, D. (2000). *Porezni vodič za građane*, Institute of Public Finance, Zagreb.
27. Kesner-Škreb, M. (1999). Trošarine, *Financial Theory and Practice* (pp. 765-767), Zagreb, Vol. 23, No. 6.
28. Ministry of Finance (2014). *Annual Report of Ministry of Finance for 2014*, Republic of Croatia Ministry of Finance, Zagreb.
29. Ministry of Social Policy and Youth (2014). *Godišnje statističko izvješće o primljenim pravima socijalne skrbi u 2014. godini*, Republic of Croatia Ministry of Social Policy and Youth, Zagreb.
30. Moss, D, A. (2004). *When all else fails: Government as the Ultimate Risk Manager*, Harvard University Press, Cambridge MA.
31. Musgrave, R. (1989). *Public Finance in Theory and Practice* (5th ed.), McGraw-Hill Inc.
32. Organisation of Games of Chance and Prize Games Act. (2014). Official Gazette of the Republic of Croatia. No. 87/09, 35/13, 158/13, 41/14, 143/14.
33. Orsag, S. (2011). Oporezivanje kapitalnih dobitaka, *Economics* (pp. 57-98), Zagreb Vol. 18, No. 1.
34. Piketty, T. (2014). *Capital in the Twenty-first Century*, The Belknap Press of Harvard University Press, Cambridge, Massachusetts, London, England.
35. Piketty, T. (2015). *The Economics of Inequality*, The Belknap Press of Harvard University Press, Cambridge, Massachusetts, London, England.
36. Profit Tax Act. (2014). Official Gazette of the Republic of Croatia, No. 177/04, 90/05, 57/06, 146/08, 80/10, 22/12, 148/13, 143/14.
37. Rakowski, E. (1999). Can Wealth Taxes be Justified?, *Tax Law Review* (p. 3), New York, Vol. 53.
38. Smith, A. (1776). *An Inquiry into the nature and causes of the wealth of nations*. Sálvio M. Soares (Ed.) MetaLibri Digital Library.
39. Stiglitz, J. (2013). *The Price of Inequality*, W. W. Norton & Company, New York.
40. Šimović, H. (2012). Development of Personal Income Tax in Croatia: Reforms and Failures, *Croatian Journal of Social Policy* (pp. 1-24), Vol. 19, No. 1.
41. Šimović, H. (2012). Effect of expenditures in personal income taxation on horizontal equity in Croatia, *Financial Theory and Practice* (pp. 245-267), Zagreb, Vol. 36, No. 3.
42. Škarica, M. (2009). Real Regression Frames of the Croatian Value Added Tax, *Economic Thought and Practice* (pp. 259-278), Zagreb, Vol. 18, No. 2.

43. Tax Administration (2004). *Dio osobnog odbitka za izdatke zdravstvenih usluga i stambenih potreba*. Retrieved 06.03.2016 from <http://www.porezna-uprava.hr>.
44. Tax Administration (2015). *The Croatian Tax System*, Republic of Croatia Ministry of Finance, Zagreb.
45. Tax Administration (2015). *Najam stanova, soba i postelja putnicima i turistima i organiziranje kampova* (12th ed.), Republic of Croatia Ministry of Finance, Zagreb.
46. Tax Administration (2015). *Popis dospjelih i nenaplaćenih dugova*. Retrieved 05.09.2015 from <http://duznici.porezna-uprava.hr/>.
47. Turković-Jarža, L. (2014.). Promjena načina oporezivanja s dohotka na dobitak, *Računovodstvo Revizija i Financije*, 2014 (12/14), p. 201.
48. Urban, I. (2011). Raspodjela poreznog opterećenja u Hrvatskoj, *Newsletter: Povremeno glasilo Instituta za javne financije*, 2011(No. 58.), pp. 1-6.
49. Wijnvliet, L. (2014). Too Little, Too Late: The Uneasy Case for a Wealth Tax as a Means to Mitigate Inequality, *Intertax* (pp. 632-643), Vol. 42, No. 10.

ANALYSIS OF THE PRACTICE OF LEADERS OF SUCCESS IN THE RUSSIAN MEDIUM-SIZED BUSINESSES: AGRICULTURE VS INDUSTRIAL PRODUCTION

Nikolaeva Ekaterina

*Chelyabinsk State University, Russia
nikolaeva@csu.ru*

Pletnev Dmitri

*Chelyabinsk State University, Russia
pletnev@csu.ru*

ABSTRACT

The article is devoted to a generalizing analysis of successful practices of the Russian agricultural and industrial enterprises functioning - subjects of medium business. On the basis of the case analysis of 64 most successful enterprises (leaders of success) their features that allow them to function successfully in the market were identified. The industrial, operational and financial characteristics of successful enterprises activity were researched during the analysis; on the basis of these characteristics the conclusion about success factors in the researched industries is drawn. The article provides a comparative analysis of the success factors of industrial and agricultural medium-sized enterprises, which demonstrates essential differences in the set of these factors.

Keywords: *Business Success, Russian Economy, SME, Industrial Production.*

1. INTRODUCTION

The analysis of successful practices of enterprises functioning is a very popular theme. The study of leaders of success' features allows understanding the role of this or that factor in achievement of the company's success, which is very important and indicative for other companies of the market which are desperately trying to overcome difficulties on the path of life. However, it is necessary to notice, that in Russia such researches are practically absent. In recent years, more and more attention in the scientific community has been paid to a problem of the effective size of the enterprise that is much caused by emergence on the arena of the small companies. Their results are impressive and often exceed the results of large corporations which are inefficient and unable to satisfy the interests of all their subjects. Small and medium business also has a number of problems of an entirely different nature. They are generally connected with the survival and steady functioning. Despite it, there are real stars among them which example proves that the growth is not the only one trajectory of development of the successful enterprise. The purpose of the article is to make the comparative analysis of the most successful medium-sized enterprises in Russia operating in two spheres – agriculture and industrial production. The choice of industries is caused by their importance for the Russian economy, to bring it on the path of sustainable development in the turbulent world.

Among the scientific papers devoted to the success of enterprises can be distinguished the researches of a number of foreign scientists: E. Romar determined the ratio of strategic expectations and the success of the company (Romar, 2009), Ph. Sieger investigated the long-term success of private family companies (2011), M. Jensen pointed to the possible ways of resolving the contradiction in the two competing indicators of the company's success - value

maximization and public welfare (Jensen, 2001), J. Drucker introduced the concept of "industrial success" for industrial enterprises (Drucker, 2007), J. Bronsteen, Ch. Buccafusco, J. Masur considered a new measurement of business success - "Well-Being Analysis" as an alternative to the "Cost-Benefit Analysis» (Bronsteen, Buccafusco, Masur, 2013).

Among the popular scientific works, it would be desirable to pay attention to which are devoted to the analysis of successful practices of small and medium businesses. Namely: H. Simon in a series of books "Hidden Champions" (Simon, 1996; Simon 2006) one of the first paid attention to the most successful medium-sized companies in Europe which are leaders in their industries and at the same time do not aim to pass into a rank of the large companies; B. Burlingham in the book "Small Giants: Companies That Choose To Be Great Instead Of Big" (Burlingham, 2005) reveals the successful business practices of medium-sized US companies have become well-known thanks to their special philosophy of development.

2. METHODOLOGY AND DATA

The main approaches to the definition of success, its assessment and the description of the success factors are developed in the works of V. Barkhatov, D. Pletnev, E. Nikolaeva, I. Belova (Barkhatov, Pletnev, 2014; Pletnev, Barkhatov, 2016; Nikolaeva, Pletnev, 2015; Barkhatov, Belova, 2015). Within these researches at an initial stage the heads of the small and medium - sized enterprises were questioned regarding their understanding of business success and its factors, as well as evaluating their enterprise from the point of view of success.

Having analysed the results of a questionnaire survey of more than 200 representatives of small and medium-sized businesses, we have come to the conclusion that the business success is determined by the heads differently. The category is not limited only by the profitability or growth, but also described in such terms as "to be better than a competitive environment". It also seemed interesting to us, that the majority of heads (about 85%) considered their business successful during the researched period (2013-2014), that especially surprises in the situation of economic crisis, which most strongly strikes small and medium businesses. It became clear that the heads of business, speaking about the success, understand it much wider, than a company's ability to make a profit or to grow steadily for several years. For small and medium business it is determined by features of the establishment and operation of the enterprise. All researched by us subjects are private enterprises, where the founder or his heirs are aimed not only on the "removal of profit" from the enterprise but also on its long and harmonious functioning. Therefore, in case of an assessment of business success it is necessary to consider a set of the signs determining a capability of the enterprise to achieve various goals that in different periods of the enterprise development and the economic situation will change and determine the success of the business.

In this research the methodology of integrated evaluation of small and medium business success developed by authors D. Pletnyov, E. Nikolaeva is used (Pletnev, Nikolaeva, 2015). The methodology represents the weighted evaluation of a number of key parameters (success indicators), such as growth rate of sales, return on sales and the equity, as well as the time of the company's existence. When calculating the final coefficient of the success indicator, the

factor "to be better than competitors" by comparing of success parameters of the separate enterprise to average ones on sample is also considered.

In total, during this research 4347 Russian medium-sized businesses from various industries of economy are analysed. For these enterprises the integrated success indicator which values are in the range from 0 to 10 has been determined. To the leaders of success we referred the enterprises with the indicator values from 7 to 10 (from 0 to 4 – unsuccessful, 4-7 for successful). In total, there were 64 such entities. These enterprises have been studied in detail during this research. The analysis of leaders of success is carried out in the following directions:

1. The features of industry (average profitability in the industry, growth rates of the industry);
2. The operating features (type of ownership, scale of activity of the company, existence period, the size of the authorized capital, number of employees);
3. The financial features (profitability, liquidity, credit worthiness, business activity, financial stability).

The purpose of the analysis is to identify the internal factors that determine the success of the enterprise, as well as the detection of trends in these factors.

The comparative analysis of indicators with the industry average values is applied to the description of factors, as leaders of success are provided by a wide range of the industry groups significantly differing from each other in operating cycles, elasticity of demand, dependence on the external economic factors, level of the state support, etc. It causes in considerable degree the distinctions in the level of financial and non-financial indicators and their "normal" industry average values.

The majority of the industry groups provided in the sample are characterized by the presence of subgroups of the industries significantly differing from each other on dynamics of development. In the analysis are used not absolute values of the researched indicators, but their comparative (point) characteristic with the industry average values. During the research the data provided by the information and analytical system FIRA PRO (FIRA PRO, 2016) is used.

The sphere of production in our sample of success leaders is presented by a wide range of sectors of industrial production, including: production of electrical machines and electric equipment; production of foodstuff, including beverages; production of rubber and plastic products; production of other non-metallic mineral products; production of the equipment for radio, television and communication; production of machines and equipment; generation, transmission and distribution of electricity, gas, steam and hot water; production of metal goods; production of clothes; dressing and dyeing of fur; processing of secondary raw materials; chemical production.

The agricultural enterprises researched in the article relate to the following industries: breeding of pigs; breeding of poultry; cultivation of cereals and other crops which are not included in other categories; cultivation of grain and leguminous crops; plant growing; cultivation of potatoes, root crops and tuber crops with the high content of starch or inulin; breeding of horses,

donkeys, mules and hinnies; cattle breeding; cultivation of sugar bee; oilseed cultivation; vegetable growing.

The enterprises included in this sample work in different industries that complicates their comparative analysis. However, the possibilities of the FIRA PRO system allows carrying out the comparison of indicators of each chosen enterprises with the industry average values (i.e. with the enterprises of that sphere in which this enterprise operates).

3. RESULTS

The first thing should be noted is that the majority of industrial enterprises operate in the industries which are characterized by the low level of profitability of their activity. The industry average profitability is higher than an average or is much higher than an average on economy only at 8 researched companies of the production sphere. The remaining 24 companies have this indicator at an average or below average values on economy. The similar tendency is observed on dynamics of industry development. Only in 9 cases the growth rates of an industry are significantly higher than the average level of growth rate on economy. In other industries in 2014 average (13 industries) and below an average (10) values of industry development on economy are observed.

Thus, it can be assumed that the enterprises - leaders of success - are established in spite of negative trends of development in the industries, that is partly determined their opportunity to become "better than the others."

On the scale of activity (volume of annual turnover) almost all enterprises occupy a significant position in the industry (28 companies), among them - 12 largest and most important companies in the industry and 1 leader of the industry. Other 4 enterprises occupy a middle position in the industry.

However, at the majority of the researched enterprises (20) the market share is insignificant and constitutes less than 10% (the indicator was calculated for the region in which the enterprise is registered). Many of them have a market share of less than 1%. There are also larger enterprises in this sample: 10 enterprises have a market share higher than 10% (5 from them – more than 20%). Two companies hold a dominant position in the relevant regional markets (with a market share of more than 30%).

By headcount, the majority of the enterprises can also be referred to the representatives of medium-sized businesses. Only 3 enterprises have the small number of employees (30-100 people). Other 2 enterprises have the high number of employees (500-750 people) and can be referred to large business on this indicator. The majority of enterprises (24) have an average number of employees - from 100 to 500 people.

The peculiarity of the investigated companies – leaders of success in the sphere of production is the long term of existence: 27 of 32 companies work in this industry market more than 10 years, 12 companies – more than 20 years. At other 5 enterprises the term of existence is more than 5 years. All researched representatives of medium-sized businesses have the substantial size of the authorized capital (average value – 28032237 roubles, median – 8882000 roubles).

Only 3 companies from this sample have the size of the authorized capital at the minimum level (10000 roubles). It demonstrates the considerable own capital investments made by leaders of our research in development of their business and aiming at long-term existence in this sphere.

One of the success indicators of the enterprise in our research was growth rate of the enterprises income. The enterprises having the highest in comparison with all enterprises on economy annual growth rate of income were referred to the leaders of success. The comparative analysis of this indicator with the industry average values is interesting. Only 11 companies observed the significantly higher dynamics of development than the industry average value. Still 10 enterprises have dynamics of development at the average level in an industry. At other 11 enterprises is below an average in an industry. That is only one-third from the researched enterprises – leaders of success have dynamics of development above an average value.

Another feature of the leaders of success is the high level of profitability of operating activities. 26 of 32 enterprises have profitability of operating activities significantly above industry average. Other enterprises in 2014 have the profitability at the average level on an industry. The level of profitability was one of the success indicators when calculating an integrated indicator, which partly explains the results, received on it. However, the analysis of various industries has shown that not all medium-sized enterprises – leaders of success had equally high level of profitability. Therefore intra-industry comparative analysis of profitability is justified in this research.

The similar picture is observed also on liquidity level. The majority of the enterprises (26) have indicators of liquidity at the high level (is significantly higher than the industry average value). At 4 enterprises liquidity is at the average level or is slightly higher than the average. Only in 2 cases the level of liquidity is lower than industry average. Therefore, it is possible to conclude that liquidity is a significant success factor of medium-sized businesses in the sphere of industrial production. It is interesting, that at the same time the level of business activity is hardly referred to the significant factors of success. Only 6 researched enterprises have a level of business activity higher than the industry average value, in the others 26 – at the average level or below.

Considerable part of industrial enterprises - leaders of success (23 enterprises) is characterized by the high financial stability, in comparison with the industry average indicators (estimated in such parameters as availability of working capital financed by owner's equity, debt-to-equity-ratio). At other 9 enterprises financial stability is at the average level or below the industry average value. In a capital structure of 30 enterprises the equity prevails (is significantly higher than debt capital - more than 70% of the enterprise capital). At 2 enterprises the debt capital in structure slightly exceeds the equity (for 10-15%).

Besides all the researched enterprises demonstrate high level of covering of liabilities and a high rating of creditworthiness (at the level of 5 and above that is characterized as high creditworthiness). Only 2 enterprises have a creditworthiness rating at the level of 4 (rather high creditworthiness) (CMNT – this indicator was calculated by the method of the information and analytical system FIRA PRO on 14 key coefficients of the analysis of financial activities of the

enterprise). Thus, the factor - "financial stability" is also important for achievement of business success in the sphere of industrial production.

The second sample of leaders of success among medium-sized enterprises was created in the industry "agriculture, hunting and provision of services in these areas". In total 32 enterprises are referred to leaders of success that constitutes significant part from total number of the leading enterprises (about 25%). Despite the obvious problems in agricultural industry in our country, among representatives of medium-sized businesses there are many successful enterprises. And by number of leaders of success the industry win the first rate in our research.

In this case, it makes sense to pay attention to the industry subgroups in which the enterprises operate, as the analysis shows that within this industry the essential differences in operational indicators and financial indicators of various subgroups of industries were observed.

Most of all leaders of success appeared in crop production where in general are observed higher rates of development and return on investment in comparison with other industry subgroups of agricultural industry.

On the level of development in 2013-2014 the industry can be referred to the number of leaders of economy. The industry average profitability in the majority of subgroups where the leading enterprises works, is much higher than average on economy. Only in 1 case (cultivation of potatoes, root crops and tuber crops with the high content of starch or inulin) the industry average profitability is significantly lower than average. Growth rates in all subgroups are significantly higher than the average on economy. Here it is possible to tell about the influence on success of the combination of external factors, such as favourable market conditions, industry support from the state, restriction of import to the country of products manufacturers. It has allowed the medium-sized businesses working in agricultural industry to achieve high financial results of their activities.

The specific feature of agricultural industry is the large share of medium-sized enterprises which are typical for the industry. All researched enterprises are significant or largest players in the industry. On amount of an annual turnover 11 enterprises are the largest players in the industry, 18 enterprises – the most significant in the industry, 2 enterprises - significant in an industry, were the largest players in the industry. Among the researched enterprises one was the leader in the industry. However, due to the high competition in agricultural industry, the market share of the majority of the enterprises is insignificant (less than 5%).

The number of employees of the majority of enterprises (29) is average (100-500 people). Three enterprises have the considerable number of personnel - 500-750 people and on this indicator can be considered as large businesses.

All enterprises – leaders of success - are characterized by a long time of existence in the market. At 29 enterprises the lifetime exceeds 10 years; 16 enterprises exist more than 20 years. Three enterprises exist in the market less than 10 years.

The researched enterprises have different forms of ownership. In 19 of 32 enterprises the owner is a physical person or several physical persons. 9 enterprises have an owner – the legal entity. Also among the enterprises – leaders of success - there are 4 collective farms.

This sample has the following distribution according to the organizational and legal forms: limited liability companies – 14 entities, joint-stock companies – 11 (3 of them public), production cooperatives – 9.

Most of the leading enterprises have a significant amount of the authorized capital (24 enterprises), which average value is 46234337 roubles (and median - 15896276). However, at other 8 companies the authorized capital is at the level of minimum (10000 roubles) or is a little higher (to 40000 roubles).

The majority of agricultural enterprises from the leaders of success are characterized by high levels of profitability. At 30 enterprises the profitability of operating activity is above an average or significantly higher than an average. Only two enterprises have profitability level below the industry average values. In this case the situation is similar to that we observed at the medium-sized enterprises operating in the sphere of industrial production.

The enterprises of the industry considerably lose out to other leaders of success on the level of liquidity. Only 2 enterprises had the average level of liquidity of assets on the industry and above industry average. At other 30 enterprises the level of liquidity was lower than industry average.

Indicators of business activity in the companies are not high. In most cases they are at the average level or below average on the industry (in 26 companies). Other 6 – the level of business activity is higher than industry average.

Agricultural enterprises – leaders of success lose out to other leading enterprises on the level of financial stability. Only in 15 enterprises the level of financial stability was estimated as high or sufficient, in structure of their enterprises the equity prevails (a share - more than 70%). Other 17 entities are characterized by low financial stability. However, only at 4 of them the debt capital prevails over the equity. Insufficient security of the enterprises with their own current assets is the reason of high risk of financial dependence.

In the capital structure of 23 enterprises the equity prevails (a share - more than 50%). From them 9 enterprises use the insignificant amount of debt funds (no more than 10% of the aggregate capital). At 6 enterprises in structure prevails the debt capital (more than 50%). At 4 enterprises the debt capital practically in 3 times exceeds the equity capital. It is interesting that at the same time the enterprises generally have the high level of satisfaction of liabilities (24 of 32 entities). Therefore, the factor "a capital structure and satisfaction of liabilities" can be considered as significant in achievement of business success in agricultural industry.

Creditworthiness rating of the enterprises is not lower than 44 (sufficient creditworthiness), at the same time at the majority of the enterprises the rating was at the level of 5 or higher (high creditworthiness).

Table 1: Portrait of leader of business success in Russia: agriculture vs industrial production

Success factor	Industrial production	Agriculture
OPERATIONAL		
activity scale	significant situation in industry	the most significant and the largest in industry
market share	at the majority up to 10%, however, there are also large players from market shares of 20% and more in the sample	insignificant, less than 5%,
number of employees	average (100-500 people)	average (100-500 people)
lifetime of the enterprise	long, more than 10 years (at one third – more than 20 years)	long, more than 10 years (at a half - more than 20 years)
size of the authorized capital	significant: the average value of 28032237 roubles, median - 8882000 roubles	at the majority – significant: the average value of 46234337 roubles, median – 14896276 roubles, at a quarter of the entities – at the level of minimum
property type	in most cases, the owners - individual	in most cases, the owners - individual
legal form	limited liability companies (16); joint-stock companies (16), including 2 public	limited liability companies (14); joint-stock companies (11), including 3 public; production cooperatives (9)
FINANCIAL		
profitability of operating activities	significantly higher than the industry average	higher or significantly higher than the industry average
liquidity	significantly higher than the industry average	below the industry average
business activity	average and below the industry average	average and below the industry average
financial stability	above industry average; in a capital structure of the majority of the entities the equity (more than 70%) prevails; high level of satisfaction of liabilities	low financial stability, more than at a half of the enterprises lower supply of own current assets, than on average on the industry, at the majority – in a capital structure prevails the equity; high level of satisfaction of liabilities
creditworthiness	high creditworthiness	high creditworthiness

Within the comparative analysis, mainly, it is necessary to pay attention to differences in success factors in the researched industries. As we see, on values of operational parameters leaders of success from two groups have only insignificant differences. In general, according to these signs they can be characterized as: they are the significant players in their industry, but do not occupy a dominant position in the market, with an average number of employees and rather long lifecycle, owned by one or more individuals.

As for financial factors, here are, on the one hand, the accurate tendencies in the researched groups and on the other – visible differences in values of the analyzed parameters between groups are traced. So it is possible to tell that the factor "liquidity" has high importance for enterprises of the production sphere and at the same time is little significant for agricultural enterprises. The same situation is observed on a factor of "financial stability" - it is one of determining for the enterprises of the sphere of industrial production. As for the agricultural enterprises, the low level of financial stability due to insecurity of its own current assets does not prevent them to be highly profitable, to show high growth rates and to be among leaders of success.

The medium-sized enterprises from two researched groups show similar values on the rest of the financial parameters: these enterprises significantly exceed the competitors on the level of profitability of operating activities, having at the same time not the highest level of business activity, but, at the same time, a high rating of creditworthiness.

4. CONCLUSION

The research of business practices of most successful medium-sized enterprises in production sphere and agriculture allows us to talk about some stable tendencies in operational and financial activities of these companies.

The methodology used in this research allows to carry out ranging of the enterprises on the level of success and to identify the leaders of success among them, and the provided database (FIRA PRO) allows to compare the indicators of the separate enterprise to the industry average values. It was important for us as it allows to reveal in what the analyzed enterprises (the leader of success) are better or worse than their competitors and to answer a question of importance of these or those factors in achievement of success.

In this research two fields of activity are investigated – industrial production and agriculture which differs from each other on the structure of industry groups, on the conditions of operation and on the level of state support. The first key difference consists in features of industry groups: it is revealed that the industrial enterprises in the sample mostly work in low-profitable industries with low rates of development; the sphere of agricultural industry, on the contrary, is provided by dynamically developing industries with the profitability level considerably exceeding the average on economy. Thus, external environment is not always incentive or an obstacle to development of the separate enterprise.

The second group of the researched factors – operating– allows making the general portrait of successful medium-sized enterprise, because in both areas of activity almost in one hundred percent of cases the similar signs are observed: lifetime, number of employees, pattern of ownership, activity scale, and size of the authorized capital. The vast majority of the researched successful enterprises are the non-public companies having long lifecycle, a significant position in the industry, a substantial amount of the authorized capital and the average number of employees.

Industry features are much shown in the research of the group of financial success factors of the enterprises. Here, special attention is paid to the fact that for success of the entity are non-

significant a number of parameters which traditionally considered the key factors in achievement of efficiency (the level of business activity in both samples of leaders of success was extremely low). It is also found that the high risk of financial dependence and low liquidity does not prevent the enterprises of the agricultural sphere to remain successful. At the enterprises of the sphere of industrial production all researched financial indicators (profitability, liquidity, financial stability) are significantly higher than the industry average values, thus, it is concluded that for this sphere financial factor plays an important role in achievement of success.

In general, the results of this research would be logical to use in their practice by leaders of medium-sized business, as well as the authorities in the development of the state support programs of small and medium-sized businesses. The specified subjects should direct address investments in a number of sectors of industrial production, to stimulate the enterprises to increase the number of jobs, widen the scales of activities, to develop effective criteria for evaluation of creditworthiness of borrowers within the state programs, to reduce the tax burden for dynamically developing subjects of medium-sized businesses.

ACKNOWLEDGEMENT: *The study was performed at the expense of a grant of the Russian Science Foundation (project №14-18-02508)*

LITERATURE:

1. Romar, E.J. (2009) Strategic Intent, Confucian Harmony and Firm Success. *Acta Polytechnica Hungarica* Vol. 6, No. 3, pp. 57-67
2. Sieger, P. (2011). Long-term success of family firms: Investigating specific aspects of firm-level entrepreneurship and individual-level antecedents. *Germany, University of St. Gallen*.
3. Jensen M.C. (2001) Value Maximization, Stakeholder Theory, and the Corporate Objective Function. *Journal of Applied Corporate Finance*, 14 (3), pp. 8–21
4. Drucker, J. (2007) Regional Dominance and Industrial Success: A Productivity-Based Analysis. *Dissertation submitted to the faculty at the University of North Carolina at Chapel Hill in partial fulfillment of the requirements for the degree of Doctor of Philosophy in the Department of City and Regional Planning. Chapel Hill*
5. Simon, H. (1996) *Hidden champions : lessons from 500 of the world's best unknown companies*. Boston (Mass.): Harvard Business School Press
6. Simon, H. (2009) *Hidden Champions of the 21st Century : Success Strategies of unknown World Market Leaders*. London: Springer.
7. Burlingham B. (2005) *Small Giants: Companies That Choose To Be Great Instead Of Big* the Portfolio, a member of Penguin Group (USA) LLC, 272 p.
8. Bronsteen, J, C.J. Buccafusco, J.S. Masur (2013) Well-Being Analysis vs. Cost-Benefit Analysis, *Duke Law Journal*, v., 62, pp. 1603–1689
9. Barkhatov V.I., Pletnev D.A. (2014) Sravnitel'nyy analiz podkhodov k opredeleniyu ponyatiya «uspešnost' biznesa» v sovremennoy nauke [A comparative analysis of approaches to the definition of "business success" in modern science]. *Vestnik Chelyabinskogo gosudarstvennogo universiteta [Bulletin of the Chelyabinsk State University]*. № 18 (347). vol. 46. pp. 8-18.

10. Pletnev D., Barkhatov V. (2016) Business Success of Small and Medium Sized Enterprises in Russia and Social Responsibility of Managers. *Procedia - Social and Behavioral Sciences. Volume 221, 7 June 2016, pp. 185–193*
11. Nikolaeva E., Pletnev D. (2015) Internal Business Success Factors of Small and Medium-Sized Enterprises in Russia. *Journal of Advanced Research in Law and Economics, Volume VI Issue 4(14) Winter 2015, pp. 761-774*
12. Barhatov V., Belova I. (2015) Tax Legislation as External Factor of Small and Medium-scale Business Success in Russia. *Mediterranean Journal of Social Sciences. Vol 6 No 6 S4, pp. 590-595*
13. Pletnev D., Nikolaeva E. (2015) Metodologiya Integral'noy Otsenki Uspeshnosti Predpriyatiy Malogo i Srednego Biznesa v Rossii [Methodology of Integral Evaluation of Business Success of Small and Medium Enterprises in Russia], *Zhurnal ekonomicheskoy teorii [Journal of Economic Theory], vol.4, pp. 66-77*
14. FIRA PRO, Informatsionno-analiticheskaya sistema FIRA PRO [Information and Analytic System FIRA PRO] (retrieved 10/06/2016) <http://www.fira.ru>

“WORK–LIFE BALANCE” AND ITS IMPORTANCE FOR THE WORK PROCESS IN THE HOSPITALITY INDUSTRY. A PERSPECTIVE OF GENERATION Y EMPLOYEES

Aleksandra Grobelna

Gdynia Maritime University, Poland
a.grobelna@wpit.am.gdynia.pl

Anna Tokarz - Kocik

University of Szczecin, Poland
anna.tokarz@wzieu.pl

ABSTRACT

The importance of people in the world economy has been emphasized in many previous studies (e.g. Skrzyszewska and Milić Beran, 2015), including the critical role of employees in successful hotel business operations (e.g. Enz and Siguaw, 2000; Davidson, 2003). However, today modern hospitality industry faces a generational change in the labor market. Although generation Y employees create an increasing pool of hospitality workforce, their characteristics may pose real challenges for human resources management (see Kong et al., 2015). This may result from the fact that work does not play a central role in their lives, thus they may be less engaged in work and more likely to leave the organization than the older generations in the hospitality workplace (Park and Gursoy, 2012; Solnet et al., 2012). Therefore, the aim of this study is to identify the importance that employees of generation Y attach to the work–life balance and what its consequences are for the work process in the hospitality setting. More specifically this study develops and tests a research model that investigates the relationships between both work–family conflict (WFC) and workplace support for work–life balance (WSWLB) with work engagement (WE) and its correlation with employees’ intention to leave (ItL). Additionally, direct correlations between WFC and WSWLB with intention to leave (ItL) are examined. The research was conducted among contact employees of hotels located in Northern Poland (Pomeranian Voivodeship). Data were collected using a questionnaire survey. The findings of this study provide empirical support that young people want to have more control over their own lives with less interference from their work. Only then will they be more likely to engage in their work and stay in a hotel organization for longer. The research value of this study may result from the fact that, to the best of authors’ knowledge, this is the only attempt to measure the correlations between the proposed study context taking into account generation Y employees in the context of the Polish hospitality industry.

Keywords: generation Y employees; hospitality industry; intention to leave; work engagement; work–life balance.

1. INTRODUCTION

Due to the conditions in which hotel enterprises operate nowadays, the businesses change what they require from their employees. Increasingly often, they expect their employees to be more flexible, creative and pursuing self-development while simultaneously be more engaged in the organization and achieve higher work efficiency levels.

As a result, an increasing number of employees do not have enough time for their families, to rest or to pursue their own interests. Not only this imbalance between work and personal life has negative consequences for the employees and their families, but it also does not favour high work quality and efficiency. Exhausted and burnout employees are a major problem for hotel enterprises in the long term.

The aim of this study is to identify the importance that employees of generation Y attach to the work–life balance and what its consequences are for the work process in the hospitality setting. The research problem is to find an answer to the questions whether the work–family conflict and the workplace support for the work–life balance can significantly relate to young employees' work engagement and whether an increase in work engagement may reduce young people's leaving intention.

The rationale for such a research problem stem from the fact that the hierarchy of needs for employees has changed significantly (see Raport Barometr 2015); Grobelna and Marciszewska, 2016a, p. 139-140). In 2004, respondents said that the most important factors for taking an employment were the scope of responsibilities (68%) and remuneration (64%). The third most important factor was work atmosphere (53%). Nowadays, the situation is completely different. Research conducted in 2014 showed that work atmosphere is the most important aspect for employees as 94.3% respondents indicated this factor. The second most important were flexible working hours (85.9%) and career development opportunities (84.5%). What is interesting, remuneration was ranked the last among the factors determining whether to change the job (Raport Barometr 2015). This research show how much the priorities and needs of employees have changed within the last decade. Opportunities for development, good atmosphere and flexible working hours are more valued than remuneration. Potential employees put much more emphasis on work-life balance (this factor was indicated by 27% respondents in 2004 and 67.9% in 2014). This is of utmost importance in the hotel industry whose some specific work characteristics (such as long working hours, night shifts, weekend and holiday work) can hinder maintaining work-life balance and not meet the expectations of young employees in that respect.

2. WORK-LIFE BALANCE

The term 'work' describes a human activity that leads to the production of goods and services, which create life and development conditions for a person. (Orczyk, 2004, p. 115).

From the perspective of economic concepts, work is a special type of goods which a person sells on the labour market in the form of labour and moral powers, skills and qualifications, in order to produce goods and services that will satisfy their material and spiritual needs (Kamerschen, McKenzie and Nardinelli, 1991, p. 670).

Most families' livelihood is based on gainful employment; however, one should not perceive work only in the terms of material gains. It constitutes a dimension in which people can use their own skills, fulfil ambitions and achieve self-fulfilment. Work provides a sense of identity, sets the employee's social status and satisfies the need for belonging (Schulz and Schulz, 2002, p. 46). The free time outside the professional life is a time that may be used for relaxing or entertainment. It is also a time which employees spent with their families (Kozioł, 2000, p. 94). Being engaged both in work career and family life can lead to serious stress for employees, especially during certain periods in life. These periods can, for example, include promotion and taking on new responsibilities, which automatically results in being more engaged in the professional life or having a child born, which in turn increases the engagement in family life (Clutterbuck, 2005, p. 149). The repercussions of not having work-life balance include such phenomena as: professional burnout, physical and mental medical conditions, health problems and no work or life satisfaction at all (Greenglass, 2005, p. 141; Syper-Jędrzejak, 2014. p. 154; Wilsz, p. 439-440). Losing the control over work-life balance is a slow but treacherous process. It can be constrained, among other things, with the support from the organization which should help employees to establish what they want to achieve in various spheres of life (Clutterbuck, 2005, p. 75).

3. GENERATION Y IN THE HOTEL LABOUR MARKET

The hotel business is a social service activity, focused on in providing hospitality to guests. It satisfies the needs for rest, food, sleep, hygiene, health and wealth care, cultural entertainments and communication with the society (Kowalczyk, 2001, p. 10).

The hotel labour market can be perceived as a place where the supply and demand meet and the price is established, i.e. the remuneration in the meaning of compensation for work (Zieliński, 2012, p. 9). The demand side of the labour market comprises hotel enterprises. They vary in structure. We may distinguish transnational enterprises (hotel chains) and small and medium hotel enterprises which are associated with low-scale turnover, flat organizational structure and few opportunities for staff development or promotion.

The supply side in the hotel industry comprises unemployed high-school and university graduates, as well as employees that plan to change their current employer. The quantity aspect of labour supply consists of the number of job-seekers and the offered work time. Whereas the quality aspect of labour supply comprises the skills, qualifications, education, performance and personal traits of potential employees. The last features greatly depend on the employee's age and which generation they represent (Tokarz-Kocik, 2016, p. 948).

In the literature of the subject, a generation is defined as "all of the people of similar age, from a particular cultural environment, regarded collectively, who have similar attitudes, motivations, mindset and value system as a result of their shared historical and social situation"

(Griese, 1996, p. 23).

There are members of three generations on the modern labour market: baby boomers, Generation X and Generation Y. Their members birth timeframe are relative and researchers have not reached consensus as to the correct version of this division. For example, baby boomers are people born between 1943 and 1960 or 1943 and 1964; Generation X includes people born between 1961 and 1981 or 1965 and 1979, while Generation Y members were born between 1982 and 2002 or 1980 and 1989 (Kołodziejczyk-Olczyk, 2014, p. 92; Woszczyk and Gawron, 2014, p. 81-99).

Generation Y includes people who are now 14 to 32 years old, so these are teenagers, university students, young adults entering the labour market and starting families (Kachniewska and Para 2014, p. 158).

Generation Y, which is now entering the labour market, has different sets of values, expectations and communication methods as well as distinct way of fulfilling tasks than the representatives of prior generations. The individual feature of Generation Y is independence that disrupts functioning in the work environment (taking orders, performance assessment, being controlled). This fact may cause some problems to modern employers in the hotel industry (majority of them represent the baby boomers generation or Generation X) who are used to different work and professional relations standards. Furthermore, research shows that 75%-90% Generation Y members cannot imagine working for one employer for longer than 3 years (Massalski, 2012). This lack of loyalty comes from the need to develop, take on new challenges, look for diversity and high mobility.

Generation Y members highly value work flexibility (being able to combine different tasks, breaking the routine) and possibility to organize the way they work (even the working hours) (Barron at al., 2007, p. 121-122). The specificity of the hotel industry work makes meeting these expectations by employers undoubtedly challenging (Tokarz-Kocik, 2015).

4. METHODS

This study develops and tests a research model that investigates the relationships between both work-family conflict (WFC) and workplace support for work-life balance (WSWLB) with work engagement (WE) and its correlation with employees' intention to leave (ItL).

Additionally, direct correlations between WFC and WSWLB with intention to leave (ItL) are examined (Fig.1). More specifically, the following hypotheses are proposed:

H1: There is a negative relationship between work–family conflict that is experienced by generation Y hotel employees and their work engagement (1a), and a positive relation between workplace support for work–life balance and those employees’ work engagement (1b).

H2: There is a positive relationship between work–family conflict experienced by generation Y hotel employees and their intention to leave (2a) and a negative relation between workplace support for work–life balance and those employees’ leaving intention (2b).

H3: There is a negative relationship between generation Y hotel employees work engagement and their intention to leave.

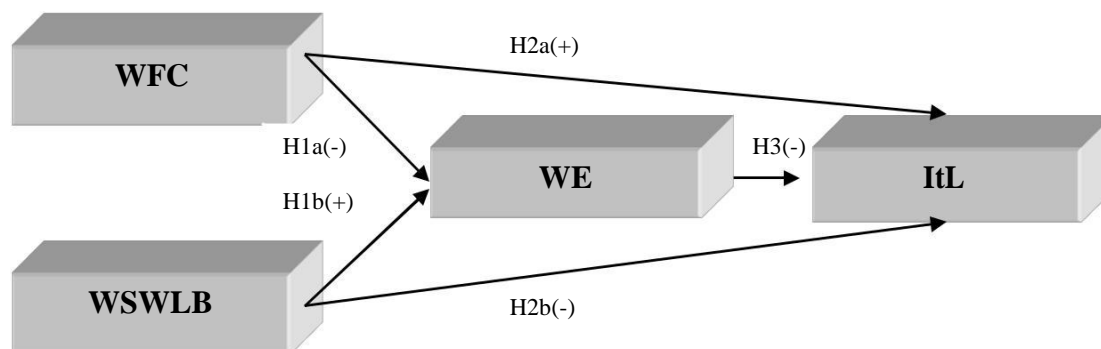


Figure 1: Research model

Note: WFC (work–family conflict); WSWLB (workplace support for work–life balance); WE (work engagement); ItL (intention to leave)

The above-mentioned relationships were tested using data from employees of hotels that are located in Pomeranian Voivodeship. Pomeranian Voivodeship is a well-known tourist destination of Northern Poland. The attractive image of the destination can be perceived as one of the strategic tools in building the competitive advantage (Studzieniecki, 2016, p. 969).

Managers of five hotels agreed to participate in this study and the research was preceded by consultations with them. A detailed explanation of the study aim and the questionnaire was given to hotel managers.

The research was directed at all hotel employees who met two selection criteria:

- *first* – they had direct and frequent contact with hotel guests (contact employees),
- *second* – they declared their age below 32 years old (Generation Y).

The adoption of the above criteria results from the fact that:

- *first* – employees working in contact positions in hotels are exposed to high job demands, and it is said that they are particularly susceptible to work–family conflict (Karatepe, 2008, p. 238),
- *second* – the younger generation of employees create real challenges for hospitality managers, as they are characterized by high mobility on the labor market (Kachniewska and Para, 2014, p. 155), thus seeking an answer to the problem of how to enhance young people’s work engagement and reduce their leaving intention from hotel organizations seems to be critical.

Data were collected using a questionnaire survey (Kaczmarczyk, 2002, p. 171). All questionnaires were distributed to hotels in a pack containing a cover letter and return envelopes. The respondents were requested to fill out the questionnaires in a self-reported manner and they were assured of anonymity and confidentiality.

Study constructs shown in Fig. 1 were operationalized using scales derived from the relevant literature and had also been applied in previous studies in the hospitality setting, which provides a chance to compare the findings in the context of different social and cultural backgrounds.

Work-family conflict (WFC) was measured using five items in line with Karatepe and Kilic (2007) and Karatepe and Sokmen (2006), who based on Netemeyer et al. (1996) and Boles et al. (2001) and measured work-family conflict among frontline hotel employees. *Workplace support for work-life balance (WSWLB)* was operationalized using 3 items from Wong and Ko (2009), who conducted their research among hotel employees in Hong Kong. *Work engagement (WE)* was measured using 9 items from the shortened version of the Utrecht Work Engagement Scale (UWES) (Schaufeli, Bakker and Salanova, 2006). These scale items had also been applied in previous studies conducted in the hospitality setting (e.g. Karatepe et al., 2014). *Intention to leave (ItL)* was assessed by three items, used in line with Karatepe and Uludag (2007), who based on Boshoff and Allen (2000) and adapted these items to operationalize hotel employees' intention to leave in their research in Northern Cyprus. To assure equivalent meaning for all items and to reduce errors resulting from translation from one language into another, the survey instrument was originally prepared in English and then translated into Polish via the back-translated method. All scale items were measured on a five-point scale, ranging from

“1=strongly disagree” to “5 = strongly agree”. The scale reliability was assessed by Cronbach's alpha, whose values were as follows: 0.90 (*WE*); 0.87 (*WFC*); 0.86 (*ItL*); 0.59 (*WSWLB*). All values, except *WSWLB*, are above the commonly accepted the cut-off point of 0.7, however, in the previous studies the scales with lower alpha values can be also found to be acceptable (e.g. Richardson, 2010, p. 4; Ghafoor et al., 2011, p. 11098; Alniacik et al., 2012, p. 360-361). A descriptive statistical method was used to analyze a profile of study respondents, and to verify the relationship between the study constructs, Pearson's correlation has been applied.

5. RESULTS

60 hotel employees below the age of 32 years participated in this study. Most of the respondents were female (76.7%). 61.7% of the study participants declared the level of secondary school education and almost 33.3% had a higher level of education. The rest of the investigated group (5%) indicated vocational education. As for the status of employment, most of the respondents were working in full-time jobs, whereas 35% of the participants declared working in part-time system. As depicted in Fig. 2, most correlations among the study constructs, were significant and in the predicted directions, except the correlation between workplace support for work-life balance and intention to leave, where the correlation was insignificant.

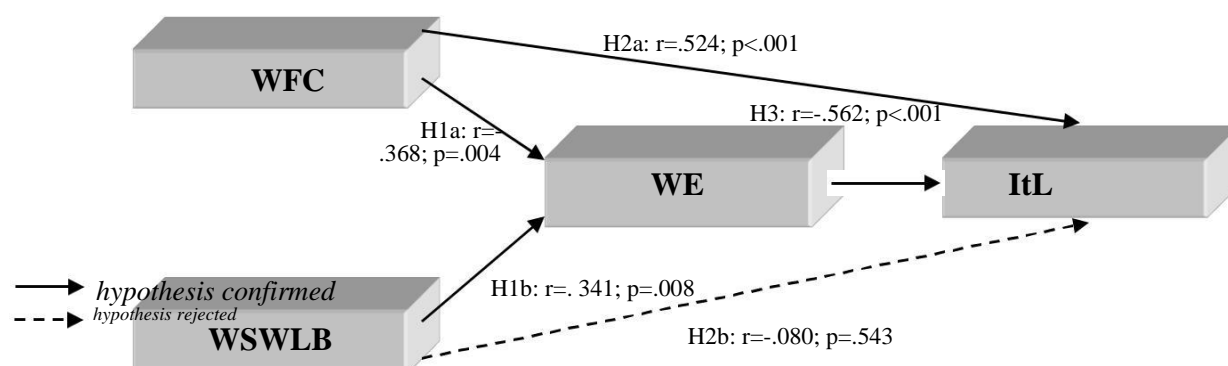


Figure 2: Verified research model

Note: WFC (work-family conflict); WSWLB (workplace support for work-life balance); WE (work engagement); ItL (intention to leave)

More specifically, results of this study demonstrate that there is both a significant and negative correlation between WFC and WE and a significant positive correlation between WSWLB and WE. In other words, the greater the conflict between work and family young people experience, the less engaged they are in work, which provides support for Hypothesis 1(a). By contrast, the more supportive workplace they have in the context of work–life balance, the more generation Y hotel employees feel engaged in their work. Thus, Hypothesis 1(b) was also supported. Additionally, the results of this study demonstrate a significant and positive correlation between WFC and ItL; however the correlation between WSWLB and ItL was insignificant. These findings give support for Hypothesis 2a and reject Hypothesis 2b.

6. IMPLICATIONS AND CONCLUSIONS

This study provides useful information that is relevant to human resources management literature. Although the results of this study cannot be generalized, the study findings show that the work–life balance relates positively to young employees' work engagement, whereas work–life conflict appears to have detrimental effect on it. Work engagement, in turn, may diminish employees' leaving intention. Therefore, the findings of this study provide empirical support that young people want to have more control over their own lives with less interference from their work. Only then will they be more likely to engage in their work and stay in a hotel organization for longer, which simultaneously can give a chance to use and benefit from their skills and their unique intellectual capital.

These findings also raise a number of important issues for managing young employees in the hospitality context. In short time, Generation Y members will become the majority of labour force and they will likely reorganize the work environment in accordance with their own vision (Brownstone, 2014). So it is the task of the hotel industry employers to create conditions for harnessing Generation Y's potential more efficiently (Grobelna and Marciszewska, 2016b, p. 95-98).

The basis for efficient organization operations is integration of its goals with the goals of employees. However, it is vital to remember of the importance of the non-financial motivational factors, including flexible work-time that seems to be valued by employees, but the frequency of its occurrence in the organisations is perceived on the lower level (see Dolot, 2014, pp. 69, 71).

It leads to a conclusion that all employer's activities that facilitate having work -life balance may result in increased work efficiency. Work-life balance activities should encompass, for example (Cascio, 2001, p. 180):

- helping employees in taking care of their children and their dependents;
- providing flexible working conditions;
- giving special leaves at the request of the employees who find themselves in special life circumstances (additional maternity and paternity leaves, study leave);
- providing support for the personnel in non-work areas, e.g. organizing family picnics and meetings for employees and their families.

Taking into consideration work-life balance solutions and instruments currently used in hotels, applying more open approach should be recommended to the management of the researched enterprises. For instance, formalize the aspects that have already been functioning in a form of social agreement and goodwill of some particular managers.

LITERATURE:

1. Alniaçik Ü., Alniaçik E., Akçin K., Erat S. (2012). Relationships Between Career Motivation, Affective Commitment and Job Satisfaction. *Procedia-Social and Behavioral Sciences* 58, 355-362.

2. Barron P., Maxwell G. A., Broadbridge A., Ogden S. M. (2007). Careers in hospitality management: Generation Y's experiences and perceptions, *Journal of Hospitality and Tourism Management*, 14 (2), 119-128.
3. Boles J.S., Howard W.G., Donofrio H.H. (2001). *Journal of Managerial Issues* 13(3), 376-390.
4. Boshoff, C., Allen, J. (2000). The influence of selected antecedents on frontline staff's perceptions of service recovery performance. *International Journal of Service Industry Management*, 11(1), 63-90.
5. Brownstone S. (2014). Fast Company Millennials Will Become The Majority In The Workforce In 2015. Is Your Company Ready? Retrieved 27.06.2016 from www.fastcoexist.com/3037823/millennials-will-become-the-majority-in-the-workforce-in-2015-is-your-company-ready.
6. Cascio W. (2001). *Kalkulacja kosztów zasobów ludzkich*, Kraków: Dom Wydawniczy ABC.
7. Clutterbuck D. (2005). *Równowaga między życiem zawodowym a osobistym*. Kraków: Oficyna Ekonomiczna.
8. Davidson, M.C.G. (2003). Does organizational climate add to service quality in hotels? *International Journal of Contemporary Hospitality Management* 15(4), 206-213.
9. Dolot, A., (2014). Wybrane czynniki motywowania do pracy w świetle badań empirycznych, *Zeszyty Naukowe Politechniki Śląskiej, Organizacja i Zarządzanie* z. 71, Nr kol. 1917, 63-73.
10. Enz, C.A., Siguaw, J.A. (2000). Best Practices in Human Resources. *Cornell Hotel and Restaurant Administration Quarterly* 41(1), 48-61.
11. Ghafoor A., Qureshi T.M., Azeemi H.R., Hijazi, S.T. (2011). Mediating role of creative self- efficacy, *African Journal of Business Management* 5 (27), 11093–11103.
12. Greenglass E. (2005). Różnice wynikające z ról płciowych: wsparcie społeczne i radzenia sobie ze stresem. In H. Sęk, R. Cieślak (eds.), *Wsparcie społeczne, stres i zdrowie*, 138-151, Warszawa: Wydawnictwo PWN.
13. Griesse M., (1996). *Socjologiczne teorie młodzieży*, Kraków: Impuls.
14. Grobelna A., Marciszewska B. (2016a). Undergraduate students' attitudes towards their future jobs in the tourism sector: challenges facing educators and business. In D. Vasilenko, N. Khazieva (eds.), *Proceedings of The 4th International Conference on Management, Leadership and Governance*, ICMLG 2016, (138-145). Academic Conferences and Publishing International Limited, UK.
15. Grobelna A., Marciszewska B., (2016b). Work motivation of tourism and hospitality students: implications for human resource management. In C. Bagnoli, Ch. Mio, A. Garlatti and M. Massaro (eds.) *Proceedings of the 8th European Conference on Intellectual Capital*, ECIC 2016, (95-103). Academic Conferences and Publishing International Limited, UK.
16. Massalski M. (01.10.2012). Jak budować kapitał z pokoleniem Y. Retrieved 20.07.2016 from http://www.publikuj.org/jak_budowac_kapital_z_pokoleniem_y.html.
17. Kachniewska M, Para A.(2014). Pokolenie y na turystycznym rynku pracy: fakty, mity i wyzwania. *Rozprawy Naukowe Akademii Wychowania Fizycznego we Wrocławiu* nr 45, 153-166.
18. Kaczmarczyk S. (2002). *Badania marketingowe. Metody i techniki*, Warszawa: PWE.
19. Kamerschen D. R., McKenzie R. B., Nardinelli C. (1991). *Ekonomia*. Gdańsk: Fundacja Gospodarcza NSZZ „Solidarność” .
20. Karatepe O.M. (2008). Work-family conflict and facilitation: implications for hospitality researchers. In D.V. Teasone (ed.), *Handbook of hospitality human resources management* (237-264), Routledge (published in 2013), Taylor & Francis Group London and New York

21. Karatepe, O. M., Kilic, H. (2007). Relationships of supervisor support and conflicts in the work–family interface with the selected job outcomes of frontline employees. *Tourism Management*, 28 (1), 238–252.
22. Karatepe, O. M., Sokmen, A. (2006). The effects of work role and family role variables on psychological and behavioral outcomes of frontline employees. *Tourism Management*, 27 (2), 255-268.
23. Karatepe, O. M., Uludag, O. (2007). Conflict, exhaustion and motivation: a study of frontline employees in Northern Cyprus hotels. *International Journal of Hospitality Management*, 26 (3), 645-665.
24. Karatepe, O.M., Beirami, E., Bouzari, M. Safavi, H.P., (2014). Does work engagement mediate the effects of challenge stressors on job outcomes? Evidence from the hotel industry. *International Journal of Hospitality Management* 36, 14-22.
25. Kołodziejczyk-Olczyk (2014). Zaangażowanie pracowników w różnym wieku. In *Zarządzanie Zasobami Ludzkimi*, nr 2, 84-95.
26. Kong H. , Wang S., Fu X. (2015). Meeting career expectation: can it enhance job satisfaction of Generation Y?, *International Journal of Contemporary Hospitality Management*, 27(1), 147 – 168.
27. Kowalczyk A. (2001). *Geografia hotelarstwa*, Łódź: Wydawnictwo Uniwersytetu Łódzkiego.
28. Kozioł L. (2000). *Zarządzanie czasem pracy*. Kraków: Drukarnia Antykwa.
29. Netemeyer R.G., Boles J.S., McMurrian R. (1996). Development and validation of work–family conflict and family–work conflict scales, *Journal of Applied Psychology*, 81 (4), 400–410.
30. Orczyk J. (2004). Zmiany zakresu pojęcia „praca” a zatrudnienie. In Z. Wiśniewski, A. Pochtowski (eds.), *Zarządzanie zasobami ludzkimi w warunkach nowej gospodarki*, (190-219), Kraków: Oficyna Ekonomiczna.
31. Park, J., Gursoy, D. (2012). Generation effects on work engagement among U.S. hotel employees, *International Journal of Hospitality Management* 31(4), 1195 – 1202.
32. Raport Barometr pracownika EDENRED-IPSOS 2015: Samopoczucie i motywacja pracowników w Europie. Retrieved 20.07.2016 from http://inwestycje.pl/kadry_i_place/Barometr-pracownika-EDENRED-IPSOS-2015-Samopoczucie-i-motywacja-pracownikow-w-Europie;269005;0.html.
33. Richardson, S. (2010). Tourism and hospitality students' perceptions of a career in the industry: a comparison of domestic (Australian) students and international students studying in Australia. *Journal of Hospitality and Tourism Management*, 17 (1), 1-11.
34. Schaufeli W.B., Bakker A.B., Salanova M. (2006). The Measurement of Work Engagement With a Short Questionnaire. A Cross-National Study. *Educational and Psychological Measurement*, 66 (4) , 701-716.
35. Schulz P., Schulz S. E. (2002). *Psychologia a wyzwania dzisiejszej pracy*. Warszawa: Wydawnictwo PWN.
36. Skrzyszewska, K., Milić Beran I. (2016). Maritime Governance – Differences Between Assumptions and Realizations. In D. Vasilenko, N. Khazieva (eds.), *Proceedings of the 4th International Conference on Management, Leadership and Governance, ICMLG 2016* (312-320). Academic Conferences and Publishing International Limited, UK.
37. Solnet D., Kralj A., Kandampully J. (2012). Generation Y Employees: An Examination of Work Attitude Differences, *Journal of Applied Management and Entrepreneurship*, 17(3), 36-54.
38. Studzieniecki T. (2016). An international political region as a tourist destination; a case study of the Visegrad Group. In Klímová, V., Žitek, V. (eds.), *19th International*

Colloquium on Regional Sciences. Conference Proceedings (969-976). Brno: Masarykova Univerzita.

39. Syper-Jędrzejak M. (2014). Narzędzia wspierania równowagi praca-życie - wybrane przykłady z praktyki gospodarczej, *Zarządzanie Zasobami Ludzkimi*, nr 1, 153-163 Retrieved 20.07.2016 from <https://www.ipiss.com.pl/?zsl=narzedzia-wspierania-rownowagi-praca-zycie-wybrane-przyklady-z-praktyki-gospodarczej>.
40. Tokarz-Kocik A. (2015). Wpływ zmian demograficznych na rynek pracy w hotelarstwie, SGH, Warszawa (*forthcoming article*).
41. Tokarz-Kocik A. (2016). Procesy demograficzne jako determinanta zachowań pracodawców w branży hotelarskiej w Polsce, *Marketing i Rynek*, nr 3, 947-958, Retrieved 20.07.2016 from http://www.marketingirynek.pl/archiwum/marketing_i_rynek_nr_03_2016,p645125686.
42. Wilsz J. (2009). *Teoria pracy. Implikacje dla pedagogiki pracy*, Kraków: Oficyna Wydawnicza Impuls
43. Wong S. Ch-k., Ko A. (2009). Exploratory study of understanding hotel employees' perception on work-life balance issues, *International Journal of Hospitality Management*, 28(2), 195-203.
44. Woszczyk P., Gawron M. (2014). Nowe trendy, stare przyzwyczajenia. Zarządzanie wielopokoleniowe w polskich przedsiębiorstwach, *Zarządzanie Zasobami Ludzkimi*, nr 5, 81-99.
45. Zieliński M. (2012). *Rynek pracy w teoriach ekonomicznych*, Warszawa: CeDeWu.

THE LABOUR MARKET IN THE SLOVAK REPUBLIC – STRUCTURAL PROBLEMS

Eva Rievajova

*University of Economics in Bratislava, Faculty of National Economy, Dolnozemska 1, 852 35
Bratislava
eva.rievajova@euba.sk*

Roman Klimko

*University of Economics in Bratislava, Faculty of National Economy, Dolnozemska 1, 852 35
Bratislava
roman.klimko@euba.sk*

ABSTRACT

The labour market is sensitive and vulnerable place in the Slovak economy, as shown by the global crisis, since 2009 with significant signs in case of Slovakia compared to most EU economies. Unemployment in Slovakia has significant economic, social and political dimensions, as well as many socio-economic, regional, generational, ethnic and other specifics. Adverse effects of the crisis have affected mainly the category of disadvantaged persons, as well as some of the lagging regions of Slovakia. Unemployment in Slovakia is one of the most serious economic and social problems, which prevents the full realization of the growth potential of the economy, with regard to its structural nature. Slovakia is among the countries which are struggling with high long-term unemployment rate (over 12 months). During the whole period since in the Slovakia is real long-term unemployment known (end of 1992), its structure and causes have not been fundamentally changed. But it changed its scope and the duration of unemployment has increased as well as at the national level, and in individual regions. Serious and long-lasting economic and social problems are regional differences in unemployment. Unevenness in the distribution of the unemployment in different regions is linked not only to the historical development of the Slovak economy, but also with its modern, highly differentiated development, and despite economic recovery these differences remain significant. Nowadays, young people in the age group 15-24 years are the most vulnerable group in the labour market. The youth unemployment rate is generally higher than the overall unemployment rate. Creating inequalities in access to the labour market is largely due to lack of abilities, skills and work experience in own field of study that are currently unfolding barriers in access to the labour market. The aim of this paper is to assess developments in the labour market with an emphasis on unemployment and its structural characteristics, identify persistent problems and risk factors for the employment growth.

Keywords: *Labour market, Regional differences, Structural problems, Trends, Unemployment.*

1. INTRODUCTION

Labour market is a sensitive and vulnerable place of the Slovak economy. Previous years of the economic crisis with its onset in 2009 have been expressed more distinctly than in other EU countries, resulting in more profound structural problems on the labour market, and increased unemployment rate. Unemployment in the Slovak conditions has a strong economic, social and political dimension, as well as many socio-economic, regional, generational, ethnical and other specific aspects. Unfavourable effects of the crisis have mainly affected the category of disadvantaged people, as well as certain regions of Slovakia with typically lower economic activity and wages. Unemployment of the disadvantaged is a huge problem in Slovakia, compared to Europe. Latest economic prognoses confirmed slight revitalization of Slovakia in the terms of lower energy cost and very friendly currency strategy. Development of summary

indicators of the Slovak labour market is positive and this trend should continue in the following two years, based on short-term prognoses. However, huge regional differences in both economic growth and the employment have been reported on the labour market outcomes. As stated also by the European Commission, unemployment has been one of the biggest problems of the economic strategy, taking in account its structural nature.

The paper is aimed at evaluating the labour market development in Slovakia with focus on the unemployment and its structural characteristics, identifying pending problems and risk factors of the increasing unemployment. Selective survey of the household labour force conducted by the Statistical Office of the Slovak Republic, the Unemployment Record IS kept by the Central Office of Labour, Social Affairs and Family, and Eurostat data represent basic statistical information sources.

2. LABOUR MARKET TRENDS

Labour market trends are partially the result of cyclic movements and especially major economic crisis, but they are also caused by structural and institutional issues of the labour market affecting the economic activity and labour markets performance. During the previous three years, after the aftermath of the most significant manifestations of the crisis, Slovakia made considerable effort to remove macroeconomic imbalance from previous years, however there are still many problematic areas and there are always new challenges. After the crisis, the economic growth of Slovakia was one of the highest in the EU and the convergence continues, albeit at slower pace. The economic production quickly recovered and in 2011 achieved levels, which exceeded levels prior to crisis, however the growth rate after the crisis is still lower (Figure 1). During 2012-2014 the annual growth of GDP slowed to an average of 1.8%, while during 2006-2008 the average level was 8.3%. During the last quarter of 2015 the economic growth was as much as 4.3%, which was the best result for the past 5 years.

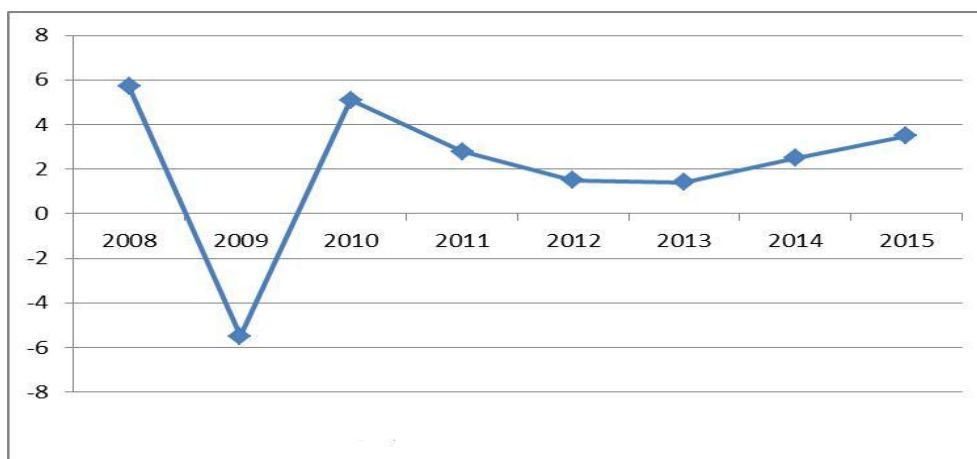


Figure 1: Annual percentage growth rate of GDP at market prices
(Eurostat) Note: forecast for 2015

Despite continued economic recovery the production gap remained negative in 2015 and it is expected that it will be closed only in 2017. The real convergence towards more developed member states continues, albeit at slower pace than before the crisis. Actual GDP per capita in 2014 in Slovakia was approximately 75% of the EU level. The growth of actual GDP in 2015 increased to 3.5%. The driving factor was major increase of investment activity tied to the use of the EU funds and a major growth of consumption of households (Európska komisia, 2016). In the following years it is expected that the strongest impulse of growth will continue to be the growing private consumption with contribution of increasing employment, growth of actual

salaries, low interest rates and continuing decline of energy costs. Crisis years 2009-2010 again confirmed the vulnerability of the Slovak labour market against cyclic economic slumps, due to which the employment rate fell more sharply than in the EU and in the Eurozone. The Slovak labour market traditionally remained in employment rate significantly behind the average, in the last third of countries with the lowest rate of employment. Higher rate was achieved also by the V4 countries, of which the best results were achieved by the Czech Republic (Figure 2). In Slovakia 2014 was the long awaited year of labour market recovery, after the economic growth of 2010 through 2012 did not introduce significant growth of employment. The year 2013 and especially 2014 recorded in this context positive development. Employment of 20 through 64-year-old persons increased in Slovakia in 2014, when compared to the previous year, but it is still below the level of 2008. Employment growth continued also in 2015. Employment grew significantly in this year and the labour market should continue its positive growth, copying the stable economic growth.

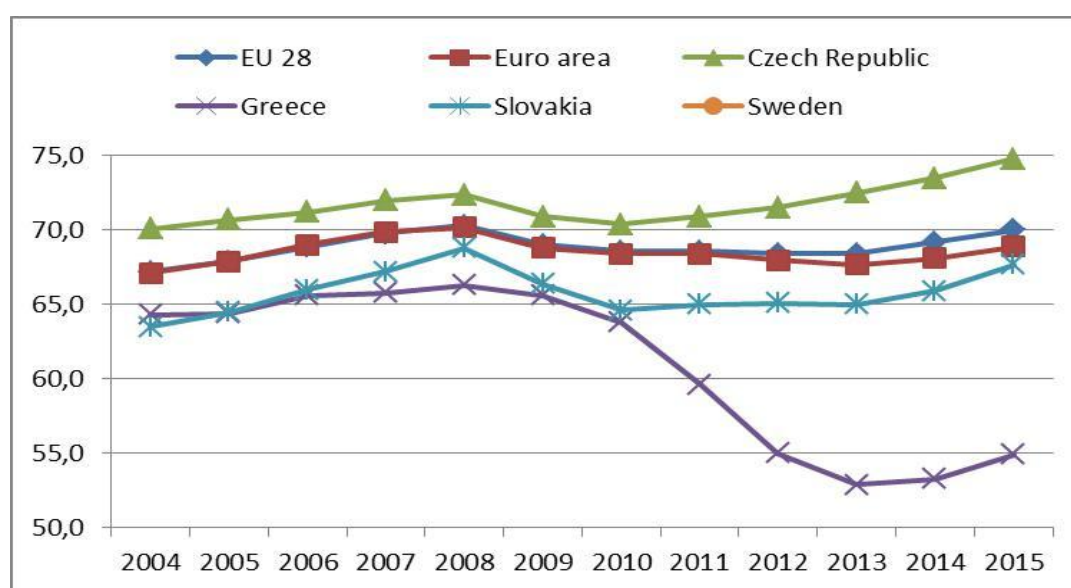


Figure 2: Employment rates in EU and Euro area (%), age group 20-64 (Eurostat)

Unemployment in Slovakia is one of the most serious economic and social issues, which long-term prohibits the full realization of the economic growth potential. The last biggest growth of unemployment rate related to the drop of employment manifested itself during the economic slump due to the global crisis in 2010, when almost every sixth individual in the active population was looking for a job and the average annual unemployment rate was 14%. During the following 4 years the share of economically active persons looking for a job was above 13% (Figure 3). Neighbouring countries of the Visegrad Four were in significantly better shape; Hungary with the closest development of unemployment was 2-3 percentage points better, when compared to Slovakia; the Czech Republic record post crisis unemployment 5 to 6 percentage points lower than Slovakia (Lubyová – Štefánik et al., 2015).

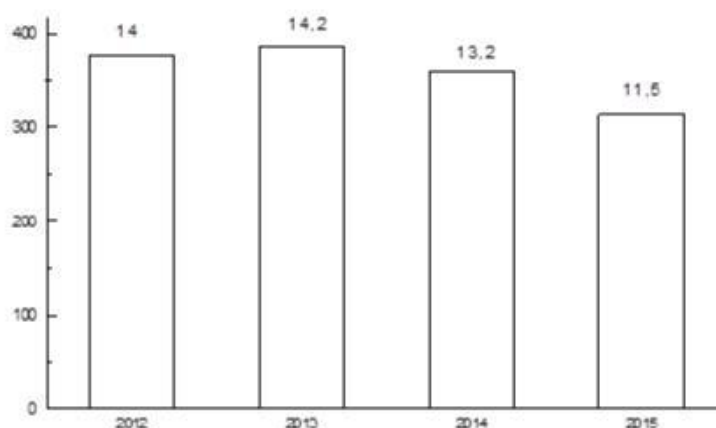


Figure 3: Unemployment in the Slovak Republic, in thousands and % (Eurostat)

Continuous structural problems represent pending and unsolved issues on the labour market, namely (Tichá, 2011, pp. 34-35):

- low mobility of labour force (continuous unemployment rate differences);
- high gap between the levies and taxes resulting from their high rates;
- minimum difference between the rate of social benefits, unemployment benefits and minimum wage (missing pressure on increased interest in acceptance of low-paid job);
- labour market rigidity (expressed with low headcount of persons in other than full – time work relation);
- not recorded employment and insufficient inspection by the involved institutions;
- low qualification level;
- labour market discrimination that has been formally removed but it actually exists.

3. LONG-TERM UNEMPLOYMENT

Slovakia is one of the countries, which fight especially high level of long-term unemployment (more than 12 months). This fact significantly contributes to the negative development of public finances, but it also reflects possibly insufficient use of production resources in the economy. High unemployment rate is not related only to lack of demand for work force, but it is also the result of imbalance between them (Workie Tiruneh – Štefánik et al., 2014). Long-term unemployment structure and the causes thereof have not changed significantly since the related talks that began at the end of 1992; on par with the unemployment extent and duration on both Slovakia-wide and regional level. The unemployment „hard core“ has been profiled out on the labour market, especially of that „long-term“ one (job seekers with elementary education and a part of those with apprenticeship, as well as Roma people, etc.). Lack of interest in finding a job because of secured social benefits represents one of the reasons thereof, which is a sufficient reason for many people to remain a long-term unemployed. On the other hand, it is also the lack of willingness of the employers to give a job to the one who has been unemployed for a longer time. Another cause of staying unemployed or not being interested in seeking a job by many people refers to low wages. Compared to the original EU member countries, labour value is still very low in Slovakia. Non-flexibility of labour market, low spatial and professional

mobility, avoidance of mobility and obstacles at mobility improvement, differences between jobs offer and demand structure, and mostly the absence of knowledge and skills of the unemployed that are required for obtaining a job – these factors mostly affect the unemployment duration (Rievajová, Stanek, Krausová, 1997).

In 2014 the long-term unemployment rate was one of the highest in the EU (9.3% when compared to 5.1% in the EU-28). Two thirds of the unemployed are long-term unemployed and majority of the long-term unemployed don't have work for more than two years, while the rate of the very long-term unemployment rate is 6.6% (more than double of the EU average). Figure 4 shows two basic facts. The first is the fact that there is no direct correlation between the share of long term unemployment on the total unemployment and the total unemployment. Examples are the years 2004-2006, when there was decrease of overall unemployment, but the share of long-term unemployment on the total unemployment continued to grow. This development shows that the Slovak labour market was not capable to absorb the long-term unemployed – employers are not interested in hiring long-term unemployed, since they assume they lost their qualification and their work ethics, and the long-term unemployed got used to life without work, social benefits and don't strive to find a new job. The second is the fact that long-term unemployed make on average more than two thirds of all unemployed. In an effort to reduce the overall unemployment, this fact represents a major problem, since it is a group of people, which has greater problems when re-entering the labour market.

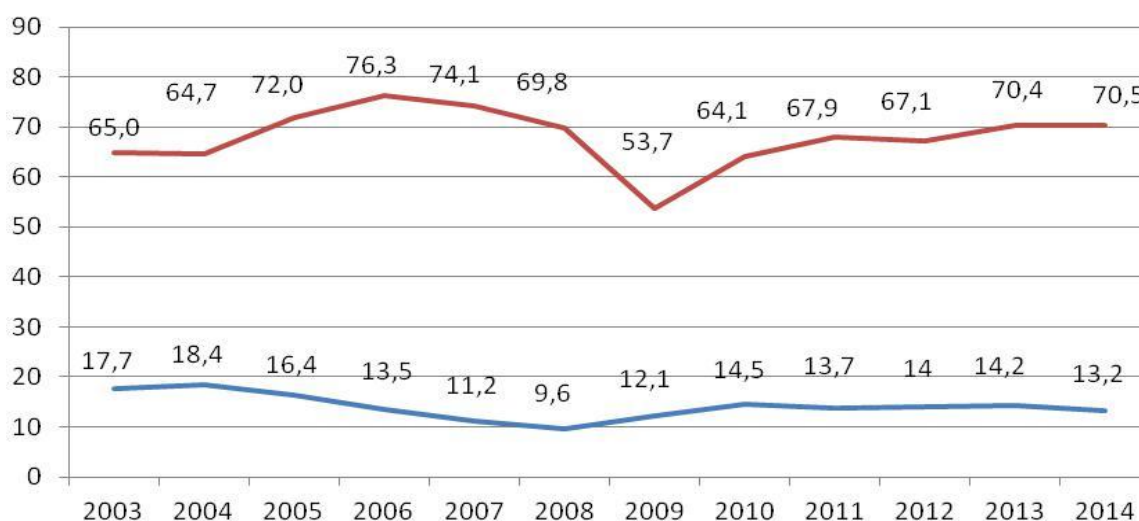


Figure 4: Long-term unemployment and its share (red line) on total unemployment (blue line), in % (Eurostat)

Long-term unemployment represents for the workers with low qualification and young people a significant risk. Slovakia has the highest rate of unemployment of workers (age 20-64) with a low qualification in the entire EU (36.9% compared to 16.3% in the EU-28 in the third quarter of 2015). Workers with low qualification represent a high percentage of the long-term unemployed. In 2014 workers with low qualification represented 24% of the long-term unemployed compared to 4% of workers with low qualification in the employed population. Unemployment of young people in the third quarter of 2015 dropped to 26.6%, which is still significantly above the EU average of 20.1%. The share of young people, who are not employed and they are not in the educational process or process of professional training also declined and in 2014 it was 12.8% (12.5% in the EU-28). Young workers (less than 25 years) represented 17% of the long-term unemployed (compared to 6% in the employed population) (Európska komisia, 2016). For young people in Slovakia the transition from school to work continues to be difficult, while the educational system doesn't react immediately to the needs of the labour

market despite the reform measures of 2012 focused on improving the quality and relevancy of education for the needs of the labour market. Territorial classification confirmed the fact that the higher the unemployment rate, the higher job seekers from amongst those long-term unemployed. Of total headcount of recorded job seekers in particular territory, most long-term job seekers are from the Eastern and Southern Slovakia and the fewest of them are from Bratislava.

4. REGIONAL DIFFERENCES IN UNEMPLOYMENT

Slovakia is composed of heterogeneous regions. Various areas have various economic infrastructures, various developmental conditions and differentiated access to resources, due to which spatial structures are defined, which have different unemployment rate. Regional unemployment represents in Slovakia a serious and long-term economic and social issue. Unevenness of unemployment development in individual regions is related not only to the historical development of the Slovak economy, but also to its modern, very differentiated development. After the 1990's the West of the SR developed even more intensively than the East. It is true that the regional disparities in the labour market remain in the direction from the Bratislava region, which has a dominant position (allocation of international investments, lowest unemployment rate, richest offer of jobs), towards the Eastern part of the Republic. Regional unemployment is affected by a whole set of factors, which are mutually interconnected and are found on various levels of the decision-making process. These factors can be split into two basic groups, namely into direct factors and indirect factors. Both groups of factors affect regional unemployment, specifically in terms of its rate and differentiability. Basic determinants affecting regional unemployment include indicators of the labour market, heterogeneous development of salaries and productivity, insufficient territorial mobility of the work force, economic development of the region and qualification of the work force. Differentials express especially the internal quality aspect of the regions, correlation of individual components within the regions, their overall status, which subsequently transforms into the character of differences of individual regions (Rievajová et al, 2015). In terms of geography unemployment in Slovakia is concentrated in the Southern and Eastern counties of the country with lower economic activity and lower salary rate - in these regions due to the current status of the market there aren't simply enough jobs created. Thus if the applicants aren't willing to commute or move because of work to larger cities, their chances of finding a job are slim (Dinga – Ďurana, 2015). Despite economic recovery the regional differences of unemployment are still significant. Despite certain progress achieved under removing these differences, in 2015 the unemployment of the Bratislava region (5.34%) was still less than a half of that of the Prešov region in the East of Slovakia (15.50%). Main reasons for this fact is the combination of low growth and low creation of new jobs in the Central and Eastern part of the country, as well as insufficient regional mobility of the work force into areas with higher number of free job positions. Factors prohibiting higher mobility include insufficient transportation infrastructure, higher travel and accommodation costs when compared to the average salary, as well as insufficiently developed market with rented housing. The situation is complicated by the insufficient infrastructure and business environment, which prevents the inflow of investments into less developed regions and the creation of new jobs. When compared to the rest of the EU there are always shortcomings in the business environment of Slovakia. Reasons listed most often are frequent changes of legislation, complexity of administrative procedures, as well as burdening requirements based on government regulations. Administrative and regulatory burdens damage the business environment, lower external competitiveness and restrict domestic economy.

Table 1: Registered unemployment rate in the Slovak Republic: by region, in % (Central Office of Labour, Social Affairs and Family)

Region/Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Bratislava	2.6	2.29	1.98	2.27	4.36	4.63	5.4	5.7	6.17	6.13	5.34
Trnava	7.15	5.22	4.3	4.29	8.37	8.17	8.9	9.4	9.16	8.03	6.71
Trenčín	6.8	5.19	4.5	4.95	10.1	9.51	10.0	10.9	10.7	9.56	7.71
Nitra	11.4	9.09	7.1	7.41	11.7	11.8	13.3	14.1	12.5	11.21	9.71
Žilina	9.33	7.03	5.55	6.2	10.9	10.9	11.9	12.8	12.5	10.91	8.86
Banská Bystrica	18.3	16.1	14.1	14.3	19.2	18.9	19.8	20.8	18.2	17.22	14.94
Prešov	15.8	13.7	12.1	12.9	18.3	17.8	19.0	20.7	19.4	17.45	15.50
Košice	17.5	15.2	13.0	13.1	17.3	16.8	18.8	19.6	17.2	15.92	14.39
Slovak Republic	11.4	9.4	7.99	8.39	12.7	12.5	13.59	14.44	13.5	12.29	10.63

Table 1 shows the development of the percentage of the unemployment rate since 2005, which is a year after the Slovak Republic joined the European Union, until 2015. Statistics show that while the regional differences in the unemployment rate grew after joining the EU, average unemployment from 2005 was decreasing in Slovakia until 2008. Permanently low unemployment rate was and is in the Bratislava region. Unemployment was high above the Slovak average until the end of 2013 in the Banská Bystrica, Prešov and Košice regions. In 2015 the number of unemployed declined annually with the exception of the Trnava region in all regions, in the range from 2.5% in the Žilina region to 16.6% in the Košice region. The greatest number of the unemployed was concentrated in the regions of Eastern Slovakia (Prešov and Košice regions) and in the South of the Central Slovakia (Banská Bystrica region), which also showed the highest unemployment rate. Despite positive results of the national economic growth, major regional differences in the unemployment rate still remain. Unemployment rate below the SR average is found in five regions (Bratislava, Trnava, Trenčín, Nitra and Žilina), unemployment rate above the average was showed in 2015 by the Košice, Prešov and Banská Bystrica regions. A very serious problem is long-term unemployment, which is crucially concentrated in East of Slovakia and South of Central Slovakia. The fact that majority of the Roma population lives in the Southern and Eastern counties plays also its role.

5. YOUNG JOB SEEKERS

Table 2: Unemployed young people aged 15-24 years (Statistical Office of the Slovak Republic, 2015)

Year	2010	2011	2012	2013	2014
SR in Total	381 209	399 800	425 858	398 876	373 754
15 – 24 years	67 462	68 782	84 372	72 629	65 469
rate in %	17,7	17,2	19,8	18,2	17,5

Young people and school graduates in the age group 15-24 represent currently one of the most endangered groups on the labour market. Young people in this age group share on total headcount on economically active people with 7.8%. Share of young employed people on total employed Slovak people has been rather stable during the last 5 years, reaching slightly more than 6%. Unemployment rate of young people is generally higher than the rate in all age categories. Regarding the age structure, the age group 15–24 is the largest one among the job seekers, corresponding to more than 17% of total job seekers headcount (Table 2). In the terms

of current trends, it refers to slight drop and corresponds to total unemployment rate development; however it has remained a very serious problem when more than each fourth young person in Slovakia is unemployed (Figure 5).

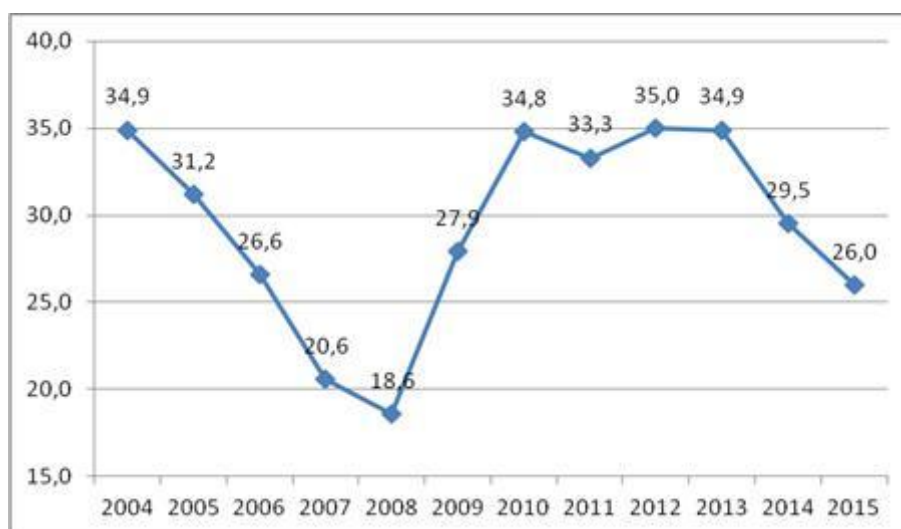


Figure 5: Youth unemployment rate (under 25) in the Slovak Republic (Eurostat)

In the terms of education, young people with elementary education, apprentice education without leaving exam and high school with leaving exam shared mostly on the unemployment rate of young people in Slovakia (approx. 80% share on total unemployed young people). Almost two thirds of unemployed young people have been seeking a job for a year or longer, which is the highest count amongst all EU member countries. The change from school to employment is still too slow and the educational system doesn't promptly respond to the labour market needs. The National Young People Guarantee Implementation Plan was adopted in February 2014, including a few reforms (e.g. reform of professional training and education mentioned below). The guarantee applies to young people who received quality job offer, offer of further education, apprentice training or internship within four months from having lost job or finishing a formal educational process. The imbalance between the employers' requirements and qualification of available labour force on the labour market is expressed as a structural unemployment that results in huge lack of labour force of particular qualification in certain industrial sectors (e.g. sector of information and communication technology) vs surplus of available labour force in other sectors, on the other hand. The skill mismatch represents the „existence of disharmony between the qualified labour force demand and offer caused by under-education, as well as over-education, i.e. exceeded needs for qualification, knowledge, and skills for chosen profession“ (Workie Tiruneh – Štefáňik et al., 2014). Creation of unevenness in the access in labour market is caused by mostly missing abilities, skills and work experience in the studies specialization, which concurrently represents a deepening obstacle in the access to labour market. Currently, we included missing inter-sectional competences, and especially „soft skills“ in frequent deficiencies of the graduates who seek job (Rievajová et al, 2015, p. 120).

Young people unemployment problem is even more significant when considering, based on the Institute for Forecasting of the Slovak Academy of Sciences mid-term projections, that post-productive age population in Slovakia should increase from 11% to 16% as of 2035 (i.e. from current approximately 600,000 to 850,000 people). In the segment of 80+ years old people, the population should even double, compared to current headcount. The pension system shall depend on the people in productive age amongst who many fall nowadays within the category of the young unemployed. From long-term point of view, it is important to effectively solve the

youth unemployment issue in the terms of current labour market balance and the future pension system sustainability. It is essential to pay attention to the risks and challenges and possible solutions of the situation of these people, since they represent a source of future society dynamism.

The following are major factors of high unemployment of the youth in Slovakia (Záruka pre mladých ľudí v Slovenskej republike, 2014):

- insufficient interconnection between the educational systems and labour market, expressed in the disharmony of skills resulting from lack of skills required by employers on one hand, and surplus of skills that young people dispose with on the other hand;
- disharmony of qualifications between the labour market requirements and achieved qualification of young people and the graduates – i.e. structural horizontal disharmony;
- insufficient labour force demand;
- complicated process of transition from school to the labour market;
- necessity to overcome the transition stages up to obtaining a stable job;
- insufficient practical experiences and lack of willingness of the employers to admit people to work without any previous experience;
- so called „escape of brains“ within the mobility, associated with high-qualified labour force;
- required increase of job quality.

6. CONCLUSION

Macroeconomic development in Slovakia has showed a stable GDP growth in Slovakia until the global economic and financial crisis onset with effects that started expressing in our country in 2008, and culminated on the labour market in 2009 and later. Situation on the labour market started stabilizing after 2010 through revived economic stability and system performance. Development of the Slovak labour market represents a key issue in short-term and long-term Slovak economy development prospects. During the whole period since the long-term unemployment became a problem (the end of 1992), its structure and the causes have not changed significantly. The „hard core“ of the unemployment has been profiled out on the labour market, especially of the long-term one (job seekers with elementary education and a part of those with apprenticeship, as well as Roma people, etc.). It seems that solving the problem and mainly the long-term unemployment should become a priority in the economic but mainly social and education strategy, since the employment obstacles are increasing with time passing

(Paukovič, 2007, p. 78). With the share of the unemployed, the Slovak Republic ranks among the top countries in EU, which is contradictory to the share of young people on the population that is not much higher than in many other EU countries. Along with aggregate problem, i.e. insufficient creation of new jobs, Slovakia suffers also the structural problem – the employers' demand vs the educational system offer. Educational system in Slovakia shows the signs of inability to adapt the study programs to the labour market needs in a flexible way. Responding

of technical and apprentice education has especially lacked behind in relation to the labour market needs.

The Slovak labour market has currently experienced cyclic improvements. The unemployment rate has dropped and further drop below 10% is expected in the following two years as a result of the economic growth and increased consumption by households. However, structural unemployment represents continuous key problem, expressing vast geographic differences in labour market conditions, accompanied by low labour force mobility. The unemployment rate has not been distributed evenly in Slovakia but on the contrary, it is spatially differentiated in relation to the economic performance and demographic characteristics. The regional differences are determined by their different conditions, be they of natural or socio-economic nature, which is reflected in the regional population employment rates. Increasing unemployment on the axis „west – east“ is a typical characteristics of the Slovak labour market, leading to concentrated unemployment and poverty in certain regions of the Central and Eastern Slovakia. It resulted from different demographic, economic, technical and further potential, in association with geographical characteristics. High unemployment rate is associated also with insufficient infrastructure and inadequate structure of job seekers, which often discourages the investors, despite of low labour cost. The economic theory and praxis state that behaviour of individuals on the labour market has been affected also by the social system, thus their willingness to find a job, labour force mobility, etc. This principle can be applied also to the Slovak conditions with insufficient motivation of a few risk groups to find a job. The economic and social policymakers should pay more attention to this fact.

ACKNOWLEDGEMENT: *The paper is the outcome of scientific project VEGA No. 1/0001/16 ‘Súčasnost’ a perspektívy zmien zamestnanosti a súvisiacich procesov v kontexte naplňania cieľov Európskej stratégie zamestnanosti’.*

LITERATURE:

1. Dinga, J. – Ďurana, R. (2015). *Nezamestnanosť. Systémový problém slovenského hospodárstva*. Bratislava: INESS.
2. Európska komisia. (2016). *Správa o krajine za rok 2016 – Slovensko. SWD(2016) 93 final*. Retrieved 04.06.2016 from http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_slovakia_sk.pdf.
3. Lubyová, M. – Štefánik, M. et al. 2015. *Trh práce na Slovensku 2016+*. Bratislava: Ekonomický ústav SAV.
4. Paukovič, V. (2007). *Problém nezamestnanosti – vybrané makroekonomické a mikroekonomické kontexty*. Košice: UPJŠ v Košiciach, Fakulta verejnej správy, Katedra sociálnych vied.
5. Rievajová, E. et al. (2015). *Trh práce - premeny a výzvy*. Bratislava: Vydavateľstvo EKONÓM.
6. Rievajová, E., Stanek, V., Krausová, A. (1997). *Transformácia sociálnej sféry v Slovenskej republike*. Bratislava: SPRINT.
7. Tichá, A. (2011). *Dôsledky nezamestnanosti na slovenskú rodinu*. Banská Bystrica: Bratia Sabovci.
8. Workie Tiruneh, M. – Štefánik, M. et al. (2014). *Trh práce na Slovensku: Analýza a prognózy*. Bratislava: Ekonomický ústav SAV.
9. Záruka pre mladých ľudí v Slovenskej republike. (2014). Retrieved 01.06.2016 from <https://www.employment.gov.sk/sk/praca-zamestnanost/podpora-zamestnanosti/zaruka-mladych-ludi-sr/>.

INFRASTRUCTURE OF STATE SUPPORT OF SMALL AND MEDIUM-SIZED BUSINESS IN RUSSIA

Victor Barhatov

*Department of Economics of Industries and Markets
Chelyabinsk State University, Russia
ieo-science@csu.ru*

Irina Belova

*Department of Economics of Industries and Markets
Chelyabinsk State University, Russia
belova@csu.ru*

ABSTRACT

In the current economic conditions, the development of small and medium-sized business in Russia is impossible without the support. The national small and medium-sized businesses have especially acute need for the state support. Now it is possible to say that the state is attempting to strengthen the assistance in its turn. Special funds, corporations, agencies are set up. The support programs for various departments of the Russian Federation and development institutions are being developed and implemented. The infrastructure of the state support within the establishment and functioning of such institution as JSC «Federal Corporation for Developing Small and Medium-sized Business» (SME Corporation) develops. The analysis of infrastructure development of small and medium-sized enterprises state support in modern Russian conditions is the purpose of this report. The internet portal of JSC «Federal Corporation for Developing Small and Medium-sized Business» (SME Corporation) was used as information base of the research. General scientific research methods were used in the data processing: the comparative analysis, graphical analysis, synthesis, grouping, generalization. The following results are obtained. First, the state support infrastructure of small and medium-sized businesses in five main support directions is researched: financial, property, consulting, innovative and production, legal infrastructures. Second, the analysis of presence of the regional organizations in each direction of support infrastructure in the subjects of the Russian Federation was carried out. Third, the subjects of the Russian Federation with the most developed support infrastructure both within one direction, and on a set of directions of the state support were distinguished. Our results will help in further researches to go into practice and evaluate the impact of state support infrastructure on success indicators of small and medium-sized business in Russia.

Keywords: *infrastructure, medium-sized business, small and medium-sized enterprises, small business, state support.*

1. INTRODUCTION

In the current economic conditions, no small or medium business can develop without support in Russia. The most critical for the national subjects of small and medium business is the governmental support. Nowadays we can see the state taking certain steps to make this kind of support more effective by establishing special funds, corporations and agencies. The support programs implemented by such federal bodies as the Ministry of Economic Development, the Ministry of Agriculture and others are being extended. The infrastructure of the governmental support is developing through establishing the Federal Corporation for the Development of Small and Medium Business (SMB Corporation) and through its activities. But do those governmental support measures ensure stable conditions for the development of small and medium businesses? Does their implementation provide any synergetic or multiplicative effect?

Do they help small and medium businesses become more successful? These are exactly the questions which answers have to be found to, not only by us, those who are studying and analyzing the problem, but mainly by the state. The objective of this work consists in the study and analysis of the infrastructure which has been established for the governmental support of small and medium business in Russia.

Both Russian and foreign scientists are involved in the study of the problems concerning the activities of small and medium businesses, in the examination of the factors producing effects on their successful operation, and in the analysis of the governmental support provided to small and medium businesses. However, we cannot speak of any numerous works in this realm. But still, we have found some which are well worth being paid attention to. In particular, Burlutskaya (2016) and Beksultanova *et al.* (2015) studied the factors of growth of small business and the development restrictions and problems of small and medium business in Russia. Korotaeva and Cheglova (2014) discovered the influence of the state and the governmental supporting measures on the operation of small and medium businesses. The problems concerning the effects produced by the regional factors on the development of small business were studied by Nasonov (2014). The economic nature of the business success was studied by Barkhatov (2014). A group of authors headed by Barkhatov and Pletnev (2015) suggested a typology of success factors based on the division into internal and external factors. The key success factors, including the tax load and tax concessions, were studied by Belova (2015); the transaction costs were analyzed by Nikolaeva (2015), and the manager's social responsibility was explored by Pletnev (2015). The study of the prospects and development issues of small and medium business and of the support programs was done by Kudryavtseva (2015) and Filippova (2015).

At the same time, the problems concerning the successfulness of small and medium business are also dealt with in the works by some foreign scientists. Stonkutė and Vveinhardt (2016) studied the key success factors in the context of the global procurement system. Ligthelm (2011) performed an analysis of the survival potential of small companies in South Africa in 2007–2010. He defined the essential surviving ability factors of small companies: human capital, entrepreneurial abilities and business keeping skills. Chittithaworn *et al.* (2011) analyzed the success factors of small and medium business in Thailand. They found out that the main factors were the environment, the relations with customers, the way of business keeping and cooperation, which is actually the relations with suppliers, and the availability of financial and other resources. The tax legislation as a factor producing effects on small and medium business was studied by Hansford and Hasseldine (2012) and by Chittenden *et al.* (1999). They assumed that observation of the tax law represents an external factor increasing the expenditures of small and medium companies. And so they asserted that the regular requirements for business, especially for small and medium companies, were burdensome and could constrain their growth and success.

2. METHODOLOGY AND INFORMATION

The research was based, theoretically and methodologically, on analytical articles and reviews by Russian and foreign scientists who dealt with the problems concerning the activities of small and medium businesses, the governmental support of small and medium companies, and the success factors of small and medium forms of economic management.

The internet portal of the Federal Corporation for the Development of Small and Medium Business (MSB Corporation) served the informational resource for the study.

When processing the information, the following general scientific research methods were applied: comparative analysis, graphical analysis, synthesis, grouping, and generalization.

3. RESULTS

To ensure the implementation of the support programs aimed at establishing the proper conditions for the development of small and medium business, the state creates dedicated institutions of the support infrastructure. The activities of such institutions are performed in five principal areas. We would like to describe every one of them in a more detailed way.

3.1. Financial infrastructure of the support

The main constituents of this area of support are guarantee support of small and medium businesses by providing bails and independent guarantees, organizing other forms of support including leasing and factoring operations, as well as developing mechanisms for refinancing of the small and medium businesses' debt instruments, and arranging financing for the lending agencies providing their financial support to small and medium businesses. These activities are performed by the regional organizations building the financial infrastructure: guarantee funds (GFs), microfinance organizations (MFOs) and leasing organizations (LOs). Our analysis of the availability of such organizations in the federal subjects of Russia has shown that guarantee funds work in every subject of the country except the Jewish Autonomous Oblast. The distinctive feature is that every federal subject has one guarantee fund. A bit worse is the situation regarding the MFOs: they work in 76 federal subjects of Russia and provide microfinance loans to small and medium businesses. The average number of the MFOs in a federal subject varies from three to four. The absolute leaders are Irkutsk Oblast (22 MFOs), Kemerovo Oblast (15), Samara Oblast (15), and Rostov Oblast (14). Only five federal subjects have leasing organizations acting as lease providers: Altai Krai, Vladimir Oblast, Zabaykalsky Krai, the Republic of North Ossetia-Alania, and Yamalo-Nenets Autonomous Okrug have one LO each.

The generalized information on the financial infrastructure of the support is represented in Table 1.

Table 1: Financial infrastructure of the support provided to small and medium businesses (Federal Corporation for the Development of Small and Medium Business (SMB Corporation), 2016)

Type of organization building the infrastructure	Activities	Number of federal subjects with organizations of this type
Guarantee fund	Bails	84
Microfinance organization	Microfinance loans	76
Leasing organization	Finance lease	5

The analysis of the financial support infrastructure has shown that there are 356 organizations providing support to small and medium businesses in this area. Only five federal subjects of Russia have organizations of all the three types: Altai Krai, Vladimir Oblast, Zabaykalsky Krai, the Republic of North Ossetia-Alania, and Yamalo-Nenets Autonomous Okrug. Irkutsk Oblast (23), Samara Oblast (16), Kemerovo Oblast (16), Rostov Oblast (15), and Kirov Oblast (11) have the most regional organizations working in this area, while the Jewish Autonomous Oblast has none. All the rest of the federal subjects have at least two organizations each.

3.2. Consulting infrastructure of the support

The main objective of this area of support is providing consulting services to small and medium businesses through six types of regional organizations: regional integrated center (RIC), support coordination center for export-oriented small and medium businesses (ESC), center for

innovations in the social sphere (CISS), center for entrepreneurship support (CES), center for folk and artistic industries (CFAI), and consulting center for agriculture (CCA).

The work of the RICs is aimed at providing assistance to export-oriented small and medium companies in establishing and developing collaboration with foreign partners. There are 50 RICs: 41 federal subjects have one RIC each, and there are 9 RICs in Yaroslavl Oblast. The number of ESCs is lower: 34 federal subjects have one ESC each; the centers provide consulting and organizational support for the foreign economic activities of small and medium companies. The number of CISSs is yet lower: there are 23 of them, with 21 federal subjects possessing one CISS each and with 2 more centers located in Altai Krai. There are 318 CESs in 63 federal subjects of Russia, with the absolute leaders being Altai Krai (71), Kemerovo Oblast (30), Leningrad Oblast (25), Nizhny Novgorod Oblast (41), Tomsk Oblast (22), and Voronezh Oblast (14). The number of CFAIs is the lowest, with only one center located in each of the 7 federal subjects: Belgorod Oblast, Kirov Oblast, Kursk Oblast, Leningrad Oblast, Ryazan Oblast, and in the Komi Republics and the Republic of Tatarstan. 5 federal subjects have CCAs: Altai Krai, Khabarovsk Krai, Nizhny Novgorod Oblast, Rostov Oblast, and Ulyanovsk Oblast – there are 18 centers in total, with 14 of them working in Rostov Oblast.

The generalized information on the consulting infrastructure of the support is represented in Table 2.

Table 2: Consulting infrastructure of the support provided to small and medium businesses (Federal Corporation for the Development of Small and Medium Business (SMB Corporation), 2016)

Type of organization building the infrastructure	Area of consulting support	Number of federal subjects with organizations of this type
Regional integrated center	Collaboration with foreign partners, including export	41
Support coordination center for export-oriented small and medium businesses	Foreign economic activities, including export	34
Center for innovations in the social sphere	Social entrepreneurship	22
Center for entrepreneurship support	Business keeping and legal aspects	63
Center for folk and artistic industries	Folk and artistic trades and industries	7
Consulting center for agriculture	Agriculture	5

The analysis has shown that the federal subjects of Russia have the most consulting support providing organizations if compared to the number of organizations dealing with the other areas of support. There are 450 centers in total, but no federal subject has organizations of all the six consulting types. Ulyanovsk Oblast has consulting centers of five types; Altai Krai, Stavropol Krai, Khabarovsk Krai, Vologda Oblast, Nizhny Novgorod Oblast, Omsk Oblast, the Republic of Bashkortostan, the Republic of Tatarstan, and Khanty-Mansi Autonomous Okrug have centers of four types each.

3.3. Property infrastructure of the support

Property support of small and medium businesses is provided by means of transferring the right to own or use federal or municipal property, including land, buildings, constructions, nonresidential premises, equipment, machines, mechanisms, plants, vehicles, stocks, instruments, both on free and paid basis and on preferential terms. The area of the support infrastructure comprises the following regional organizations: center for property support (CPS), business incubator (BI), industrial park and/or industrial site (IP/IS), agro-industrial park (AIP), technology park (TP), and technology town (TT).

Today, there are 4 CPSs in Russia, one in each of the following federal subjects: Irkutsk Oblast, Omsk Oblast, Smolensk Oblast, and the Chechen Republic. Business incubators represent the most widespread type: there are 219 BIs in 68 federal subjects, with 26 of them in Ryazan Oblast and 5 in the Republic of Tatarstan. Almost two times lower is the number of IPs/ISs – 112, with most of them working in the Republic of Tatarstan (46) and the Republic of Bashkortostan (11). The number of AIPs leaves much to be desired – 5 agro-industrial parks in 4 federal subjects: one in Kaluga Oblast, Ulyanovsk Oblast and the Republic of Khakassia each and two in the Republic of Tatarstan. There are currently 78 TPs in 26 federal subjects of Russia, with 19 of them in Moscow, 12 in Sverdlovsk Oblast, and 10 in the Republic of Tatarstan. And there are only two technology towns, both working in Moscow.

The generalized information on the property infrastructure of the support is represented in Table 3.

Table 3: Property infrastructure of the support provided to small and medium businesses (Federal Corporation for the Development of Small and Medium Business (SMB Corporation), 2016)

Type of organization building the infrastructure	Activities	Number of federal subjects with organizations of this type
Center for property support	Providing production space and equipment	4
Business incubator	Providing beginner entrepreneurs (registered and working for no longer than a year) with production and office space and accompanying services	68
Industrial park and/or industrial site	Allocating industrial facilities of small and medium companies in the areas equipped with engineering and energy infrastructure	30
Agro-industrial park	Allocating small and medium companies working in the agro-industrial sphere and providing them with engineering and energy infrastructure	4
Technology park	Renting out production space	26
Technology town	Providing support to small and medium companies whose work is aimed at production of innovative and progressive products or development of new high-end technologies, in the context of collaboration with universities and scientific and technical centers	1

The analysis of the property support infrastructure has shown that the number of the organizations working in this area is a little bit lower than in the consulting support infrastructure. There are 420 organizations in total, with no federal subject possessing organizations of all the six types. There are four types of such regional organizations working in Moscow, Irkutsk Oblast, Kaluga Oblast and the Republic of Tatarstan, and organizations of three types are available in Altai Krai, Belgorod Oblast, Lipetsk Oblast, Nizhny Novgorod Oblast, Ryazan Oblast, Sverdlovsk Oblast, Tula Oblast, Ulyanovsk Oblast, the Republic of Bashkortostan, the Udmurt Republic, and the Chuvash Republic.

3.4. Innovation and production infrastructure of the support

This area of support has the greatest diversity. There are 15 types of organizations there: center of innovations, nanocenter, engineering center (EC), center for standardization, certification and tests (shared use) (CSCT), prototyping center (PC), center for cluster development (CCD), subcontracting center, investment fund, specialized company for innovative regional cluster (SCIRC), center for shared access to equipment (CSA) and center for shared use (CSU), center for technology transfer (CTT), center for commercialization of technologies, center for additive technologies, center for innovative personnel training, and nursery complex.

The biggest share (30% or 66 organizations) belongs to ECs – they are available in 40 federal subjects of Russia. CCDs have a share of 15% (33 organizations) of all the organizations of this infrastructure. 7.7% (organizations) is the share of the centers of innovations (registered in 9 federal subjects) and the SCIRCs (in 14 federal subjects). The total number of prototyping centers is 19 (8.6%); they work in 14 federal subjects. There are 13 (6%) nanocenters in 9 federal subjects. There are currently 15 investment funds and CSCTs in 13 and 12 federal subjects respectively. There are only 2 CSAs, both in the Republic of Bashkortostan, and 6 CSUs in 5 federal subjects. Organizations of the other types are quite scarce, with only one or two in various regions: CTTs in Moscow, Irkutsk Oblast, Ulyanovsk Oblast, and Stavropol Krai; centers for commercialization of technologies in Penza Oblast and Tyumen Oblast; one center for additive technologies and one nursery complex in Voronezh Oblast only; and centers for innovative personnel training in Voronezh Oblast and Irkutsk Oblast.

The generalized information on the innovation and production infrastructure of the support is represented in Table 4.

Table following on the next page

Table 4: Innovation and production infrastructure of the support provided to small and medium businesses (Federal Corporation for the Development of Small and Medium Business (SMB Corporation), 2016)

Type of organization building the infrastructure	Activities	Number of federal subjects with organizations of this type
Center of innovations	Providing assistance to innovative activities	9
Nanocenter	Marketing and managerial support in commercialization of nanotechnologies, improving and implementing new technologies in the nanoindustry	9
Engineering center	Improving the technological preparedness of small and medium companies by means of developing and providing solutions for designing, technical, engineering, technological, and organizational tasks	40
Center for standardization, certification and tests (shared use)	Tests of equipment, engineering procedures and product samples	12
Prototyping center	Creation of models, prototypes, trial models and other short-batch products at the stages from computer modeling to production	14
Center for cluster development	Implementation of projects ensuring the development of regional clusters	32
Subcontracting center	Providing assistance in production cooperation of Russian companies, aimed at involving small and medium businesses in the chain of suppliers of large companies	5
Investment fund	Attracting investments and supporting investment projects of small and medium companies	13
Specialized company for innovative regional cluster	Implementation of projects for the development of regional innovation clusters, carried out jointly by two or more organizations, including small and medium companies	14
Center for shared access to equipment and center for shared use	Providing access to high-technology equipment	1 CSA, 5 CSUs
Center for technology transfer	Ensuring the transfer of technologies (and the rights for their use) between individuals or organizations, including small and medium companies, aimed at their further implementation in production and/or commercialization	4
Center for commercialization of technologies	Obtaining income from the results of scientific researches and competences of small and medium companies	2
Center for additive technologies	Finding solutions for modernization and creation of new production models for small and medium companies by means of adding production materials	1
Center for innovative personnel training	Personnel training and education for innovative areas	2
Nursery complex	Providing access to high-technology equipment, growing selectively improved kinds of plants	1

The analysis of the innovation and production infrastructure of the support has shown that there are a lot fewer organizations in this area than in the others, only 220 of them. And none of the federal subjects has organizations of all the 15 types. There are organizations of 8 types working in Moscow and Novosibirsk Oblast; 6 types are represented in Irkutsk Oblast and Kaluga Oblast and 5 in Altai Krai, Krasnoyarsk Krai, Khabarovsk Krai, Voronezh Oblast, Chelyabinsk Oblast, Saint Petersburg, and the Republic of Tatarstan.

3.5. Legal infrastructure of the support

Currently, no regional organizations representing the legal infrastructure of the support provided to small and medium businesses are available. But the government has already defined its priority areas of activities for the period of 2016–2018: first, it is establishing measures for the legal support including the required implementation instruments and mechanisms which would allow minimizing the business keeping costs of small and medium companies and improving their legal competence; second, deep elaboration of the suggestions concerning the normative legal regulation in relation to the support provided to small and medium businesses.

4. CONCLUSION

The analysis of the infrastructure of the governmental support of small and medium business in Russia allows us to come to certain conclusions. First, the range of the support programs and the number of organizations providing the support are really impressive, with the objectives of the support and the support recipients also being quite diverse. Second, the greatest number of the types of organizations in the support infrastructure have been established within the innovation and production infrastructure (15). But the number of the organizations themselves is higher in the consulting infrastructure. Third, there are federal subjects which have organizations of the biggest number of the types in all the areas of the support: Altai Krai, Irkutsk Oblast, Kaluga Oblast, Moscow, the Republic of Bashkortostan, the Republic of Tatarstan, and Khabarovsk Krai.

The results that we have obtained will allow us to switch to the practical aspect in our further studies and to determine the effects produced by the governmental support infrastructure on the success and efficiency of small and medium businesses in Russia.

ACKNOWLEDGEMENT: *The study was performed at the expense of a grant of the Russian Science Foundation (project №14-18-02508).*

LITERATURE:

- 1 Barhatov, V. et al. (2015). *Priroda, faktory i izmerenie uspehnosti predpriyatij malogo i srednego biznesa v Rossii* [Nature, factors and measuring the success of small and medium-sized businesses in Russia]. Moscow: Pero. Retrieved 28.05.2016 from <http://www.csu.ru/Shared%20Documents/ИЭКОБиА/Новости/Монография.pdf>.
- 2 Barkhatov, V. (2014). *Priroda i protivorechija uspehnosti malogo i srednego biznesa v sovremennoj jekonomike* [Nature and contradictions success of small and medium businesses in today's economy]. *Vestnik Chelyabinskogo gosudarstvennogo universiteta*, 2014, № 21 (350), pp. 8-14. Retrieved 08.06.2016 from http://www.csu.ru/scientific-departments/Documents/47_pyc_Eng.pdf.
- 3 Beksultanova, A. (2015). *Ogranichenija i problemy razvitija malogo biznesa v Rossii na sovremennom jetape* [Limitations and problems of small business in Russia at the present stage]. *Molodoj uchenyj*, 2015, №23, pp. 481-483. Retrieved 06.06.2016 from <http://www.moluch.ru/archive/103/22816/>.

- 4 Belova, I. (2014). Nalogovaja nagruzka kak faktor uspešnosti predpriyatij srednego biznesa Tjumenskoj oblasti [The tax burden as a factor in the success of midsize businesses Tyumen region]. *Nauka XXI veka: problemy, poiski, reshenija: Materialy XXXIX nauchno-praktičeskoj konferencii s mezhdunarodnym uchastiem, posvjashhennoj 70-letiju Pobedy v Velikoj Otechestvennoj vojne (Miass, 24 aprelja 2015 g.)*, 2015, pp. 77-83. Retrieved 01.06.2016 from <http://elibrary.ru/item.asp?id=24497295>.
- 5 Burlutskaya, Ju. (2016). Problemy razvitija malogo i srednego biznesa v Rossii [Problems of development of small and medium-sized businesses in Russia]. *Molodoj uchenyj*, 2016, №2, pp. 436-439. Retrieved 29.05.2016 from <http://old.moluch.ru/archive/106/25035/>.
- 6 Chittenden, F., Poutziouris, P., Michaelas, N., Watts, T. (1999). Taxation and small firms: creating incentives for the reinvestment of profits. *Environment and Planning C: Government and Policy*, 1999, Vol. 17, pp. 271-286.
- 7 Chittithaworn, Ch., Islam, A., Keawchana, T., HaslizaMuhd, Y.D. (2011). Factors Affecting Business Success of Small & Medium Enterprises (SMEs) in Thailand. *Asian Social Science*, 2011, Vol. 7, №5, pp. 180 -190.
- 8 Federal Corporation for the Development of Small and Medium Business (SMB Corporation). (2016) Retrieved 25.05.2016 from <http://corpmsp.ru/infrastruktura-podderzhki/imushchestvennaya-infrastruktura/>.
- 9 Filippova, I. (2015). Problemy i perspektivy malogo biznesa v uslovijah izmenenij nalogovogo zakonodatel'stva [Problems and perspectives of small business in the conditions of changes in tax legislation]. *Sovremennoe razvitie malogo biznesa: materialy III Vserossijskoj professional'noj konferencii s mezhdunarodnym uchastiem*, 2015, pp.110-111. Retrieved 27.05.2016 from https://www.chiep.ru/pics/uploads/docs/NIR/CONFERENC/2015_SRMB.pdf
- 10 Hansford, A., Hasseldine, J. (2012). Tax compliance costs for small and medium sized enterprises: the case of the UK. *eJournal of Tax Research*, 2012, vol. 10, no. 2, pp. 288-303.
- 11 Korotaeva, N., Cheglova, E. (2014). Mery gosudarstvennoj podderzhki malogo i srednego biznesa [Measures of state support for small and medium-sized businesses]. *Social'no-jekonomicheskie javlenija i process*, 2014, № 1 (059), pp. 28-32. Retrieved 16.05.2016 from <http://elibrary.ru/item.asp?id=21215026>.
- 12 Kudryavtseva, T. (2015). Programmy podderzhki malogo biznesa cherez sistemu kreditovanija [Programs to support small businesses through the credit system]. *Sovremennoe razvitie malogo biznesa: materialy III Vserossijskoj professional'noj konferencii s mezhdunarodnym uchastiem*, 2015, pp. 150-152. Retrieved 27.05.2016 from https://www.chiep.ru/pics/uploads/docs/NIR/CONFERENC/2015_SRMB.pdf.
- 13 Ligthelm, A. (2011). Survival Analysis of Small Informal Businesses in South Africa, 2007–2010. *Eurasian Business Review*, 2011, Vol.1, Issue 2, pp 160-179. Retrieved 18.05.2016 from <http://link.springer.com/article/10.14208/BF03353804>.
- 14 Nasonov, V. (2014). Problemy vlijanija regional'nyh faktorov na razvitie malogo predprinimatel'stva [Problems of influence of regional factors on the development of small business]. *Molodoj uchenyj*, 2014, №1, pp. 405-407. Retrieved 16.05.2016 from <http://www.moluch.ru/archive/60/8708/>.

- 15 Nikolaeva, E. (2015). Vlijanie transakcionnyh izderzhok na uspešnost' predpriyatij malogo i srednego biznesa v rossijskih regionah [The impact of transaction costs on the success of small and medium business in the Russian regions]. *Vestnik Cheljabinskogo gosudarstvennogo universiteta*, 2015, 18 (373), pp. 140-148. Retrieved 25.05.2016 from <http://www.lib.csu.ru/vch/373/016.pdf>.
- 16 Pletnev, D. (2015). Vzaimosvjaz' uspešnosti malogo i srednego biznesa v Rossii i social'noj otvetstvennosti ego rukovoditelej [Relationship success of small and medium-sized businesses in Russia and the social responsibility of its leaders]. *Institucional'naja transformacija jekonomiki: rossijskij vektor novej industrializacii: Materialy IV Meždunarodnoj nauchnoj konferencii: v 2 ch. Ch.1*, 2015, pp. 492-497. Retrieved 25.05.2016 from <http://elibrary.ru/item.asp?id=24200945>.
- 17 Stonkutė, E., Vveinhardt, J. (2016). Key Success Factors for Small and Medium Size Enterprises in a Context of Global Supply Chains. *Entrepreneurship, Business and Economics* - Vol. 1, Eurasian Studies in Business and Economics, 2016, 3/1, pp.89 -102. Retrieved 20.05.2016 from <http://www.springer.com/us/book/9783319275697#aboutBook>.

IMPLEMENTED ACTIVITIES IN THE SPHERE OF DISTRIBUTION – AN EXAMPLE OF DAIRY COOPERATIVES FROM ŚWIĘTOKRZYSKIE PROVINCE

Izabela Konieczna

The Jan Kochanowski University in Kielce, Poland

izabela.konieczna@ujk.edu.pl

ABSTRACT

Cooperatives like other enterprises operate in the market economy in the turbulent environment. Every decision, every activity before it will be implemented must be adapted to the environment, also to the turbulent one, taking into account customers' value. Therefore, the aim of the article is an analysis of market activities in the sphere of distribution, which according to managers of dairy cooperatives from Świętokrzyskie Province, have an influence on customers' value. The research of the implementation of activities in the sphere of distribution was conducted on the sample of 50% of dairy cooperatives from Świętokrzyskie Province in Poland by using an interview questionnaire. Cooperatives' representatives were asked to indicate activities that, in their opinion, have an influence on customers' value on such markets as: Świętokrzyskie Province, other Polish provinces, European Union markets, and other major markets. The activities that the representatives had to indicate include: the sale of products on the Internet, the ownership of retail chain, the ownership of warehouses, and distribution centers, the provision of easy access to the product on the market, the provision of products in a shorter time than competitors, the provision of products on time, the assurance of convenient time of purchase, the assurance of convenient place of purchase, the differentiation of distribution methods, individualization of deliveries in terms of time, size, range and method of delivery, the assurance of the reliability of supplies in terms of time, quality and quantity of delivered products, the assurance of the fast communication with the buyer (on-line), the assurance of the logistics and transport services.

Keywords: *Implemented activities, Distribution, Cooperatives.*

1. INTRODUCTION

Today most business activities are global in scope. Technology, research, capital investment, and production, as well as marketing, distribution, and communications networks, all have global dimensions. Every business must be prepared to compete in an increasingly interdependent global economic and physical environment, and all businesspeople must be aware of the effects of these trends when managing either a domestic company that exports or a multinational conglomerate (Cateora, Gilly, Graham, 2011, p. 6). Therefore, the growth and the increasing importance of distribution in recent years and having efficient distribution channels can be considered a competitive advantage for manufacturers (Saremi, Zadeh, 2014, p. 455). Marketing channel decisions are among the most critical decisions facing an organization. The chosen channels intimately affect all other marketing decisions. The organization's pricing depends on whether it uses mass merchandisers or high-quality boutiques. The firm's sales force and advertising decisions depend on how much training and motivation the dealers need (Berry, Wilson, 2000, p. 166). Thus, managers responsible for developing and managing the distribution channels that make products and services available to literally billions of customers around the world face a more complex challenge than the previous generation of channel managers. Not only do today's channel managers need to think globally, but they must also act locally in terms of providing the appropriate array of channels desired by heterogeneous markets all over the world (Rosenbloom, 2004; referenced by Rosenbloom, 2010, p. 7).

The research of the identification of the actions of value creation for the customer by dairy cooperatives from Świętokrzyskie Province in the area of distribution logistics, which have been divided into the implemented activities, outsourced and controlled activities, outsourced and uncontrolled activities, and activities that are not present in the cooperative showed that respondents did not indicated activities outsourced and uncontrolled and activities that are not present in the cooperatives. The implemented activities by cooperatives include: the storage of the final products, and completing the assortment. Outsourced and controlled activities are: the storage of the final products, and sales to end-buyers (Konieczna, 2014a, pp. 14368-14369). Another research of identification of the validity of the features of the offer for clients in the area of distribution from the point of view of the dairy cooperatives from the Świętokrzyskie

Province had been conducted among representatives of the cooperatives with the use of a questionnaire. Clients for the purpose of the research were divided into the following groups: consumers, companies - users (gastronomy), wholesalers, independent retail grocery stores, large and local retail chains, intermediary agents in food trade, other dairies and other institutional purchasers. Analysis of the results showed that among the clients of cooperatives there are no independent grocery stores, large retail chains, intermediary agents in food trade, other dairies and other institutional purchasers (Konieczna, 2014, p. 14364). In addition, it was found that in each group of clients other features of the offer were the highest rated.

While considering the average rating for all customer groups, the highest rated¹ was the convenient time of purchase of the product (the mean assessment of the validity of the feature was 4.33), then: provision of easy access to the product on the market, and timely deliveries (4.29), provision of a convenient place of purchase (4.25), completeness of delivery - delivery compliance with the order (4.21), the frequency of deliveries (4.17), differentiation of distribution method (4.12), the delivery time of the product (4.08), the opportunity to purchase products via the Internet, and flexibility of supply in terms of time, size, assortment and the method of delivery (4.04), and the reliability of supply in terms of time, quality and quantity of delivered products (3.92) (Konieczna, 2014, p. 14363).

Another research that was conducted showed how future managers, i.e. management and economics students, perceive actions in the sphere of distribution, realized by their potential future places of work, i.e. cooperatives. The research results show that the respondents considered that cooperatives, in the average extent, pursue activities in the sphere of distribution. Analysis of the research results also showed, that students from Ukraine, better assessed the implementation of activities of cooperatives in this area than students from Poland. However, respondents from both countries agreed that in the greatest extent cooperatives implement the following action: having their own warehouses, distribution centers, and in the least extend, cooperatives sell products by the Internet (Konieczna, Garasym, 2014, p. 37).

The purpose of this article is to examine market activities in the sphere of distribution, which according to managers of dairy cooperatives from Świętokrzyskie Province, have an influence on customers' value. The activities that were examined include: the sale of products on the Internet, the ownership of retail chain, the ownership of warehouses, and distribution centers, the provision of easy access to the product on the market, the provision of products in a shorter time than competitors, the provision of products on time, the assurance of convenient time of purchase, the assurance of convenient place of purchase, the differentiation of distribution methods, individualization of deliveries in terms of time, size, range and method of delivery, the assurance of the reliability of supplies in terms of time, quality and quantity of delivered products, the assurance of the fast communication with the buyer (on-line), the assurance of the logistics and transport services.

¹ In the Likert scale from 1 to 5, where 5 – extremely important, 4 – very important, 3 – quite important, 2 – little important, 1 – completely unimportant.

2. THE ESSENCE OF DISTRIBUTION IN DELIVERING VALUE FOR CLIENTS

Distribution is one of components of marketing mix that in simplest task transfer the product from the production place to the purchase place to the customer (Saremi, Zadeh, 2014, p. 452). Marketers therefore spend considerable effort on finding the right channels of distribution, and on ensuring that the products reach consumers in the most efficient way (Blythe, 2005, p. 190).

The key role that distribution plays is satisfying a firm's customers and achieving a profit for the firm. From a distribution perspective, customer satisfaction involves maximizing time and place utility to the organization's suppliers, intermediate customers, and final customers (Burnett, 2008, pp. 253-254). In other words, the main task of distribution management is placing the goods in hand of potential customers at the right time and place (Saremi, Zadeh, 2014, p. 452). Distribution encompasses a system of all activities that are related to the transfer of economic goods between manufacturers and consumers. It includes such a coordinated preparation of manufactured goods according to their type and volume, space and time, so that supply deadlines can be met (order fulfilment) or estimated demand can be efficiently satisfied (when producing for an anonymous market) (Domschke, Schield, 1994; referenced by Segetlija, Mesarić, Dujak, 2011, p. 787). In business-to-business marketing, distribution is often the real key to success. Business buyers may buy through agents or wholesalers rather than direct from producers, so that tapping into a good distribution network is the most important step a company can take (Blythe, 2005, p. 190). The distribution strategy should deliver the information and service the enterprises' prospects need. For each customer segment, the enterprise should consider:

- How and where they prefer to buy;
- Whether they need personalized education and training;
- Whether they need additional products or services to be used alongside yours;
- Whether the product needs to be customized or installed;
- Whether the product needs to be serviced (Moderandi, 2009, p. 15).

Therefore, when the enterprise is making decision about the channel of distribution it should take into account the following issues:

1. Direct or/and indirect channels;
2. Single or multiple channels;
3. Cumulative length of the multiple channels;
4. Types of intermediary;
5. Number of intermediaries at each level;
6. Which companies as intermediaries to avoid 'intrachannel conflict' (Whalley, 2010, p. 96).

Distribution can be defined by:

- *path (route)* that goods undergo between the moment when the manufacturing is done and the entry in the final consumption;
- *distribution channels* (participants in the successive movement of goods along this route);
- *the flow of physical operations* that goods are subjected to on that route (sorting, prepackaging or packaging, handling, transportation, storage etc.) that raise the their value (and price);
- *economic operations* (sale and purchase, concession, consignment etc.) implied by their successive passing through each link, until entry into consumption, through which the

successive transfer of ownership on goods from one market agent to another is accomplished;

- *physical distribution or logistics*, with all components of the technical system that perform the operations (network units, equipment and machinery, personnel etc.);
- *the chain of decisions* that transfers imply, closely correlated to those regarding the other components of the marketing mix [Gherasim, 2014, p.

84]. Distribution systems are usually divided into:

- acquisition distribution system;
- logistic, i.e. physical distribution system (Segetlija, Mesarić, Dujak, 2011, p. 787).

According to Specht, acquisition distribution system management includes the management of distribution routes, i.e. distribution channels. Logistic distribution system is focused on bridging the space and time by transportation and storage, as well as order processing and shipment, supply logistics, i.e. the movement of materials (Specht, 1988, pp. 34-35; referenced by Segetlija, Mesarić, Dujak, 2011, p. 787).

Physical distribution activities provide the bridge between the production activities and the markets that are spatially and temporally separated. Physical distribution management may be defined as the process of strategically managing the movement and storage of materials, parts, and finished inventory from suppliers, between enterprise facilities, and to customers. Physical distribution activities include those undertaken to move finished products from the end of the production line to the final consumer. They also include the movement of raw materials from a source of supply to the beginning of the production line, and the movement of parts, etc., to maintain the existing product. Finally, it may include a network for moving the product back to the producer or reseller, as in the case of recalls or repair (Burnett, 2008, p. 264).

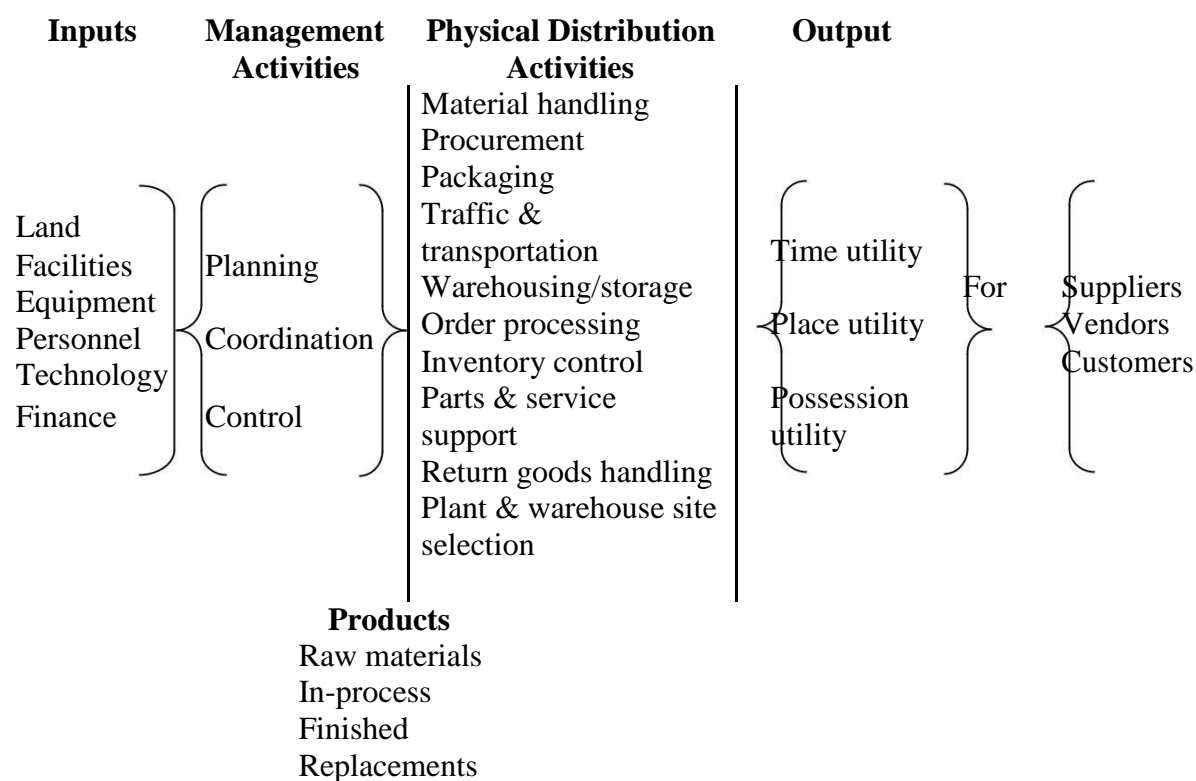


Figure 1: The physical distribution management process (Burnett, 2008, p. 266)

Distribution management serves the primary function of ensuring that the product or service is made available to the consumer within an arm's length of his desire. Distribution management takes care of the availability (physical distribution) and the visibility. It provides 'time', 'place', and 'possession' utility to the consumer (Havaladar, Cavale, 2007, p. 1.14).

As it is seen in Figure 1, successful management of the flow of goods from a source of supply (raw materials) to the final customer involves effective planning, implementation, and control of many distribution activities. These involve raw material, in-process inventories (partially completed products not ready for resale), and finished products. Effective physical distribution management results initially in the addition of time, place, and possession utility of products; and ultimately, the efficient movement of products to customer and the enhancement of the firm's marketing efforts (Burnett, 2008, p. 267).

However, designing an optimal physical distribution system is dependent on choosing those levels of services that minimize the total cost of physical distribution, whose objective function might read: $C + T + F + I + L$, where C - total distribution cost, T - total freight cost, F - total fixed warehouse cost, I - total inventory cost and L - total cost of lost sales (Baker, Hart, 2008, p. 210).

3. ACTIVITIES AFFECTING CUSTOMER VALUE REALIZED BY DAIRY COOPERATIVES FROM THE ŚWIĘTOKRZYSKIE PROVINCE – RESEARCH RESULTS

Cooperatives' executives were asked to indicate activities carried out by cooperatives that have influence on value creation for customers from different markets. Respondents indicated whether on province within which the cooperative is established, i.e. Świętokrzyskie Province, other Polish provinces, EU markets and other major markets they perform activities in the area of distribution. Interview results are shown in Table 1, Chart 1, and Chart 2.

Table following on the next page

Table 1: Activities affecting customer value realized by dairy cooperatives from the Świętokrzyskie Province on particular markets in the area of distribution (in %) (compiled by author)

Activity	Świętokrzyskie Province*	Other Polish provinces*	UE markets*	Other major markets*
the sale of products on the Internet	0	33	0	0
the ownership of retail chain	67	67	0	0
the ownership of warehouses, and distribution centers	0	0	0	0
the provision of easy access to the product on the market	0	0	0	0
the provision of products in a shorter time than competitors	0	0	0	0
the provision of products on time	33	33	0	0
the assurance of convenient time of purchase	0	33	0	0
the assurance of convenient place of purchase	33	0	0	0
the differentiation of distribution methods	33	33	0	0
individualization of deliveries in terms of time, size, range and method of delivery	33	0	33	0
the assurance of the reliability of supplies in terms of time, quality and quantity of delivered products	0	33	0	0
the assurance of the fast communication with the buyer (on-line)	33	0	0	0
the assurance of the logistics and transport services	0	0	0	0

* multiple answers.

When analyzing Table 1 and Chart 1, it is clear that:

- Activities related to the sale of products on the Internet implement 33% of cooperatives in other Polish provinces market. On Świętokrzyskie Province market, on the EU markets, and on other major markets, these activities are not implemented.
- Activities related to the ownership of retail chain implement 67% of cooperatives on Świętokrzyskie Province market, and in other Polish provinces market. On the EU markets, and on other major markets, these activities are not implemented.
- Activities related to the ownership of warehouses, and distribution centers are not implemented on any of indicated markets.
- Activities related to the provision of easy access to the product on the market are not implemented on any of indicated markets.
- Activities related to the provision of products in a shorter time than competitors are not implemented on any of indicated markets.
- Activities related to the provision of products on time implement 33% of cooperatives on Świętokrzyskie Province market, and in other Polish provinces market. On the EU markets, and on other major markets, these activities are not implemented.
- Activities related to the assurance of convenient time of purchase implement 33% of cooperatives in other Polish provinces market. On Świętokrzyskie Province market, on the EU markets, and on other major markets, these activities are not implemented.

Chart following on the next page

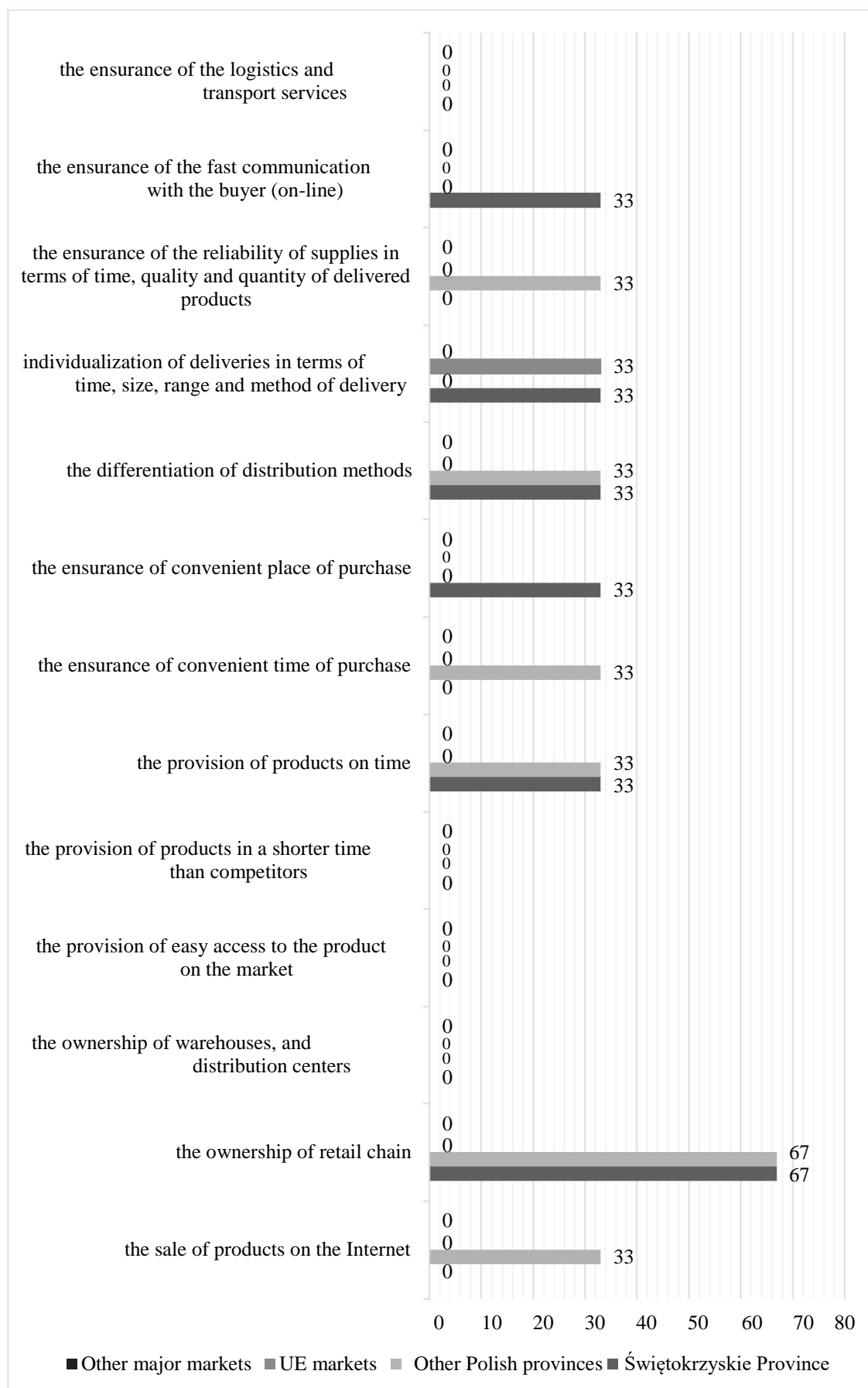


Chart 1: Chart for the data of Table 1 (in %) (compiled by author)

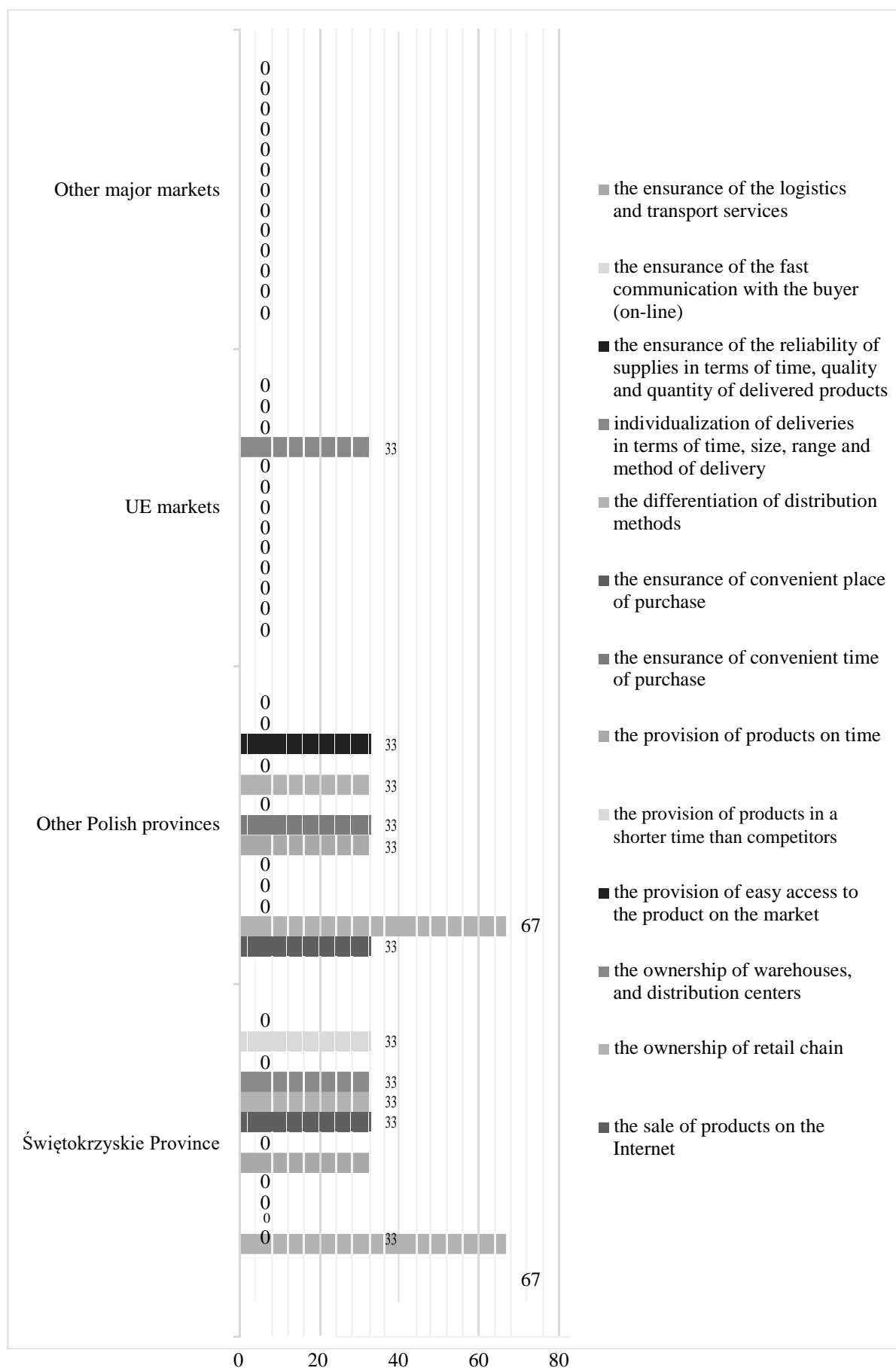


Chart 2: Chart for the data of Table 1 (in %) (compiled by author)

- Activities related to the assurance of convenient place of purchase implement 33% of cooperatives on Świętokrzyskie Province market. In other Polish provinces market, on the EU markets, and on other major markets, these activities are not implemented.
- Activities related to the differentiation of distribution methods implement 33% of cooperatives on Świętokrzyskie Province market, and in other Polish provinces markets. On the EU markets, and on other major markets, these activities are not implemented.
- Activities related to the individualization of deliveries in terms of time, size, range and method of delivery implement 33% of cooperatives on Świętokrzyskie Province market, and on the EU markets. In other Polish provinces market, and on other major markets, these activities are not implemented.
- Activities related to the assurance of the reliability of supplies in terms of time, quality and quantity of delivered products implement 33% of cooperatives in other Polish provinces market. On Świętokrzyskie Province market, on the EU markets, and on other major markets, these activities are not implemented.
- Activities related to the assurance of the fast communication with the buyer (on-line) implement 33% of cooperatives on Świętokrzyskie Province market. In other Polish provinces market, on the EU markets, and on other major markets, these activities are not implemented.
- Activities related to the assurance of the logistics and transport services are not implemented on any of indicated markets.

When analyzing Table 1 and Chart 2, it is clear that:

- On the Świętokrzyskie Province market 67% of cooperatives have their own retail chain. Moreover, on this market 33% of cooperatives implement the following actions: the provision of products on time, the assurance of convenient place of purchase, the differentiation of distribution methods, individualization of deliveries in terms of time, size, range and method of delivery, and the assurance of the fast communication with the buyer (on-line).
- On other Polish provinces market 67% of cooperatives have their own retail chain. Furthermore, on this market 33% of cooperatives implement the following actions: the sale of products on the Internet, the provision of products on time, the assurance of convenient time of purchase, the differentiation of distribution methods, the assurance of the reliability of supplies in terms of time, quality and quantity of delivered products.
- On the EU market 33% of cooperatives individualize deliveries in terms of time, size, range and method of delivery.
- In other major markets it is not implemented any of the identified activities.

4. CONCLUSION

Taking into account the results of research, it is clear that, despite the fact that for the customer is not only important the product itself, but also its value, the analyzed cooperatives rather in a small extent implement activities that affect the value for the customer associated with the distribution of their products. The activities, if implemented, are only in essentially implemented on two markets, namely the Świętokrzyskie Province, and other Polish provinces.

In the EU markets is performed only one activity, and in other markets, none of the activities is implemented. In the Świętokrzyskie Province and other Polish provinces are implemented six of the thirteen activities identified in the area of distribution. An opportunity for cooperatives

appears to be an extension of their activities in the area of distribution to the EU markets, and other markets. It seems that cooperatives should focus more on the implementation of activities affecting the value for the customer in the area of distribution, because the client when choosing a product is influenced by various factors, which he believes will bring him the highest value. Drawing attention to the customer and value created for him has a significant importance especially in turbulent environment, where the fight for the customer is more tightened and there must be introduced such an offer, which will satisfy most customer requirements. Then it will be possible to maintain existing customers and attract new ones and as a result winning the market competition.

LITERATURE:

1. Baker, M.J., Hart, S. (2008). *The Marketing Book* (6th edition). Oxford: Elsevier.
2. Berry, T., Wison, D. (2000). *On Target: The Book on Marketing Plans*. Eugene: Palo Alto Software, Inc.
3. Blythe, J. (2005). *Essentials of Marketing* (3rd edition). Harlow: Pearson Education Limited.
4. Burnett, J. (2008). *Core Concepts of Marketing*. Zurich: Global Text Project.
5. Cateora, P., Gilly, M.C, Graham, J.L. (2011). *International Marketing* (15th edition). New York: McGraw-Hill/Irwin.
6. Gherasim, A. (2014). Distribution on the International Market, *Economy Transdisciplinarity Cognition*, (2014, 1(17)), pp. 84-89.
7. Havaladar, K.K., Cavale V.M. (2007), *Sales and Distribution Management. Text an Cases*. New Delhi: Tata McGraw-Hill.
8. Konieczna, I. (2014). Ważność cech oferty dla klienta w obszarze dystrybucji z punktu widzenia spółdzielni mleczarskich z województwa świętokrzyskiego, *Logistyka*, (2014, 6), pp. 14354-14364.
9. Konieczna, I. (2014a). Zakres działań spółdzielni mleczarskich z województwa świętokrzyskiego związanych z tworzeniem wartości dla klienta w obszarze logistyki, *Logistyka*, (2014, 6), pp. 14365-14371.
10. Konieczna, I., Garasym, P. (2014). Perception of the Activities of Cooperatives in the Area of Distribution. The evidence from conducted research in Poland and Ukraine. In M. Mokrys, S. Badura, A. Lieskovsky (eds.). *Proceedings in Scientific Conference (SCIECONF 2014)* (pp. 34-37). Žilina: University of Žilina.
11. Moderandi Inc. *Strategic Marketing Process*. (2009). Retrieved 12.05.2014 from www.MarketingMO.com.
12. Rosenbloom, B. (2010). Six Classic Distribution Paradigms for Global Marketing Channel Strategy, *Emerging Issues in Management*, (2010, 1), pp. 7-17.
13. Segetlija, Z., Mesarić, J., Dujak, D. (2011). Importance of distribution channels - Marketing channels - for national economy, *22nd CROMAR Congress*, pp. 785-809.
14. Saremi, H., Zadeh, S.M.M. (2014). Management of distribution channels, *Indian Journal of Science Research*, (2014, 5(3)), pp. 452-456.
15. Whalley, A. (2010). *Strategic Marketing*. Frederiksberg: Ventus Publishing ApS.

GOVERNANCE CHALLENGES AND SOLUTIONS FOR OFFSHORE RENEWABLE ENERGY

Flavia Guerra

*School of Law and Politics
The University of Hull, United Kingdom
F.Guerra@2015.hull.ac.uk*

ABSTRACT

As potential contributors to climate change mitigation and reduction of greenhouse gas emissions, and drivers of economic growth, harnessing offshore renewable energies (ORE) depends on safe and reliable technology, appropriate policy and regulatory instruments, and stable sources of funding. However, the nature, location and maturity of ORE have led to several legal and policy challenges which condition the success of these industries.

Even though the ability to generate electricity from marine renewables is not in question, since technology is moving ahead of policy, its integration in wider energy networks might be problematic given the localised nature of the resources, and the high variability/low predictability of their output over multiple timescales.

Limited practical experience with the deployment of these technologies coupled with the difficulty of studying the marine environment represent barriers to acquiring knowledge on their impacts, particularly wave and tidal energy. These data gaps are amplified by underdeveloped regulatory frameworks regarding marine planning and sitting processes, including Environmental Impact Assessment, not adapted to manage uncertainty, and often making it too difficult for potential developers to get consent and thus invest.

As part of EU's Blue Growth Strategy, ORE's demand for exclusive rights over resources and a marine space creates potential conflicts by entering already congested oceans, traditionally regulated in a single-sector manner for different marine activities.

Previously proposed solutions to these constraints have failed to acknowledge the combined importance of all types of environmental policy instruments: evolving legal frameworks, targets and commitments; practical differences in domestic implementation of regulation, market-based and suasive instruments; and fragmentation of institutional architectures associated with constantly evolving actor networks operating for ORE governance.

Studying policy instrument mixes might demonstrate the changing roles of state and societal actors, and ultimately contribute for the debate surrounding the sustainability and governance transition to renewable energy.

Keywords: *environmental policy instruments, marine renewable energy, multilevel governance, policy instrument mixes, regulation.*

1. INTRODUCTION

The need to balance environmental protection with social needs and economic interests has been brought into sharp focus by talk of 'Blue Growth', consisting of developing policy aimed at leveraging marine natural resources to achieve economic growth (Wright, 2015). The European Union (EU) has been a pioneer with its Blue Growth Strategy which highlights the need to "harness the untapped potential of Europe's oceans, seas and coasts for jobs and growth (...) whilst safeguarding biodiversity and protecting the marine environment" (EC, 2012, p.3-4). Earlier in 2016, the Organisation for Economic Co-operation and Development (OECD) published a report as a result of a global forward-looking assessment of 'The Ocean Economy in 2030' with special emphasis on the high development potential of emerging ocean-based activities, including offshore wind and ocean energy (OECD, 2016), often referred to as offshore renewable energy (ORE) or marine renewable energy.

As EU member states are actively engaging in attempts to transition to a low-carbon economy relying on an increased use of renewable energy sources (EC Climate Action, 2016), ORE has been gaining some momentum as a clean alternative to fossil fuels. However, harnessing offshore renewable energy depends not only on safe and reliable technology, but also on appropriate policy and regulatory frameworks, and stable sources of funding (Appiott, Dhanju and Cicin-Sain, 2014). Although promising in terms of climate change mitigation and as a driver for economic development, ORE's growth has been conditioned by a few technological shortcomings, high development and operational costs, potentially adverse environmental impacts, evolving regulatory frameworks in many countries, and limited access to capital (Ibid). Scholarly literature concerning marine renewables initially focused on issues such as resource assessment and its technical aspects (IEA-RETD, 2012; Mueller and Wallace, 2008) and environmental effects (Gill, 2005). More recently, scholarly attention has turned to the social dimension (Kerr et al., 2014) and the political and legal challenges of ORE (Long, 2014; Wright, 2016). Even though some work has been done regarding the main legal and policy obstacles to ORE development, proposed solutions tend to focus on mono-instrumental approaches such as: improving regulatory frameworks, namely marine spatial planning implementation (Wright, 2015; Young, 2015) and Environmental Impact Assessment (EIA) (Guerra et al., 2015; IEA-RETD, 2012); or relying on market-based mechanisms to stimulate offshore renewable industries (Green and Vasilakos, 2011). Little to no importance has been given to suasive policy instruments, such as voluntary agreements and informational measures, in ORE governance.

However, research on 'new' modes of environmental governance (e.g. Lemos and Agrawal, 2006; Schmitt and Schulze, 2011; Wurzel, Zito and Jordan, 2013) suggests that any isolated study of either type of instrument (e.g. regulation, market tools and suasive instruments) is likely to be artificial since environmental policy instruments tend to cohere in messier 'packages' or mixes which are contingent on contextual factors, including the presence of other instruments. Harmelink and colleagues (2006) performed an *ex ante* analysis of policy instruments available for renewable energy in the EU in early 2000s. Nevertheless, they did so under the understanding that solely activities initiated by the government constituted (direct) policies (e.g. investment support schemes, feed-in tariffs, renewable energy obligations and regulations). This approach does not consider the observable governance shift with non-state actors' growing prominence in governance networks, particularly in climate change governance, one of the main challenges of the Modern World (Dias Guerra et al., 2015).

"The pressing environmental imperative to decarbonise the energy system (...) [and] the drive to exploit marine resources" (Wright et al., 2016, p.115) are leading to a rising number of ocean stakeholders and interests (Sutherland and Nichols, 2006) and high sectoral complexity of regimes operating in the ocean space (Boyes and Elliott, 2014). Consequently, the cross-sectoral policy linkages of ORE development and the low flexibility of (underachieving) command-and-control regulation (Wright, 2012) should demonstrate the need for a holistic approach to the conservation of the marine environment and management of its activities. This holistic approach will require understanding not only on all types of environmental policy instruments available, but also on the plethora of institutional arrangements and actors operating at the marine environment which might help push for offshore renewable energy.

Therefore, the first objective of this paper is to summarise the main recognised challenges to the development and deployment of ORE technologies, grounded on the resources' physical attributes, location and maturity (Section 2). Then, it puts forward key concepts and ideas that can contribute for better/effective solutions (Section 3). Finally in Section 4, it is suggested that an integrated approach to ORE governance can be achieved by considering the shared importance of: (1) developing adequate and stable legal regimes which level the playing field in the EU, at least, and provide efficient permitting and grid connection; (2) strategically

applying market-based mechanisms according to the socio-economic context of the member state; (3) acknowledging informational measures and voluntary agreements as pivotal policy instruments for ORE's development; and (4) considering the panoply of activities, institutions and actors operating in the marine space as well as their interplay. Future research should provide a fairly clear visualisation of the institutional complexity of ORE governance, and shed a light on with constitutes effective policy instrument mixes for ORE by studying the choice of policy instruments in EU member states where these industries are thriving.

2. LITERATURE REVIEW

2.1. Offshore Renewable Energy

Offshore wind energy, the most mature form of ORE, is growing rapidly as projects move from mono-pile (single-structure foundation) to gravity-based structures, and potentially to deeper waters thanks to floating platforms. By the end of 2011, total offshore wind production was close to 4GW, sufficient energy to power 4 million houses. The United Kingdom (UK)¹ is the largest producer (2GW), followed by Denmark (830MW) and the Netherlands (250MW). Approximately 100GW of offshore wind infrastructure is under development, predominantly centred in Europe and Asia (Zacharias, 2014). According to data from the International Renewable Energy Agency (IRENA, 2016), in 2015 wind energy had the second greatest capacity growth of over 63GW due to declines in onshore turbine prices.

Ocean energy includes wave, tidal range and tidal currents, ocean currents, ocean thermal energy conversion and salinity gradients. This type of ORE is starting to attract considerable interest and investment. Tidal range technology harnesses energy derived from the filling and emptying of coastal regions as a result of rising and falling tides, and represents the most developed of ocean energy at present. In 2012, worldwide installed ocean energy capacity was 530 MW, 517 MW of which were generated by the only four existing tidal range facilities in the world (Young, 2015). R&D projects on wave and tidal current energy technologies have proliferated over the past two decades, with some now reaching the full-scale pre-commercial prototype stage. According to IRENA (2016), there was a low but significant increase of 25MW of ocean energy generation in 2015.

2.2. Technical Challenges

The ability to generate electricity from marine renewables is not in question, especially since **technology** is moving ahead of policy. "Both wave and tidal technologies have overcome major technical challenges. Full scale devices on test have now delivered electricity into the national grid." (Johnson, Kerr and Side, 2013, p.495). Nevertheless, some critical issues remain such as: developing economically competitive technologies, the reliability of devices and their resilience to extreme waves and turbulence, and the cost of installation and cabling (Ibid). Economic competitiveness requires high levels of installed power which might translate into too ambitious targets for a single country, hence the need for transnational cooperation.

Integration of marine renewable resources in wider energy networks presents challenges as well, such as the localised nature of the resource (wind, wave or tidal), and the high variability and/or low predictability of the resource's output over multiple timescales. These must be considered in electric system planning and operation to ensure its reliable and economical operation. On the matter of establishing a legal regime for offshore renewables that regulates the construction of offshore cable infrastructure and resolves any **grid connection** issues, Müller and Roggenkamp (2014) consider the possibility of drawing lessons from the offshore petroleum sector. Decisions about offshore energy developments should not be taken in isolation since, for example, the supply chain which supports the day to day operation of the

¹ All UK references throughout this paper comprehend assessments made while it was still part of the EU.

offshore oil and gas industry is transferable to offshore renewable energy industries. Anyway, depending on the legal and regulatory framework in a particular region, the institutional challenges of transmission expansion can be substantial (IPCC, 2012).

2.3 Legal and Policy Challenges

Even though some technical barriers still exist due to the physical attributes and location of marine renewable resources, the great bulk of challenges conflicting with environmental protection can be found within the legal and policy domains (IEA-RETD, 2012; Portman et al., 2009; Wright et al., 2016; Young, 2015).

2.3.1 Environmental Impacts and Consenting

The impacts arising from the energy used and GHG emissions produced during manufacture, transport, installation, operation and decommissioning of wind turbines and wave converters, are small compared to the energy generated and emissions avoided over their lifetime. The IPCC (2012) recognises that the construction and operation of offshore wind power plants has some implications, particularly on: wildlife (bird collision and habitat and ecosystem modifications), benthic resources, fisheries and marine life more generally, visual impacts, land and marine usage, proximal impacts, and property value impacts. As for ocean energy projects, environmental risks appear to be relatively low in comparison with those from existing energy industries, but the early stage of deployment creates uncertainty which might contribute for social and environmental concerns and eventually hamper consenting and thus development. Efforts to better understand the nature and magnitude of ORE impacts and how to minimise and mitigate them needs to be addressed with the increasing deployment of technologies.

Potential ORE developers are typically required to obtain a series of statutory approvals administered under different laws by different agencies at various levels of government, including grid connection and/or power purchase agreements with electricity utilities, environmental approvals pursuant to EIA, leases or concessions. Developers must obtain use rights over the area and, in some instances, planning approvals² (Young, 2015). Often the permitting processes under the multiple applicable laws are not coordinated and timeframes and processes may be duplicated (e.g. public consultations) or even conflict with each other, thus multiplying regulatory complexity (Ibid). For example, according to the EU EIA Directive (Directive 85/337/CE), all EU member states must commission an assessment of the environmental consequences of certain types of projects, including “power stations” (> 300 MW, Annex I) and “industrial installations for the production of electricity” (Annex II), before building permission is granted. Further EU legislation amending or complementing this directive has appeared (1997, 2003, 2009 – all coded by Directive 2011/92/EC) and has been widely adopted. However, environmental legislation requirements for offshore renewable energy projects still remain uncertain in many countries, since even the most recent EIA Directive (Directive 2014/52/EU) allows for discretion by member states when transposing it, and its annexes do not specifically include wave or tidal energy farms specific categories (like wind farms under Annex I), probably owing to their status of development. Meanwhile developers have to be oriented along national laws where possible, but these are still under construction and differ between countries, giving rise to varying levels of scrutiny.

2.3.2 Rights and Ownership

The conceptualisation of the oceans as common heritage of mankind is being gradually supplanted, firstly at the international level by the creation of sovereign rights, and subsequently

² “Pilot projects are mostly subjected to the same permitting requirements as commercial-scale projects”, despite the former being on a much smaller scale and of shorter duration, “with the primary goal of testing a technology and collecting vital data on issues such as environmental impacts.” (Young, 2015, p.167)

by the emergence of new private rights in marine spaces. As a result of the adoption of Blue Growth agendas in several EU countries, the demand for such private or quasi-private rights at the domestic level has increased. For offshore renewable energy, such rights provide the foundation for project development since developers will require exclusive rights over resources and a marine space, mainly owing to the needs and modalities of the technology which exclude other users (Kerr et al., 2015). By doing so, ORE is in fact privatising a common good and creating potential conflicts by entering an already congested marine environment, traditionally regulated in a single-sector manner for different marine activities (e.g. fisheries, navigation, aquaculture, mineral extraction).

2.3.3 Planning and Incentives

Young (2015, p.157) raises attention to the fact that “the *ad hoc* and sectoral management approach that has dominated the marine environment to date has adverse implications for the progressive development of the offshore renewable energy industry.” As alluded before, planning and siting regulations vary dramatically across jurisdictions, and planning and siting processes have been reported as obstacles to offshore renewables in some countries and contexts. Developers are faced with the very real possibility of conflict with other user groups that may compete for the same space. So far the inexistence of forward-planning regarding offshore wind and ocean energy projects has translated into uncertainty and instability for prospective developers (private sector) which have driven up development costs and risk, potentially deterring investment (Ibid).

3. SOLUTIONS?

3.1. Multilevel Governance

The concept of *governance* covers “the whole range of institutions and relationships involved in the process of governing”, or the process of guiding, directing or steering society (Jordan, Wurzel and Zito, 2005, p.478). The high complexity and multi-layered nature of environmental problems which have not been adequately addressed by hierarchical government (Buizer, Arts and Kok, 2011) have contributed for the *governance turn*. Conversely to what *government* stands for – bureaucracy, legislation, financial control, regulation and force –, governance accounts for “the increasing importance of multilevel decision-making arenas, the involvement of more stakeholders and thus the formation of policy networks and/or networked forms of governance, so as to arrive at more ‘collaborative’ policy decisions.” (Jordan, Wurzel and Zito, 2013, p.159). As defended by the governance school of thought, this might translate into a greater use of non-regulatory policy instruments such as new environmental policy instruments (NEPIs). These are proposed, designed and implemented by non-state actors either working alongside state actors or independently (Jordan, Wurzel and Zito, 2005).

3.1.1. Institutions and Actors

It has become clear that “policy objectives for transforming existing energy systems into ones with greater renewable energy content require co-ordinated efforts and changes among many different actors, institutions and artefacts” (Smith, 2007, p.6268). There seems to be high interest (and political will too, mostly in the EU) for marine renewables to succeed, this is demonstrated by the growing attention of various key international energy governance institutions, namely: the International Energy Agency (IEA) which established the Ocean Energy Systems Implementing Agreement (IEA-OES) and the International Renewable Energy Agency (IRENA), which has started developing activities on ocean governance (Wright et al., 2016). Notwithstanding, it is important to realise that the creation of such specialised renewable energy agencies “raises the spectre of further institutional fragmentation in global energy

governance along sectoral lines, with each sector having its own international institution.” (Van de Graaf, 2013, p.24). Additionally, other relevant transnational institutions exist whose governance goal is in line with the development of offshore renewables, and are likely incremental to the degree of complexity/fragmentation within ORE governance, namely: the International Energy Forum, Renewable Energy Policy Network for the 21st Century (REN21), Sustainable Energy for All, International Partnership for Energy Efficiency Cooperation (IPEEC), Intergovernmental Panel on Climate Change (IPCC), Clean Energy Ministerial, UN Division for Ocean Affairs and the Law of the Sea (DOALOS), and many more. Even though there might be a functionalist argument concerning the potential overlap of such institutions’ competences, the priority is to map all of the relevant institutions and actors (both state and non-state) involved in governing offshore renewable energy to check if the notion of fragmentation holds (and only then assess if integration would be a better alternative for governing an activity taking place in the ocean environment).

3.2. Policy Instrument Mixes

There is no one-size-fits-all policy. In fact, different policies or combinations of policies can be more effective and efficient depending on factors such as technological maturity, affordable capital, ease of integration into the existing system and the local and national renewable energy resource base (IPCC, 2012). Hence, the flexibility to adjust as technologies, markets and other factors evolve is crucial, along with the details of design and implementation, in determining the effectiveness and efficiency of a policy instrument or mix. An enabling environment for offshore renewable energy can be created by addressing the possible interactions of a given policy instrument with other energy or non-energy policies, including climate change mitigation measures, environmental protection tools, etc. An appropriate and reliable mix of policy instruments, including energy efficiency policies, is even more important where energy infrastructure is still developing and energy demand is expected to increase in the future (Ibid). Wurzel and colleagues (2013) have classified the main types of environmental policy instruments as: regulatory, market-based and suasive. They also argued that within the pattern of instrument use in and across jurisdictions, four types of interactions can appear: co-existence, fusion, competition or replacement.

3.2.1 Regulation

Offshore renewables’ success depends upon “government policies to support development and deployment...the sector requires a comprehensive policy framework... [with] swift and targeted policy actions and EU support” (Wright, 2012, p.11). Regulatory methods need to be flexible and adaptable; facilitate the deployment of small-scale prototypes; plan for large-scale deployment; manage potential environmental impacts, human use conflicts and likely competition over sites; and ensure balance between sustainability and exploitation. In this manner, good regulation facilitates the development and sustainable deployment of renewable energy technologies by providing certainty, investor confidence, knowledge creation, equitable use and timescales, and last but not least, regulatory policy in the marine environment must rely heavily on monitoring and enforcement. Effective regulatory approaches are essential to overcome the legal and policy challenges that the sector is facing (e.g. low coherence, lack of best practice approach, long timeframes and high prices required to obtain project’s consent).

International law, especially within the domain of the law of the sea, provides a regulatory framework that is broadly suitable for the development of marine renewable energy, although it has its shortcomings (Castelos, 2014). Offshore renewable energy is not covered by a single international instrument nor is there one specific institutional framework (actually, none of the offshore activities have one) or governance arrangement operating at a global level (IRENA’s mandate includes marine renewables, but its powers are limited). “Their regulation is dispersed

not only across various areas of international law, but also in a variety of national regulations. Although marine law does make explicit reference to marine renewable energies, this is by no means a complete treatment.” (Castelos, 2014, p.228). Boyes and Elliott (2014) have illustrated the marine law complexity by means of an ‘horrendogram’ which includes a branch dedicated to renewable energy EU regulatory instruments³, but the authors do not acknowledge the cross-sectoral nature of marine renewables nor the multiplicity of relevant regulations. For example, policy targets for climate change mitigation range from reducing greenhouse gas (GHG) emissions to increasing the share of renewables in energy consumption rates and improving energy efficiency. Hence, it is reasonable to believe that the success of policies aimed at promoting offshore renewables cannot be decoupled from climate change mitigation measures. In the same manner that environmental protection arrangements aimed at the preservation of the marine environment and its resources necessarily include the management of marine renewable sources. This is not only a driver of institutional fragmentation in ocean governance but it is also at the basis of the legal instability surrounding marine renewables. International legal instruments applicable to marine renewables are already “a conciliatory factor between such energies and the legitimate uses of the sea” (Castelos, 2014, p.228). Nonetheless, what has prompted many national and international organisations to start thinking and planning in a way that brings together environmental information, current and projected uses of particular areas, the interaction between such uses, and between the plethora of uses and the marine environment, has been the adoption of marine spatial planning (MSP). It “provides legal certainty, predictability, transparency and direction for the future development of an ocean area, thus signalling to the industry that development opportunities do exist.” (Young, 2015, p.158).

3.2.2 New Environmental Policy Instruments (NEPIs)

While hierarchical governance has witnessed a relative decline, it remains the dominant mode of governance with the more interventionist instruments in EU environmental policy-making (e.g. regulative or procedural means) continuing to be passed more frequently than softer forms (e.g. cooperative and persuasive measures) (Jordan, Wurzel and Zito, 2013; Schmitt and Schulze, 2011). However, there is a tendency of NEPIs co-existing with traditional tools, thus leading to an increasingly diverse instrument portfolio.

Market-based Mechanisms

It is essential to acknowledge that “the development of offshore energy facilities takes place in an economic as well as a legal and physical environment.” (Portman et al., 2009, p.3602). Alike regulatory instruments, market-based instruments tend to be backed up with some threat, in the case of non-compliance it is typically financial. Overall dissatisfaction with regulatory control by state agencies (also verified in relation to ORE⁴) has been described as one of the main drivers of the expansion of market incentives-based instruments and in their adoption across sectors and national boundaries; critics of regulatory approaches have suggested economic instruments as a complementary or alternative approach to achieving public policy goals

³ Directive 2009/28/EC on the promotion of the use of energy from renewable sources; the 2020 climate and energy package (20-20-20 targets: 20% reduction in EU GHG emissions from 1990 levels, raising the share of EU energy consumption produced from renewable resources to 20%, 20% improvement in the EU’s energy efficiency); the EU 2030 climate & energy framework (40% cut in GHGs, at least 27% share of renewable energy consumption, at least 27% energy savings compared with the business-as-usual scenario); etc.

⁴ “In many countries offshore renewable energy proponents face a complex web of regulatory instruments that demand a significant amount of time and resources to navigate successfully. The reason for this complexity is, at least in part, based on the fact that as the industry is fairly new, very few countries have begun the process of developing dedicated legal regimes to govern and regulate the development of OREFs. As a result, most countries rely on existing laws, which were drafted with regulatory objectives other than to govern offshore renewable energy projects” (Young, 2015, p. 166).

(Zacharias, 2014). Additionally, the difficulties in implementing traditional command-and-control regulation and the high costs of compliance with environmental regulations also provide an explanation for the willingness of governments to experiment with market-oriented efforts (Lemos and Agrawal, 2006). So, when market conditions do not support the development of offshore renewables by default, public policies in the form of economic approaches can provide incentives that make ORE production more attractive (Ibid). Economic support schemes include *feed-in tariffs* and *premiums*, present particularly in Denmark and Germany, these constitute the oldest and most widely used; *tradable green certificates schemes*, also known as *Renewable Portfolio Standards*, where electricity suppliers are obliged to produce or distribute a certain quota of renewable energy (e.g. Netherlands, Denmark, Sweden, the UK) (Menanteau, Finon and Lamy, 2003); *investment grants*, although learning costs related to the development of offshore renewable energy cannot be supported exclusively by governmental or European research or innovation grants⁵, these are certainly helpful; *tenders*; *fiscal measures* or taxes/charges; and other *financing support* within the context of repayable investment (in contrast to reimbursable grants) (Kitzing, Mitchell and Morthorst, 2012).

Suasive Instruments

As Smith (2007, p.6268) has argued “renewable systems are complex. It is consequently difficult to direct them into being exclusively through hierarchical government measures like planning. Nor are they likely to arise spontaneously through energy markets. Additional problem-solving activities must be coordinated and steered outside government hierarchies and beyond markets”. Eco-labels⁶, which have been widely used in Germany, provide relevant environmental information about a product to consumers who then can take informed choices. Eco-labels form part of the sub-category of *informational measures*⁷. Green power consumers usually demand quality environmental data for increased credibility. “By contributing to the decision-making process inherent in production selection, purchasing, use and disposal, eco-labeling has wide implications for consumers, businesses and government.” (Banerjee and Solomon, 2003 p.109). It is my understanding that the application of eco-labels to ORE might help consumers and policymakers understand the associated environmental impacts, performance and supply chain dynamics, making it easier to address any liability problem, and ultimately support the issuing of permits based on informed consultations. However, the role of third-party eco-labeling, such as WindMade and EKOenergy, for green power products resultant from emerging renewable technologies in the concert of environmental policy instruments remains understudied (Truffer, Markard and Wüstenhagen, 2001). A few authors (Hoefnagel, Vos and Buisman, 2013; Toonen and Lindeboom, 2015) have used “marine informational governance” as a conceptual framework to better understand the changing role of information in marine resource management (including offshore wind energy), enterprises, institutions and actual practices of governance. In my opinion, further empirical research is necessary on all forms of offshore renewable energy, especially ocean energy, and how governance arrangements and networks accommodate the growing centrality of information,

⁵ EU Horizon 2020 Energy (2014-2020): 35% of the overall programme’s budget is to be allocated for projects and initiatives in climate-related research and innovation areas including low-carbon technologies, providing for security of energy supply, competitiveness of EU industry and ensuring affordable prices for citizens whilst combating climate change; EU emissions trading scheme (ETS) (2013-2020) involves 300 million allowances set aside in the New Entrants Reserve to fund the deployment of innovative renewable energy technologies and carbon capture and storage through the NER 300 programme.

⁶ Some authors, such as Zacharias (2014) consider product certification also as a market enhancement instrument.

⁷ Information provides the foundation for all instruments, as generally every policy needs data on technology and ecology. These can act as stand-alone instruments or supplement and reinforce effectiveness of other mechanisms. Within the context of the marine policy environment, the main informational categories include supply, research, education and public outreach campaigns (Zacharias, 2014).

including but also beyond eco-labels; which actors are information producers and/or claim information authority?

Voluntary agreements are widely used particularly in Germany and the Netherlands. They include unilateral commitments, public voluntary schemes and negotiated agreements. Voluntary agreements usually represent agreements between industry and public authorities on the achievement of certain environmental objectives. Industry and corporate actors often put forward voluntary agreements as part of a strategy which aims to pre-empt legal regulation.

A new ‘bottom-up approach’ has arguably emerged following the reinforced and central role of partnerships for implementing the United Nations’ sustainable development goals (SDGs). A quick analysis of the partnerships relevant for the promotion of ORE indicates that some of these share goals and commitments across three different SDGs⁸, this supports the argument about the cross-sectoral importance of marine renewable energy. Regardless of having already been studied from an environmental governance perspective in the past (Wurzel, Zito and Jordan, 2013), the application and effectiveness of voluntary agreements within offshore renewable industries remain unknown.

4. CONCLUDING REMARKS AND OUTLOOK

A wide range of strategies has been implemented in different EU member states to promote the deployment of offshore renewable energy, a fact that has enthused a number of scholars to conduct evaluations on the success of such strategies. Empirical research indicates that both regulatory and economic support mechanisms have shortcomings and so far have failed to address all of the challenges of ORE; marine spatial planning, private rights in the ocean space, environmental impacts and consenting have all been scrutinised by scholars who sought for answers in regulation, while the lack of investment has been patched with market incentives. Meanwhile, marine informational governance is emerging as an interesting theoretical framework to analyse new institutional arrangements taking charge of information sharing as a governance function. This can provide a starting point to further explore *suasive instruments’* contribution to ORE governance.

The energy supply sector is often conceptualised as a socio-technical system consisting of networks of actors such as individuals, firms, civil society organisations, etc., and institutions made out of societal and technical norms, regulations, standards of good practice, and others. These different elements are interactive, interrelated and dependent on each other in ways that condition the sustainability transition (from fossil fuels to renewable energy). Transitions within socio-technical systems are characterised by changes among several dimensions, from technological, material, organisational, institutional, political, economic, to socio-cultural (Markard, Raven and Truffer, 2012). Scholars have touched upon these facets distinctively, time and again in an isolated manner, often overlooking the dynamics and innovation behind them.

Previous approaches have failed to acknowledge not only the cross-sectoral policy linkages of marine renewable resources’ exploration, but also the *combined* importance of: evolving legal frameworks, targets and commitments; practical differences in domestic implementation of regulation, market-based *and* *suasive instruments*; and fragmentation of institutional architectures associated with constantly changing actor networks in ORE governance.

I intend to conduct a detailed survey and empirical analysis of what constitutes effective mixes of policy instruments, institutions and actors to address the challenges of offshore wind, wave

⁸ Stakeholders can register their initiatives and voluntary commitments to the UN SDGs, including goal 7 on ensuring access to affordable, reliable, sustainable and modern energy for all; goal 13 on urgent action to combat climate change and its impacts; and goal 14 on conserving and sustainably use the oceans, seas and marine resources for sustainable development, on a database managed by the Rio+20 at <https://sustainabledevelopment.un.org/partnerships/> (retrieved on 17.06.2016).

and tidal development. With this in mind, a thorough policy mapping exercise coupled with the creation of a database of ORE governance institutional arrangements is essential to sort out which policy instruments can be/are actually used for the success of marine renewables, how institutional contexts can be/are adapted to these mixes, and who are the central actors. Therefore, the next steps of this research will include both investigating the domestic implementation of policy instruments that support the growth of ORE industries, and describing the social, economic and political (or other) factors framing the attitudinal context in regards to the understanding and choice of these instruments in different countries. Since the choice and application of different policy instruments constitutes the very essence of governing (Wurzel, Zito and Jordan, 2013), studying these policy instrument mixes across jurisdictions should demonstrate the changing roles of state and societal actors, and ultimately contribute for the normative debate surrounding this sustainability and governance transition using the ORE industries.

LITERATURE:

1. Appiott, J., Dhanju, A., Cicin-Sain, B. (2014). Encouraging renewable energy in the offshore environment. *Ocean & Coastal Management*, 90:58-64.
2. Banerjee, A., Solomon, B. (2003). Eco-labeling for energy efficiency and sustainability: a meta-evaluation of US programs. *Energy Policy*, 31:109-123.
3. Boyes, S., Elliott, M. (2014). Marine legislation – The ultimate ‘horrendogram’: International law, European directives & national implementation. *Marine Pollution Bulletin*, 86:39-47.
4. Buizer, M., Arts, B., Kok, K. (2011). Governance, Scale and the Environment: The Importance of Recognizing Knowledge Claims in Transdisciplinary Arenas. *Ecology and Society*, 16(1):21 (online).
5. Castelos, M. (2014). Marine Renewable Energies: Opportunities, Law, and Management. *Ocean Development & International Law*, 45(2):221-237.
6. Dias Guerra, F., Widerberg, O., Isailovic, M., Pattberg, P. (2015). *Mapping the Institutional Architecture of Climate Change Governance* (Report R-15/09). Amsterdam: Institute for Environmental Studies, VU Amsterdam.
7. European Commission (EC) (2012). *Blue Growth: Opportunities for marine and maritime sustainable growth*. Retrieved 07.06.2016 from http://ec.europa.eu/maritimeaffairs/documentation/publications/documents/blue-growth_en.pdf.
8. European Commission (EC) Climate Action. (2016). *Energy*. Retrieved 07.06.2016 from http://ec.europa.eu/clima/policies/international/paris_protocol/energy/index_en.htm.
9. Gill, A. (2005). Offshore renewable energy: ecological implications of generating electricity in the coastal zone. *Journal of Applied Ecology*, 42:605-615.
10. Green, R., Vasilakos, N. (2011). The economics of offshore wind. *Energy Policy*, 39(2):496-502.
11. Guerra, F., Grilo, C., Pedroso, N., Cabral, H. (2015). Environmental Impact Assessment in the marine environment: a comparison of legal frameworks. *Environmental Impact Assessment Review*, 55:182-194.
12. Harmelink, M., Voogt, M., Cremer, C. (2006). Analysing the effectiveness of renewable energy support policies in the European Union. *Energy Policy*, 34(3):343-351.

13. Hoefnagel, E., Vos, B., Buisman, E. (2013). Marine informational governance, a conceptual framework. *Marine Policy*, 42:150-156.
14. Intergovernmental Panel on Climate Change (IPCC). (2012). *Renewable Energy Sources and Climate Change Mitigation: Summary for Policymakers and Technical Summary*. Retrieved 20.06.2016 from https://www.ipcc.ch/pdf/special-reports/srren/SRREN_FD_SPM_final.pdf.
15. International Energy Agency's Implementing Agreement on Renewable Energy Technology Development (IEA-RETD). (2012). *Offshore Renewable Energy: Accelerating the Deployment of Offshore Wind, Tidal and Wave Technologies*. New York: Earthscan.
16. International Renewable Energy Agency (IRENA). (10.04.2016). *Renewable Energy Breaks Growth Record in 2015*. Retrieved 11.04.2016 from <https://irenanewsroom.org/2016/04/10/renewable-energy-breaks-growth-record-in-2015/>.
17. Johnson, K., Kerr, S., Side, J. (2013). Marine renewables and coastal communities—Experiences from the offshore oil industry in the 1970s and their relevance to marine renewables in the 2010s. *Marine Policy*, 38:491-499.
18. Jordan, A., Wurzel, R., Zito, A. (2013). Still the century of “new” environmental policy instruments? Exploring patterns of innovation and continuity. *Environmental Politics*, 22 (1):155-173.
19. Jordan, A., Wurzel, R., Zito, A. (2005). The Rise of “New” Policy Instruments in Comparative Perspective: Has Governance Eclipsed Government? *Political Studies*, 53:477-496.
20. Kerr, S., Colton, J., Johnson, K., Wright, G. (2015). Rights and ownership in sea country: Implications of marine renewable energy for indigenous and local communities. *Marine Policy*, 52:108-115.
21. Kerr et al. (2014). Establishing an agenda for social studies research in marine renewable energy. *Energy Policy*, 67:694-702.
22. Kitzing, L., Mitchell, C., Morthorst, P. (2012). Renewable energy policies in Europe: Converging or diverging? *Energy Policy*, 51:192-201.
23. Lemos, M., Agrawal, A. (2006). Environmental Governance. *Annu. Rev. Environ. Resour.*, 31:297-325.
24. Long, R. (2014). Harnessing Offshore Wind Energy: Legal Challenges and Policy Conundrums in the European Union. *The International Journal of Marine and Coastal Law*, 29:690-715.
25. Markard, J., Raven, R., Truffer, B. (2012). Sustainability transitions: An emerging field of research and its prospects. *Research Policy*, 41:955-967.
26. Menanteau, P., Finon, D., Lamy, M-L. (2003). Prices versus quantities: choosing policies for promoting the development of renewable energy. *Energy Policy*, 31:799-812.
27. Mueller, M., Wallace, R. (2008). Enabling science and technology for marine renewable energy. *Energy Policy*, 36:4376-4382.
28. Müller, H., Roggenkamp, M. (2014). Regulating Offshore Energy Sources in the North Sea—Reinventing the Wheel or a Need for More Coordination? *The International Journal of Marine and Coastal Law*, 29:716-737.

29. Portman, M., Duff, J., Köppel, J., Reisert, J., Higgins, M. (2009). Offshore wind energy development in the exclusive economic zone: Legal and policy supports and impediments in Germany and the US. *Energy Policy*, 37:3596-3607.
30. Schmitt, S., Schulze, K. (2011). Choosing environmental policy instruments: An assessment of the 'environmental dimension' of EU energy policy. In Tosun, J., Solorio, I. (eds), *Energy and Environment in Europe: Assessing a Complex Relationship?*. European Integration online Papers, Special Mini-Issue 1, Vol. 15, Art. 9. Retrieved 10.06.2016 from <http://eiop.or.at/eiop/pdf/2011-009.pdf>.
31. Smith, A. (2007). Emerging in between: The multi-level governance of renewable energy in the English regions. *Energy Policy*, 35:6266-6280.
32. Sutherland, M., Nichols, S. (2006). Issues in the Governance of Marine Spaces. In FIG Commissions 4 & 7 Working Group 4.3. *Administering Marine Spaces: International Issues* (Report No. 36). Copenhagen: International Federation of Surveyors.
33. Toonen, H., Lindeboom, H. (2015). Dark green electricity comes from the sea: Capitalizing on ecological merits of offshore wind power. *Renewable and Sustainable Energy Reviews*, 42:1023:1033.
34. Truffer, B., Markard, J., Wüstenhagen, R. (2001). Eco-labeling of electricity—strategies and tradeoffs in the definition of environmental standards. *Energy Policy*, 29:885-897.
35. Van de Graaf, T. (2013). Fragmentation in Global Energy Governance: Explaining the Creation of IRENA. Published in *Global Environmental Politics*, 13(3):14-33..
36. Wright, G. (2016). Regulating wave and tidal energy: An industry perspective on the Scottish marine governance framework. *Marine Policy*, 65:115-126.
37. Wright, G. (2015). Marine governance in an industrialised ocean: A case study of the emerging marine renewable energy industry. *Marine Policy*, 52:77-84.
38. Wright, G. (2012). *Marine renewable energy: legal and policy challenges to integrating an emerging renewable energy source*. Presented at the IKEM International Summer Academy on Energy and the Environment, Berlin.
39. Wright, G. et al. (2016). Establishing a legal research agenda for ocean energy. *Marine Policy*, 63:126-134.
40. Wurzel, R., Zito, A., Jordan, A. (2013). *Environmental Governance in Europe: A Comparative Analysis of New Environmental Policy Instruments*. Cheltenham, UK and Northampton, MA, USA: Edward Elgar.
41. Young, M. (2015). Building the Blue Economy: The role of marine spatial planning in facilitating offshore renewable energy development. *The International Journal of Marine and Coastal Law*, 30:148-173.
42. Zacharias, M. (2014). *Marine Policy: An Introduction to governance and international law of the oceans*. London and New York: Routledge, Taylor & Francis Group.

FOREIGN DIRECT INVESTMENTS AND FISCAL STIMULATION IN BALKANS: EVIDENCE FROM ALBANIA, KOSOVO AND MACEDONIA

Florije Miftari

AAB University, Kosovo

florije.miftari@universitetiaab.com

ABSTRACT

This paper analyzes the trends and factor determinations attracting foreign capital inflows into selected Balkan countries- Albania, Kosovo and Macedonia using a documented analysis. The study revealed that despite tax incentives and promotional activities undertaken by the governments to create investment environment, capital inflow in selected Balkan countries is still modest, reflecting a weak overall investment climate in the region. According the results of the study, reason for lower FDI in analyzed countries are several: regional political instability, absence of institutional quality and prospects of EU membership, size of their economy, threats from corruption and partial observance of regulation, was the significant investment impediment.

According to the theoretical findings and empirical evidence, the paper subsequently suggests that fiscal stimulus are only marginally efficient in the absence of political stability, structural reforms, strategic development policies and EU integrations.

Keywords: *Balkans, foreign direct investment, tax.*

1. INTRODUCTION

Based on theoretical and empirical knowledge on the role of investments on stimulating production and economic development of a country, it results that direct foreign investments play a crucial role on stimulating economic development of countries.

In absence of domestic capital, the direct foreign investments are considered as an important stimulation of economic development and growth which enable entering of fresh capital in economy, unemployment decrease, access to international markets, increase of productivity, gaining knowledge, insights and managerial skills in the home country, development of human resources, productive use of natural resources and other benefits for the country in which the investment takes place.

For these reasons, the places which want to attract foreign capital, prepare strategies or stimulating programs which offer special incentives to foreign investors. Such policies are mainly oriented toward creating a favorable environment and attractiveness for running businesses of foreign investors. These are the reasons why the governments of different countries make permanent efforts to improve their macroeconomic policies, create institutional regulatory basis, implement adequate fiscal, monetary social and foreign markets policies.

Trade and FDI drive economic globalisation and help stimulate the growth of national economies. Fair and efficient tax systems are central to sharing the fruits of that growth equitably among nations and citizens. The challenge for governments is to put in place policies that attract investment and enable them to collect their fair share of taxes. (OECD, 2015 Pierre Poret).

Besides the numerous factors that influence the increase of a country's attraction to attract investments, in this work we will review and analyze the effects or the influence of the fiscal incentives in attracting foreign investments, how sensitive are foreign investments to taxes, how do fiscal reliefs influence the attraction of investments in some Balkan countries.

Nevertheless, even that the taxes are known as an important factor of business decision making on where to invest they are not the only factor and do not produce the desired effect of whether

there is an appropriate economic and political environment. Therefore, the governments which want to attract foreign capital should create political and economic stability; macroeconomic stability; access to markets and chances for profit; predictable and non-discriminative regulative legal system; infrastructural development; non-corruptive business environment; educated and well trained labor force skilled with proper abilities needed for different business fields; competitive costs, etc.

However, tax reliefs in itself carry also the risk to act as an obstacle to domestic investments by favoring foreign investors especially if the tax regulation is applied arbitrarily it also carries the risk to reduce budget revenues.

2. LITERATURE REVIEW

In literature, there are plenty of empirical and theoretic studies related to analysis of multiple factors which influence the foreign investment attraction (FDI). Many factors influence the attractiveness of the country which wants to attract foreign investments, such as: location, the macroeconomic environment, market breadth, institutional factors, etc. (Magnus Blomstrom and Ari Kokko 2003; Quan Li 2006; Jacques Morrisset and Neda Pirnia 2000 ect.)

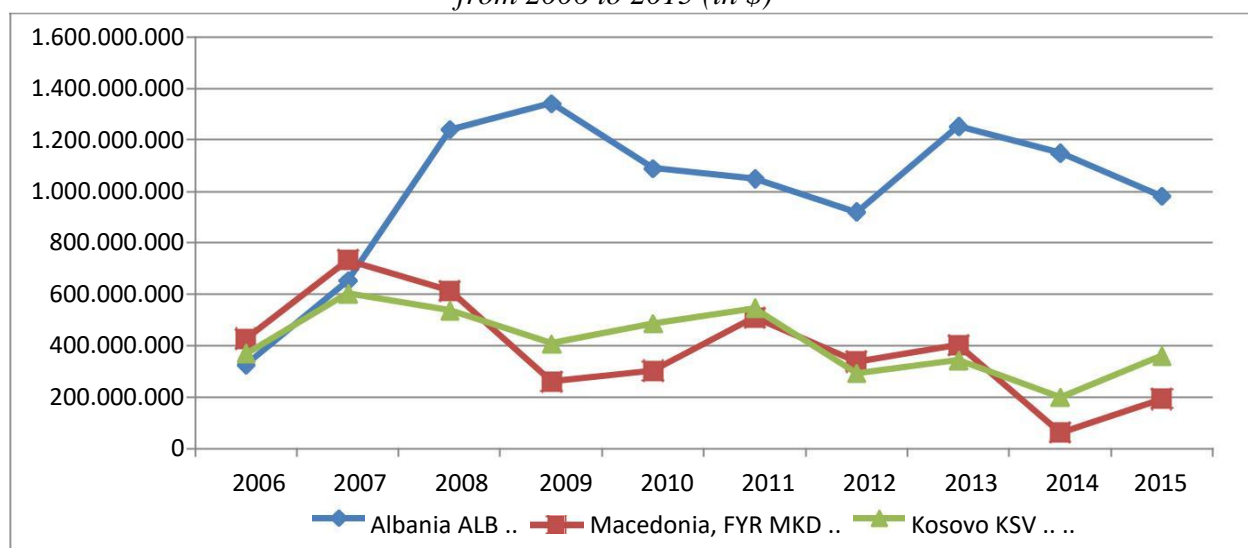
There are many papers on the topic of tax competition as a determinant of attracting FDI, among which were those of Devereux and Freeman (1995) they estimate the impact of taxation on foreign direct investment and a sophisticated measure of the cost of capital and find that the choice between domestic investment and total outward FDI is not significantly affected by taxation but that taxation does affect the location of outward. Also, Devereux, Griffith, and Klemm (2002) found that the EU and G7 countries reformed their tax system in a way of lowering the corporate income taxes and to broadening tax bases, that is, there is a process of competition among them to attract more profitable and mobile firms. They gave two explanations for mentioned reforms; by lowering tax rates, governments want to collect more revenues, and reforms are consistent with competition for more profitable projects by multinational firms. (UNCTAD 2012) also pointed that, regarding the relevance of FDI attraction, fiscal environment is secondary, whereas the fundamental determinants are market size, access to raw materials, and availability of skilled labor. H. Šimović, M. Mihelja Žaja (2010) provides an analysis of corporate income tax (CIT) incentives in the Western Balkan and found that the structure and number of incentives in individual countries are largely defined through a degree of development and achievement in becoming an EU member. These countries have applied tax reductions but they have not resulted in the same increase of investment flow in all observed countries.

On the other side, there are studies that confirm that lowering corporate rate influence on FDI attractiveness (Kevin A. Hassett and Robert G. Hubbard 1996; James R. Hines Jr. 1996; Assaf Razin, Yona Rubinstein, and Efraim Sadka 2005). Jack M. Mintz (2006) shows that tax regime is a very important factor in making some destination attractive for FDI inflows. He found that many developing countries with high levels of FDI inflows have attractive tax regimes with low rates, especially for finance or trading operations.

3. COMPARATIVE ANALYSIS OF THE FLOW OF FDI IN ALBANIA, MACEDONIA AND KOSOVO

In the absence of adequate domestic savings, foreign investment provides an important avenue for the development of emerging economies. Based on the data in the World Development Indicators, in Figure 1 is shown graphically the flow of foreign net direct investment in the observed country.

Chart 1: Foreign direct investment in Albania, Macedonia and Kosovo
from 2006 to 2015 (in \$)



Source: World Development Indicators (Last Updated: 07/08/2016)

From the above data, Albania has considerably increased the flow of foreign investments in the period 2007-2009, compared to Macedonia and Kosovo which significantly lag behind in this respect despite the various stimulating fiscal and non-fiscal measures undertaken. The decrease of foreign direct investments in Macedonia and Kosovo in the period 2011-2015 is not surprising or accidental compared to previous periods, taking in consideration the circumstances prevailing in the countries, especially the political ones. The main motive of the foreign investors is to achieve profit and security of their business and capital in the countries they invest. The government of Macedonia, despite the relief fiscal policies, numerous activities to promote the country as a favorable investment destination through “road show” events, determining the economic promoters in several key world states, has failed to increase the level of foreign investments but rather the trend has been declining especially from 2013 to 2014 and there has been a slight increase in 2015. This lets us understand that investment decline is, primarily due to political uncertainty of the country and the region, the stagnation of integrating in Euro-Atlantic structures, political, interethnic and neighborly relation make the country unsafe for investments.

Nevertheless, the reasons the existing foreign investors have chosen Macedonia as an investment country are: low production costs as a result of cheap labor force and low costs of inputs since the salary taxes and contributions as well as custom duties are exempted, low price for energy sources (electricity and gas) since VAT is exempted for these services, partial financing from the budget of Macedonia of employees’ training and building of manufacturing facilities.

Table following on the next page

Table 1: Foreign direct investment, net inflows (% of GDP) in West Balkan countries

	2000	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Albania	3.9	3.6	6.1	9.6	11.2	9.1	8.1	7.5	9.8	8.7	8.6
Kosovo	..	9.1	12.5	9.4	7.2	8.3	8.2	4.5	4.9	2.7	5.6
Macedonia	5.8	6.2	8.8	6.2	2.8	3.2	4.8	3.5	3.7	0.5	1.9
Croatia	4.9	6.5	7.6	7.4	5.1	2.4	2.3	2.6	1.6	6.9	0.3
Serbia	0.8	13.9	11.0	8.2	6.9	4.3	10.6	3.1	4.5	4.5	6.4
Bosnia and Herzegovina	2.7	6.6	11.7	5.3	0.8	2.6	2.5	2.3	1.9	2.7	1.7

Source: World Development Indicators

Analyzed in terms of foreign direct investments' participation in GDP, Albania marks a percentage twice higher and in an increasing trend compared to Macedonia and Kosovo and other countries of Western Balkan. This is as a result of the higher flow of investments and the increase of annual GDP. In the period 2000-2014 the average percentage of growth for Albania is 4,6%, for Kosovo is 4,5% while for Macedonia it is 3,2% for the same period¹.

In 2015 the foreign direct investments in Macedonia ensure additional flows in the financial account with 1,9% of GDP compared to the previous year as the weakest year of investment flow (0,5 of GDP). In terms of business activities the foreign direct investments were concentrated mainly in the service sector, food production, beverages and tobacco, as well as metal products and machinery. In 2015 Kosovo marked an increase of participation of foreign direct investments with 5,6% of GDP compared to three previous years.

3.1 Investment tax incentives in selected West Balkan Countries

The broad definition of 'investment incentives' suggests that a very large number of different investment incentives exist, such as derogations from fiscal policies, grants, soft loans, access to free or subsidized land, support in training and employment, infrastructure subsidies and ad hoc exceptions.

Besides the dominant role of tax holidays, most of the observed countries use them in the purpose of encouraging special (economic, free) zones and also underdeveloped areas.

3.1.1 Macedonia

Macedonia's legal and regulatory framework is generally favourable to foreign investors and provides numerous incentives to attract them. Macedonia offers additional incentives for development in the TIDZs, in addition to those normally associated with free economic zones. Investors in TIDZs are entitled to personal and corporate income tax exemption for the first 10 years. Investors are exempt from payment of value added tax and customs duties for goods, raw materials, equipment and machines. Moreover, up to €500.000 can be granted as incentive towards building costs depending on the value of the investment and the number of employees. Land in a TIDZ in Macedonia is available under long-term lease for a period of up to 99 years. Investors are also exempt from paying a fee for preparation of the construction site. Fast procedures for business activity registration are provided in TIDZ that further reduce the costs of setting up.

¹ World Development Indicators 2015

Other fiscal incentives undertaken by governments of countries are taxation reforms that have helped to reduce the interest rates of income tax and profit tax (Table 2) and simplification of tax procedures.

Table 2: Change in tax rates on CIT and PIT of the observed countries

	Capital income tax (CIT) Period interest rate	Personal income tax (PIT) Period interest rate
Albania	1992-2000 30% 2001-2004 25% 2005 23% 2008-2013 10% 2014- 15%	2007-2013 10% (Flat tax) From 2014 0%, 13%, 23%
Macedonia	1994-1996 30% 1997-2006 15% 2007 12% 2008- 10%	1992-2000 23%, 27%, 35% 2001-2004 15%, 18% 2005-2006 15%, 18%, 24% 2007 12% (proportional rate) 2008 10% (proportional rate) The tax base for PIT calculation is different, depending on the type of revenue realized or the activity performed by the natural persons
Kosovo	2009 10%	2003-2008 0%, 5%, 10%, 20% 2009 0%, 4%, 8%, 10%

Source: Prepared by author according to tax reform and tax regulations in Albania, Macedonia and Kosovo

The range of incentives in Macedonia includes exemption from customs duties, various tax holidays and specific tax relief measures. The low corporate income tax rate of 10% should also be a favourable incentive for the establishment of operations by foreign investors, especially under the current regime, applicable since 2009, where profit tax is not payable on undistributed profits.

3.1.2 Albania

The Government of Albania is undertaking a wide range of structural reforms to strengthen rule of law, sustainable economic growth and create an internationally competitive business environment. The Albanian economy showed a positive growth of 2.1% in 2014, characterized by a 9% growth in exports. Average annual growth of 5% is expected in the foreseeable future, with several sectors growing at well above this rate.

Under the Law on Technological Industrial Development Zones, the zones are used to facilitate economic activities to be performed under special conditions, including tax and other incentives for zone users. Albania has provided three free economic zones in the cadastral area of Tirana, Koplik and Vlora.

The tax exemptions and incentives available in the TIDZ for Albania, Macedonia and Kosovo are presented in Table 3.

Table following on the next page

Table 3: Tax holidays, exemptions and similar incentives

Country	Type of tax holiday, exemptions or similar incentive
Albania	<ul style="list-style-type: none"> ▪ Fiscal incentives for research development and training of labor force ▪ Significant customs and VAT exemptions relating to goods, raw materials and machinery for developers, users and operators of TEDAs ▪ Tax incentives and exemptions from income and real-estate taxes to minimize start-up costs ▪ Fiscal incentives for increasing employment Draft Law on TEDA Incentives ▪ From the moment goods enter Albania, they are exempted from custom duties and VAT ▪ Albanian goods that enter TEDA are exempted from VAT taxation ▪ Goods can be transported from one TEDA to another without paying custom duties or VAT ▪ Capital expenses are 120 percent deductible during a period of 2 years if developers and users invest in TEDA within three years of its operation ▪ Developers and users are also exempted from 50 percent of the profit tax rate (currently at a rate of 15 percent) for a period of 5 years ▪ A developer's project is exempted from infrastructure taxes ▪ Buildings in TEDA are exempted from real estate taxes for a period of 5 years ▪ Buildings transferred to the TEDA are not subject to the transfer tax on real estate ▪ Wages and social costs are 150 percent deductible for the first year, and new expenses for wages and social costs compared to the previous year are 150 percent deductible for the subsequent years ▪ Training costs are doubly deductible for a period of 10 years ▪ Research and Development costs are doubly deductible for a period of 10 years
Macedonia	<ul style="list-style-type: none"> ✓ Corporate income tax exemption for a period of up to ten years from the day of commencement of activities in the TIDZ. In order to fully utilise this tax exemption, the investor should start with the business activities no longer than two years after obtaining the official decision for work commencement in the TIDZ; ✓ Personal income tax exemption on salary payments for a period of up to ten years as of the moment the investor commences its business activities in the TIDZ i.e. as of the month of first salary payment to the employees; ✓ VAT exemption on the sales of goods and services within the TIDZ, excluding the sales of goods and services considered as final consumption under the VAT law; ✓ VAT exemption on the import of goods into the TIDZ intended for export, excluding the goods intended for final consumption as per the provisions in the VAT Law; ✓ Exemption from taxes and other duties related to the utilization of construction land, connections to water, sewerage, heating, gas and the power supply networks. <p>The TIDZ users are also entitled to customs duties exemptions and reliefs in accordance with the domestic customs legislation. The land in TIDZ may be leased to foreign investors for a period of up to 99 years.</p>
Kosovo	<ul style="list-style-type: none"> ➤ Carrying forward of losses. Tax and capital losses can be carried forward for up to seven successive tax periods, and shall be available as a deduction against any income in those years. ➤ Special Allowances of new assets. If a taxpayer purchases new capital goods for the purpose of the taxpayer's economic activity, a special deduction of 10% of the cost of acquisition of the asset shall be allowed in the year in which the asset has been first placed into service. This deduction is available in addition to the normal allowable depreciation deduction. ➤ Customs. Zero percent customs duty on the import and export of certain capital goods, raw materials, agricultural production inputs, and services. ➤ Investment guarantees. The Multilateral Investment Guarantee Agency (MIGA) guarantees investments in Kosovo up to the value of €20 million. The US Overseas Private Investment Corporation (OPIC) also provides political risk insurance for foreign investors in Kosovo. ➤ Land. The municipalities in Kosovo have the right to lease movable and immovable property to foreign investors. The lease can be granted for a term of ten years with an extension opportunity of up to 99 years.

Source: prepared by author according to: Technical and Economic Development Areas in Albania An Opportunity for Investors and Land Developers: Spitalla, Koplik & Vlora. Prill 20-15. Invest in Macedonia, Guide to Doing Business and Investing in Macedonia, 2014 Edition. Kosovo Investment and Enterprise Support Agency “Invest in Kosovo”.

3.1.3 Kosovo

Kosovo as the youngest country, assessed in terms of the natural resources potential it possess, particularly in mine and energy sector, labor force, geostrategic position, low tax rates, etc., it has not been successful in attracting foreign direct investments compared to Albania, Macedonia and the other Western Balkan countries. This is due to the lack of initiatives and activities that would contribute in creating and promoting a favorable investing environment to attract foreign investments, first of all in stimulating measures and fiscal and non-fiscal reliefs for foreign investors.

In fact, with a Government decision of March 2014, three free economic zones are determined in the cadastral zones of Mitrovica, Gjakovica and Prizren. However the administration and development is stalled on the point of determining the location, without a possibility of infrastructural adjustments prepared to attract investments.

In terms of fiscal incentives, except some custom reliefs during import and export of some inputs, there are not initiatives for tax reliefs or exemptions in income taxes of corporations, personal income or property taxes.

4. CONCLUSION

For the Western Balkan countries as well as for many other South-East European countries, in the process of transition and nowadays also, the foreign direct investments play a significant role as an important source of compensating the absence of domestic capital and other benefits. For this reason, the countries make efforts by undertaking political, institutional, fiscal measures etc., to create and invest in an environment as attractive and convenient as possible. Fiscal policies which include various tax reliefs and incentives are the main instruments used by these countries to attract foreign capital.

According to the analysis of our study, despite the fact that the three countries Albania, Macedonia and Kosovo have applied similar reliefs and tax incentives, such as: reducing corporate income tax, personal income tax, property tax, customs, tax exemptions for foreign investments in the free economic zones, yet the inflow of foreign direct investments is not satisfactory, particularly for the Republic of Macedonia and Kosovo, while Albanian stands better in this aspect, both in terms of the volume of investments and the participation of investments in GDP.

Albania has made various tax reforms as reducing the profit tax rate from 30% in 1992-2000; (2001-2004) 25%; 2005 with 23% tax rate; (2006-2007) 20%; (2008-2013) 10% and recent changes of 2014 the tax rate set to 15%². The government of Macedonia has also made tax reforms in this aspect by reducing the profit tax rate from 30% in the period 1994-1996; from 2007 it passes from the progressive income tax rate to the proportional rate of 10% known as the “flat tax”. Reductions of tax rates are undertaken by the Republic of Kosovo as well.

However the incentives and tax reliefs undertaken in the respective periods are not followed by an increase of foreign capital flow. Not all countries of Western Balkan and SEE are successful in attracting foreign investments by applying fiscal measures; this is as a consequence of special characteristics of each country in particular such as: the position, institutional characteristics, market volume, corruption, macroeconomic stability, political stability, EU integration etc.

² R. of Albania, on the basis of legal regulations, applies progressive CIT rate

From the analysis, we can conclude that fiscal and non-fiscal incentives by the governments of Albania and Macedonia for creating appropriate investment environment have marked effect in increasing the flow of investments in the respective periods. Nevertheless, a number of challenges remain nonetheless, including especially corruption, lack of transparency, poor customer service, excessive bureaucracy, political interference in the judiciary, lack of government capacity, communication difficulties and shortcomings in rule of law and contract enforcement. Lack of membership in the European Union also incites investors to remain cautious.

LITERATURE:

1. A. Easson, "Tax Incentives for Foreign Direct Investment", Kluwer Law International, The Hague; London; New York, 2004.
2. Albanian Investment Development Agency "Technical and Economic Development Areas in Albania, An Opportunity for Investors and Land Developers: Spitalla, Koplik & Vlora.
3. A. Shah, "Fiscal Incentives for Investment and Innovation", Oxford University Press, Oxford, 1995.
4. Becker, Johannes, Clemens Fuest, and Nadine Riedel. 2012. "Corporate Tax Effects on the Quality and Quantity of FDI." *European Economic Review*, 56(8): 1495-1511.
5. Bellak, Christian, Markus Leibrecht, and Jože P. Damijan. 2009. "Infrastructure Endowment and Corporate Income Taxes as Determinants of Foreign Direct Investment in Central and Eastern European Countries." *The World Economy*, 32(2):267-290.
6. Devereux, M.P. & Freeman, H. "The impact of tax on foreign direct investment: Empirical evidence and the implications for tax integration schemes" *Int Tax Public Finan* (1995) 2: 85.
7. H. Šimović, M. Mihelja Žaja, "Tax Incentives in Western Balkan Countries" *World Academy of Science, Engineering and Technology International Journal of Social, Behavioral, Educational, Economic, Business and Industrial Engineering* Vol:4, No:6, 2010
8. Invest in Macedonia , Guide to Doing Business and Investing in Macedonia, 2014 Edition
9. Jacques Morisset "Using Tax Incentives to Attract Foreign Direct Investment" The word Bank Group 2003
10. OECD (2006), Policy Framework for Investment, available at: www.oecd.org/daf/investment/pfi.
11. OECD (2006), Policy Framework for Investment: A Review of Good Practices OECD (2002), Checklist for Foreign Direct Investment Incentive Policies, available at: www.oecd.org/dataoecd/45/21/2506900.pdf.
12. Saul Estrin & Milica Uvalic "Foreign direct investment into transition economies: Are the Balkans different? LEQS Paper No. 64/2013, July 2013 OECD (2008), Tax Effects on Foreign Direct Investment – Recent Evidence and Policy Analysis, OECD Tax Policy Studies No. 17.

THE ROLE OF NON-GOVERNMENTAL ORGANIZATIONS IN THE FIELD OF SUSTAINABLE DEVELOPMENT OF CRUISE SHIP TOURISM

Joanna Kizielewicz

Gdynia Maritime University, Poland
j.kizielewicz@wpit.am.gdynia.pl

Katarzyna Skrzyszewska

Gdynia Maritime University, Poland
k.skrzyszewska@wpit.am.gdynia.pl

ABSTRACT

In each segment of the economy there are various non-governmental organizations whose aim is to ensure the development of a particular sector of the market, to determine the standards of products and services, to represent the interests of members affiliated to local authorities, Government and international institutions, but also to develop policies and codes of ethics in business. In recent years, a variety of activities undertaken by these organizations focuses on the idea of sustainable development and preservation of the cultural heritage and environmental protection. In the case of cruise tourism market, the natural environment of the seas and oceans and also coastal tourist destinations handling the cruise ships and passengers are subjects of the protection. In the cruise tourism sector, there are a great number of entities whose members are among the others: cruise ship-owners, tourist agents, the boards of seaports and local authorities of coastal destinations. Their objective is to develop the cruise tourism market, to promote marine voyages and tourist values of coastal destinations, but first of all to generate the largest economic revenues. However, the international law regulations regarding environmental protection of the sea and oceans and applicable standards of the CSR enforce on those entities to work out solutions for the sustainable development. The purpose of this work is to identify the entities working for the sustainable development of cruise tourism and to evaluate their commitment in this regard. The research is based on the analysis of scientific papers and reports and also source materials of leading organizations. In this study, a few methods of data collection were applied, i.e. “desk research” method, exploratory method and also a deductive reasoning. The study results may constitute a source of knowledge for territorial authorities and tourist companies in coastal areas and also for cruise ship-owners about advantages arising from the membership in various non-governmental cruise tourism organizations.

Keywords: *cruise tourism, NGO's, sustainable development.*

1. INTRODUCTION

In the last two decades, the cruise tourism market has become a mass phenomenon. CLIA reports that in 2016, about 24 million passengers will take part in a cruise voyage. It shows an increase from 15 million just 10 years prior. (CLIA 2016, p. 1.). *International Maritime Organization (IMO)* and *European Sea Ports Organization (ESPO)* report about the poor state of the environment of seas and oceans caused, inter alia, by pollutions coming from the cruise ships. *Oceana International U.S.* proved that an average “cruise ship taking about three thousand passengers onboard usually generates an astonishing amount of pollutions, i.e.: up to 25 thousand gallons of sewage from toilets and 143 thousand gallons of sewage from sinks, galleys and showers each day” (Oceana International U.S., 2009, pp. 3-4). Therefore, in the world, on the one hand, there have been established various organizations and institutions whose aims are to reduce the development of cruise tourism, protect fauna and flora, and

prevent pollutions of the marine environment and coastal regions. They also lead educational activities aimed at raising awareness of threats to the environment from uncontrolled development of cruise tourism, especially in regions heavily operated by cruise ship-owners. But on the other hand, there are founded the non-governmental organizations whose objectives are to develop the cruise tourism market in order to generate huge revenues but with respect of the idea of sustainable development.

Currently, there is a fashion for membership in various types of sector organizations. It regards both the individuals and business companies as well as public institutions. It must be stressed that the most important world organizations select carefully their members caring about the rank on the market. These requirements are referred to, inter alia, the legal form of members, the range of business activities, financial status, experience in the industry, and even the reputation on the market. Nowadays, especially entrepreneurs seek for the membership in a variety of prestigious business sector organizations and non-governmental organizations for the need to build their brands and prestige among customers and contractors. There are several reasons for that. Firstly, entrepreneurs and various other entities are aware of that in the era of strong competition on the market, the phenomenon of globalization and internationalization, computerization, smaller entrepreneurs have more difficulties to succeed on the market. Thanks to the membership in sector organizations, they see the chance to develop, have an access to information, trainings and an opportunity for cooperation with other bodies. In addition, some of them are aware of the impact, which such kind organizations have on the public institutions, including local and regional authorities, the Government or international institutions, such as: European Commission, European Parliament or United Nations. Thanks to the membership in different organizations, the entrepreneurs gain an access to interesting data on new trends, research reports, legal assistance and information about new technologies, to which otherwise would not have any access. Moreover, smaller companies have also the chance to participate in integrated marketing efforts implemented on a large scale by these organizations. However, obtaining the status of a full member is often associated with high member fees what constitutes a major barrier for some entrepreneurs.

Next to a large range of benefits of the membership in the sector non-governmental organizations, the members associated must respect various provisions, codes, recommendations and orders issued by these entities. These concern, inter alia, compliance with the code of good practice, the application of the idea of corporate social responsibility (CSR), as well as the principles of sustainable development in business. In recent years, it is particularly fashionable to create different procedures in accordance with the principles of CSR and sustainable development as it can be seen in the activities of numerous organizations in the world. This phenomenon is particularly visible on the cruise tourism market as well. Cruise ship-owners are associated together with tour-operators and travel agents in the world cruising organizations. Moreover, they are opened for cooperation with the boards of seaports and the representatives of territorial authorities of coastal regions. Their aim is to create the meeting forums for all involved in cruise tourism development, and also to work out the principles and procedures for protection of the environment. They prepare official documents regarding the reduction of exhaust gases and pollutants from ships to the environment and atmosphere, introduction of modern technology in construction of new ships, using ecological fuels and also construction and modernization of coastal infrastructure in cruise seaports in favor of protection of the environment or even the introduction of principles for tour-operators regarding organization of tourist excursions for passengers on land in order to ensure protection of cultural heritage with respect for the interests of local communities. Thanks to cooperation between all members of these organizations, it is possible to implement the relevant rules of conduct and procedures. It is worth to emphasize that the cruise tourism organizations must also take into account the law regulations and directives issued by international institutions such as: the

European Commission, the European Parliament, the International Maritime Organization (IMO) and the United Nations. For example in the Communication on an Integrated Maritime Policy for the European Union [European Commission, Brussels 2007] there was underlined the importance of reconciliation of economic development with protection of the environment and quality of life in coastal regions and islands. Whereas, in the Action Plan (European Commission, 2007) the importance of promoting of the quality of tourism development in the coastal areas was pointed out. Additionally it was also said that as a first step European Commission intends to evaluate the benefits coming from the capital investments in port infrastructure and amenities dedicated to handle cruise ships for the seaports (European Commission, 2009, p. 1.). However, the *International Convention for the Prevention of Pollution from Ships*, known as MARPOL 73/78 (IMO, 1978), is considered to be the most important international marine environmental act. Its objective is to prevent and minimize pollution of the seas and oceans. Moreover in 2005, the World Tourism Organization also issued the Guide for Policy Makers (UNEP & UNWTO, 2005) regarding actions for sustainable tourism development. In the current scientific achievements a great number of authors studied the issues on sustainable development of cruise tourism, such as e.g.: S. McMinn (1997, p. 135-141), D. Johnson (2002, pp. 161-270), H. C. Choi & E. Sirakaya (2005, pp. 380-394), J. Dawson, P. Maher & D.S. Slocombe (2007, pp. 69-83), S. Gossling & M. C. Hall (eds. 2006, pp. 24-320.), E. G. Coombes, A. P. Jones & W. J. Sutherland (2009, pp. 981-990), J. G. Brida & S. Zapata Aguirre (2010, pp. 205-226), V. Sheppard (2010, 75-92), E. Eijgelaar, C. Thaper, P. Peeters, P. (2010, pp. 337-354), R. A. Klein, (2011, pp. 107-115). However, these scientific findings focused mainly on showing the risks for the environment of seas and oceans and coastal regions and their communities posed by the development of cruise tourism market. Less space is devoted to research the role played by various stakeholders for sustainable development of cruise tourism market. Therefore, the objective of this work is to identify the entities working for the sustainable development of cruise tourism and to evaluate their commitment in this regard. In this study, there were used the analysis of scientific papers, reports and source materials of cruise tourism organizations. A few methods of data collection were applied, i.e.

“desk research” method, exploratory method and also a deductive reasoning to reach the purpose formulated in this study.

2. WORLD NON-GOVERNMENTAL ORGANIZATIONS IN THE CRUISE TOURISM MARKET

The most important organizations established to develop and promote the cruise tourism there are located in the Caribbean Sea Region. The International Council of Cruise Lines (ICCL), which was founded in 1990, is one of them. ICCL represents the interests of the 16 largest cruise ship-owners in the world¹. The Mission of this organization is to participate in the process of creating the development policy of cruise tourism market and take care of the regulations relating to this market in terms of: safety, health, environmental awareness and protection of the passengers' rights. In 2006, ICCL was merged with the world's largest organization called the Cruise Lines International Association (CLIA). CLIA was established in 1975, and since 1984, after joining the major corporations on cruise tourism market, has launched marketing activity on the wide-ranging scale. Currently, 63 cruise lines companies and more than 14 thousands travel agents affiliated from around the world are the members of CLIA (Lück, 2007, pp. 125-126.). CLIA also has offices in North America (CLIA North America, CLIA Alaska, CLIA North & West Canada), Europe (CLIA EUROPE, CLIA UK & Ireland), Asia (CLIA Asia) and Australia (CLIA Australasia). The main objective of the CLIA, next to promotion of

¹ Carnival Cruise Lines; Celebrity Cruises; Costa Cruise Line N.V.; Crystal Cruises; Cunard Line; Disney Cruise Line; Holland America Line; NCL America; Norwegian Cruise Line; Orient Lines; Princess Cruises; Radisson Seven Seas Cruises; Royal Caribbean International; Seabourn Cruise Line, Silversea Cruises; and Windstar Cruises.

sea cruises, is to ensure a high standard of cruise travels, the quality of services and the safety of passengers and crew of the ships (CLIA, 2013. p. 2.). They also want to encourage potential clients to purchase cruise voyages through wide-ranging promotional activities on a world scale. They lead so-called the Cruise Counsellor Certification Program (Lück, 2007, pp. 125-126), addressed to the travel agents, that allows them to attend the classroom, multimedia and internet trainings, and training of the cruise lines booking systems, attend the conferences with participation of representatives of ship-owners, as well as give them an opportunity to participate in inspections of ships and study tours. CLIA also conducts regular analysis and market research presenting the cruise tourism market. The CLIA is also the author of the document entitled the Cruise Industry Passenger Bill of Rights, that is the list of rights given to cruise passengers and all associated members undertook to follow it (CLIA, 2013, p. 4.) (tab. 1.).

Table 1: Leading organizations involved in the development and promotion of the cruise tourism in the world (Lück ed., 2007. pp. 125-527; Dowling, 2006. p. 16; FCCA 2013. p. 2; Lück, Maher & Stewart, 2010. p. 143).

The full name of the organization	Short name	The seat	Year of foundation	The number of members
International Council of Cruise Lines	ICCL	Arlington	1990	16 cruise ship-owners
Cruise Lines International Association	CLIA	Waszyngton	1975	63 cruise ship-owners, 13,5 thousand travel agents
Florida-Caribbean Cruise Association	FCCA	Miami	1972	19 cruise ship-owners
Pacific Asia Travel Association	PATA	Bangkok	1951	30 carriers (air lines, cruise lines), 90 public institutions; 57 educational entitles
International Association of Antarctica Tour Operators	IAATO	Newport	1991	100 entitles (cruise lines, travel agents, tour-operators, marine agencies, air lines)
Cruise Down Under	CDU	Tasmania	1997	78 entitles (seaports, travel agents, marine agencies, tour-operators)
Pacific Whale Watch Association	PWWA	Seattle	1994	18 various Canadian and us companies that offer cruises on the West Coast of Canada and North West part of the United States
Caribbean Shipping Association	<u>CSA</u>	Jamaica	1970	12 cruise lines, 15 the entities representing the maritime operators and training institutions, 18 marine agencies, 9 national organizations and 34 seaports
China Cruise & Yacht Industry Association	CCYIA	Beijing	2006	Port cities, seaports, marine agencies, travel agencies, companies chartering yachts, marine clubs, educational institutions, insurance companies.

*till 2012 - the European Cruise Council ECC

On the US market *Florida-Caribbean Cruise Association (FCCA)* is the organization which also plays an important role on the cruise tourism market. This organization was founded in 1972 as a non-governmental body. FCCA currently brings together 19 cruise lines² operating a fleet of 100 cruise ships in Florida, the Caribbean and Latin America (FCCA, 2013. pp. 2-5.). The organization provides a forum for meetings for representatives of the marine industry and tourism within the framework of tourism development policy, legal solutions, the development of cruise seaports, the safety and security of ships in the ports, and many other issues relating to cruise tourism market. Moreover, FCCA works with numerous coastal tourist destinations, where researches on cruise consumers' behavior, their spending, preferences, needs and expectations and the effect of cruise tourism on local development are regularly conducted.

² AIDA Cruises, Azamara Club Cruises, Carnival Cruise Lines, Celebrity Cruises, Costa Cruise Lines, Cunard Line Ltd, Disney Cruise Line, Holland America Line, MSC Cruises (USA) Inc., Norwegian Cruise Line, P&O Cruises, Princess Cruises, Royal Caribbean International, Seabourn, TUI and in 1986 received the current name Cruises

FCCA also runs numerous workshops, seminars and conferences inviting to participate the representatives of business and public institutions in order to encourage them to maximize the benefits from the cruise tourism market. FCCA also issues trade publications including among others: „*Cruising Magazine*” and „*Highlight Issue*” (Cruising Magazine, 2014. pp. 11-12.).

The activities of the organization under the name of *Pacific Asia Travel Association (PATA)* was launched during the Conference entitled *First Pacific Area Travel Conference* in 1952. This organization originally was called the *Pacific Interim Travel Association (PITA)* and in 1986 received the current name. The main purpose of this organization is to ensure compliance with the codes of ethics in tourism and recreation development in the area of the Pacific Ocean and Asia (Lück, 2007, pp. 347.). Currently, the members of this organization are bodies representing national tourist organizations, cruise lines, air lines and other carriers and also operators involved in the production, distribution, financing and the development of tourism sector. PATA has its branches in Asia, the Pacific Islands and in America and Europe. In the 2001, PATA thanks to the cooperation with the *Asia Pacific Economic Cooperation (APEC)*, reached a so-called the *Code for Sustainable Tourism* relating to the protection of the environment, respect and support local cultural values and traditions, implementation of environmental management systems, reducing energy consumption, reduce the number of waste and pollutants, and cooperation with different actors in order to protect the environment and cultural heritage (Lück, 2007, pp. 100-101.). PATA also publishes annual statistical reports on the tourism market regarding Asia and Pacific regions.

Already in the 50s of the 20th century, the regions of the Antarctica and the Arctic become famous tourist destinations. In the following decades, the negative effects of the mass tourism development in these regions have been observed. These facts caused establishing the entities whose purpose was to ensure compliance with the principles of sustainable development. Therefore, in 1991 thanks to the initiative of seven tour operators offering travels to the Antarctic the *International Association of Antarctica Tour Operators (IAATO)* was founded. IAATO brings together operators dealing with organization of environmentally responsible and safe sea voyages to the Antarctic. Currently, the members of this organization, there are more than 100 different operators representing cruise lines, travel agents, tour operators, marine agencies, and even the airlines from all continents in the world, mostly from North and South America, Australia and New Zealand, Europe, and East Asia. IAATO has developed a code of rules for tourists and operators organizing trips to the Antarctic. It contains, inter alia, the reporting requirements before and after the travel, sharing data on the number of passengers, the crew and staff, and their experience from previous trips and evacuation plans in the event of threats, etc. As each such organization, IAATO also draws up reports and analysis of tourist demand on travels in the Antarctic region (IAATO, 2003, pp. 1-6.).

In turn, in the Arctic region, the *Association of Arctic Expedition Cruise Operators (AECO)* was established. AECO has 26 members and 16 affiliated (i.e. cruise lines, travel agents, tour operators, national parks, marine agencies, sea ports and others.). AECO in the framework of its statutory activity pursues various projects, such as conferences organized periodically which are meeting places for representatives of the industry (*Annual Arctic cruise conference, or Arctic expedition leader conferences*). AECO leads analysis regarding the impact of cruise market for the environment, collects and provides a database on tourism and so far has released 20 specialist guides (Lück, Maher & Stewart, 2010. p. 143.).

The development of cruise ship tourism is also the subject of interests for the largest tourist organizations in the world such as: the *United Nations World Tourism Organization (UNWTO)*, the *World Association of Travel Agents (WATA)*, *Association of British Travel Agents (ABTA)*, or e.g. *The International Forum of Travel and Tourism Advocates (IFTTA)* and the others. These organizations treat the cruise tourism industry as one of other tourism market segments and include this into the market studies and analyses.

An important role in the field of environmental protection is also played by ecological organizations whose main aim is to limit pollutions of the environment and atmosphere. It is worth to mention such organizations as: the *Association of Protected Areas Management Organizations (APAMO)*, the *International Ecotourism Association Society (TIES)* and also *Whale and Dolphin Conservation Society (WDCS)*. Moreover, the organization, which is called the *Friends of the Earth*, publishes the interesting reports annually. They prepare the *Cruise Ship Report Card* estimating 17 major cruise lines and 171 cruise ships in accordance with four environmental criteria, i.e.: sewage treatment, air pollution reduction, water quality compliance and transparency (The Friends of Earth, 2016).

3. EUROPEAN NON-GOVERNMENTAL ORGANIZATIONS IN THE CRUISE TOURISM MARKET

In Europe, *European Cruise Council (ECC)* is considered to be the most important cruise tourism organization. The ECC was founded in 2004 on the initiative of the I. Foschi, the head of the Costa Cruise Lines, who proposed the creation of an entity that could become a partner for discussions with the European Commission on regulations regarding cruise tourism market in Europe. Thanks to support of the Carnival Corporation and Royal Caribbean and other entities, the ECC was founded and received an important voice in matters of cruise tourism market in Europe. Thanks to the initiatives and the involvement of this organization, the European Commission took up matters relating to cruise tourism market relating to: tax policy, environmental protection, safety, labor market on the sea etc. (Lück, 2007, p. 159.). On December 17, 2012 ECC signed the association agreement with CLIA, creating this way the entity under the name of *Cruise Line International Association CLIA Europe*, whose task is to conduct research and market analysis of cruise tourism and prepare regular market reports regarding Europe (CLIA, 2014. p. 2.). (tab. 2.).

Table 2. Leading organizations involved in the development and promotion of the cruise tourism in Europe (Lück ed., 2007. pp. 125-527; Dowling, 2006. p. 16; MedCruise 2014. p. 1; Lück, Maher & Stewart, 2010. p. 143).

The full name of the organization	Short name	The seat	Year of foundation	The number of members
European Community Ship-owners Associations	<u>ECSA</u>	Brussels	1965	22 National Association of Norway and the countries of the European Union
Association of Arctic Expedition Cruise Operators	AECO	Longyearbyen	2003	26 members and 16 affiliated (cruise lines, travel agents, tour-operators, national parks, marine agencies, seaports).
Cruise Line International Association Europe*	CLIA Europe	Brussels	2013	44 cruise lines
Association of Mediterranean Cruise Ports	MedCruise Ports	Piraeus	1996	73 members and 100 seaports
Cruise Baltic Northern Europe	Cruise Baltic	Copenhagen	2004	27 tourist destinations from 10 countries (seaports and territorial authorities)
Passenger Shipping Association	PSA	London		150 travel agents and tour-operators.

*do 2012 r. European Cruise Council ECC

Meanwhile, almost all major sea ports in the Mediterranean Sea region are members of the organization called *MedCruise Association of Mediterranean (MedCruise Ports)*, created in 1996 thanks to the cooperation of 16 Mediterranean seaports. Currently, the organization brings together 70 members from 20 countries from three continents: Europe, Asia and Africa, the members represent several ports of the same country, what makes together a total number of 100 seaports that belong to MedCruise. The objective of the organization is primarily the

development and promotion of cruise tourism market in Southern Europe and recurring research and tracking market trends of cruise tourism (MedCruise, 2014. pp. 1-2.).

A similar activity in Northern Europe is led by the *Cruise Baltic (CB)*. This organization was created in 2004 as an initiative of the representatives of 12 seaports and cities from 10 countries of the Baltic Sea region. The CB was formed for the project co-financed by the European Union, which aim was to promote and develop the cruise tourism in the Baltic Sea. The results of the project were so spectacular, that all partners decided to establish the *Cruise Baltic* and continue the cooperation for the development of cruise tourism market. Currently, 27 tourist destinations, including the boards of seaports and territorial authorities belong to this body. CB deals with the monitoring of the cruise tourism market, ensuring standards of services for passengers in cruise seaports and promotion of tourist attractions of Northern Europe on the external markets as well as popularization of the cruise voyages in the Baltic among cruise ship-owners, tour-operators and also potential tourists around the world (Cruise Baltic, 2014. p. 2.).

A huge impact on the development of cruise tourism in Europe is also made by *Cruise Europe (CB)*, which brings together more than 100 members from the four regions, i.e. Norway, the United Kingdom and Ireland, the West Coast of Europe, and the Baltic Sea. The CB was established in 1991 as a result of the meeting of 27 European seaports in order to make cooperation for the development of cruise tourism in Northern Europe. The objective of this organization is to take care about relationships with ship-owners of cruise lines in terms of environmental protection, travel safety and investment in the development of port infrastructure (MIR, 2014. p. 8.). *Cruise Europe* runs a website, which is an excellent source of information about all major destinations in the region of the North Sea, the Baltic Sea, the West coast of the northern part of the Atlantic. In addition, Cruise Europe developed a guide, where all the necessary specifications and facilities in ports in Northern Europe are presented.

4. CONCLUSION

Nowadays, in order to gain a competitive position in the market, the cooperation of various actors and groups of interest is a real necessity. The above analysis shows a few important market trends. Firstly, port cities and the boards of seaports join forces through the formation of organizations for promotion of their regions, as tourist destination both among cruise ship-owners and also potential tourists. Secondly – cruise ship-owners are opened for cooperation with other entities within various organizations for several reasons, i.e.: the implementation of a global marketing campaigns to encourage tourists to purchase a sea voyage and show the advantages of this form of a travel, take care of the safety of sea voyages, adhere to the principles of sustainable development and raise the standard of travel and the quality of services offered, and what is the most important, to develop the codes of ethical conduct to passengers, staff and crews of the ships. Moreover, thanks to this kind of cooperation, the cruise ship-owners make up the lobby representing their interests in contacts with the public institutions in matters relating to law regulations and, in particular, relating to environmental issues. Thirdly

– there are also a few key organizations attracting mostly tour operators and travel agents involved in distribution and sales of cruise travels offers. Finally – there are some organizations that have an open formula, and each of the above mentioned entities can become their members. These organizations provide a meeting forum for enterprises and institutions involved in the development of cruise tourism market and the ability to implement interesting development projects.

Nowadays, taking care of the quality of the environment is an absolute necessity resulting not only from the codes of good practice, but is forced by the international conventions. It is known that entrepreneurs always submit financial benefits over the welfare of the general public and the environment, but thanks to the activity and the involvement of non-governmental ecological and other sector organizations, the consequences of these practices should be minimized.

LITERATURE:

1. Brida J. G., Zapata Aguirre S., (2010). Cruise tourism: Economic, socio-cultural and environmental impacts, *International Journal of Leisure and Tourism Marketing*, Vol. 1. No 3, pp. 205-226.
2. Choi H. C. & Sirakaya E., (2005). Measuring Resident's Attitude toward Sustainable Tourism: Development of Sustainable tourism Attitude Scale, *Journal of Travel Research*, Vol 43, No 4, pp. 380-394.
3. CLIA, (2013), *A Unified Global Voice*, Charting the future for Cruising, 2013 Annual Report, Cruise Line International Association, New York. p. 2.
4. CLIA, (2014), *Global Voice, Charting the future for Cruising*, 2013 Annual Report, Washington, p. 2.
5. CLIA, (2016), *State of the Cruise Industry Outlook: Continued Evolution of Cruise Travel Drives Industry Growth*, Media Release, Cruise Line International Association, Washington, Dec. 2, p.1.
6. Coombes E.G., Jones A.P. & Sutherland W.J. (2009). The Implications of Climate Change on Coastal Visitor Numbers: A Regional Analysis. *Journal of Coastal Research*, Vol. 25, No 4, pp. 981–990.
7. Cruise Baltic, (2014), *Market Review One Sea – Oceans of adventures*, Copenhagen, p. 2.
8. Cruising Magazine, *The Official Magazine of the Cruise Industry*, Fourth Quarter, Miami. pp. 11-12.
9. Dowling R. K., (2006), *The Cruise Industry*, [in:] Cruise Ship Tourism, CAB International, p. 16.
10. Eijgelaar E., Thaper C. & Peeters P., (2010). Antarctic cruise tourism: the paradoxes of ambassadorship, "last chance tourism" and greenhouse gas emissions, *Journal of Sustainable Tourism*, Vol 18, No 3, pp. 337-354.
11. European Commission, (2007), *The Action Plan, SEC (2007) 1278*, Brussels.
12. European Commission, 2007, *Blue Book - Communication on an Integrated Maritime Policy for the European Union*, COM (2007) 575 final, Brussels.
13. FCCA, (2013), *Cruise Industry Overview – 2013*, State of the Cruise Industry, Florida Caribbean Cruise Association, Miami. pp. 2-5.
14. Friends of the Earth, (2016). *Cruise Ship Report Card Grade Chart 2014*, Retrieved 21.07.2016 from <http://www.foe.org/cruise-report-card>
15. Gossling S. & Hall M.C. eds., (2006). Tourism and Global Environmental Change: Ecological, Economic, *Social and Political Interrelationships*, Routledge, New York pp. 24-320.
16. IAATO, (2003), *Report of the International Association of Antarctica Tour Operators 2002-2003*, Annual Report Submitted to ATCM XXVI, pp. 1-6.
IMO (1978), *MARPOL Convention, International Convention for the Prevention of Pollution from Ships*, Retrieved 21.07.2016 from <http://www.imo.org/KnowledgeCentre/ReferencesAndArchives/HistoryofMARPOL/Pages/default.aspx>
17. Johnson D., (2002). Environmentally sustainable cruise tourism: a reality check. *Marine Policy*, Vol. 26, No 4, pp. 261-270.

18. Klein R.A., (2011), Responsible cruise Tourism: Issues of cruise tourism and sustainability, *Journal of Hospitality and Tourism Managements*, Vol. 18, Issue 1, pp. 107-116.
19. Lück M. ed., (2007), *The Encyclopedia of Tourism and Recreation in marine Environments*, CAB International, Cambridge, pp. 125-527.
20. Lück M., Maher P. T., Stewart E. J., (2010), *Cruise Tourism in Polar Regions*, Promoting Environmental and Social Sustainability?, Earthscan, p. 143.
21. McMinn S. (1997), The Challenge of Sustainable Tourism, *The Environmentalist*. No 17, pp. 135-141.
22. MedCruise, (2014), *Cruise Activities in MedCruise Ports, Statistics 2013*, MedCruise Association of Mediterranean cruise ports, Piraeus, pp. 1-2.
23. MIR, (2014), *Działalność portów morskich w 2013 r., Załącznik nr 1. do raportu, Polityka morska*, [in:] Raport z Realizacji Polityki Morskiej Rzeczypospolitej Polskiej w 2013 roku, Międzyresortowy Zespół do spraw Polityki Morskiej Rzeczypospolitej Polskiej, Warszawa, p. 8.
24. Oceana International U.S., (2009), *Needless cruise pollution, Passengers Want Sewage Dumping Stopped*, pp. 3-4.
25. Sheppard V., (2010), *Exploring the Ethical Standards of Alaska Cruise Ship Tourists and the Role They Inadvertently Play in the Unsustainable Practices of the Cruise Ship Industry* [in:] *Cruise Tourism in Polar Regions: Promoting Environmental and Social Sustainability*, pp. 75-92.
26. UNEP & UNWTO, (2005), *Making Tourism More Sustainable* Retrieved 21.07.2016 from <http://www.unep.fr/shared/publications/pdf/DTIx0592xPA-TourismPolicyEN.pdf>.

THE IMPORTANCE OF THE HISTORICAL ASPECT IN PUBLIC ADMINISTRATION REFORMS ON THE EXAMPLES OF HUNGARY

Gabor Batho

*Pázmány Péter Catholic University, Budapest, Hungary
gabor.batho1@gmail.com*

ABSTRACT

In case of a public administration reform there are many influential factors and many challenges concerning the success of the reform. One of them is the historical aspect, the former reforms, the previous system, the history of the state and the public administration. In my paper I would like to show that the importance of tradition in public administration reforms is significant. Without paying enough attention to this aspect a public administration reform is not complete, thus it cannot be successful.

According to Ádám Rixer's grouping the traditional elements of a public administration system – and especially the Hungarian public administration system – are the following: the language, the traditional institutions and the practical traditions. I would like to add three more elements to this list: the self-picture of the public servants in the public administration system, the effects of the former public administration reforms and the constitutional surroundings.

It is easily visible that some of these elements are easily changeable, and others are hard or even impossible to change, some are only changeable through organic development, and others can be changed by the will of the government or by legislature simply.

The paper shows the importance and weight of the above mentioned six traditional elements of a public administration reform through some examples in the Hungarian public administration history, especially the recent Magyar-programme. The paper describes an analysis of the reforms being silent on the above traditional elements or discussing them.

Taking the historical aspects into consideration and paying enough attention to the traditions of public administration must be an important task during the preparation of the reform. The paper also gives examples and consequences of the proper and improper handling of the traditional elements.

Keywords: *historical aspect, Hungary, Magyar-programme, public administration reform, traditions.*

1. INTRODUCTION

“Public administration has its own internal principles, and we believe, in particular, in the wake of our 1,000 years of statehood, that the building and shaping of the State has firmly-rooted cultural traditions in Hungary which thereby set a certain frame-work for the process; which permanent process cannot, and indeed, should not be separated from politics, neither from the social and economic expectations and challenges” (Magyary Programme, 2012, p. 4). During this 1,000 years of statehood and public administration there were and there are permanent questions in the solution of which the examination of the historical aspect may be helpful.

The state shall be effective, lawful and professional. In order to reach this situation it must be determined what the tasks of the state are at the beginning of the 21st century. It shall also be determined what organisations and what means are used to fulfil those tasks. The modern state has to fulfil many new tasks for which additional organisations are required. That is why the system of the state organisation is continuously changing. There are permanent scientific researches to determine the tasks of the state (Somogyvári, 2006, p. 32).

The statements of Tamás Sárközy are true: „The present governmental organisation system ensures the rule of law, but it is not efficient and not productive” (Sárközy, 2005, p. 1). The organisation is too disintegrated, oversized, the decision making procedure is ponderous, the

preparation of the decisions is slow, precipitant and shallow, the budget is lavish and deficient at the same time. We shall agree with István Bibó: „In order to make the public administration more efficient, not the executive power has to be strengthened, but – as Zoltán Magyary stressed – the political impact has to be decreased vis-à-vis the professional administration. This has to be done without considering whether the impact is coming from the executive or the legislative branch. Though this has constitutional and legal methods, but the crucial is the spirit of service and legality penetrating through the whole public administration” (Bibó, 1986, p. 272).

Nowadays the political element suppresses the professional and management approach. The government could not even make cooperation with the civil sphere (Somogyvári, 2006, p. 32). The ministers, party leaders talk much about the small state, the cheap state, the cheap but strong, the cheap but effective state. It is not obvious from the programs of the small or minimal state that the smallness or the minimalism in the programs apply to the tasks of the state to the organisation of the state or to the magnitude of the operational costs, or to all three together. Is there an evidence, has it been proved that the smaller state is more effective, more efficient meaning that the smaller states solves the public tasks faster, in better quality and with more satisfaction of the people? Is the effectiveness or the efficiency before other requirements of the quality of the state activities (for example the requirement of legality)? Forming the small state is seemingly a long work to be done, but at the same time the social-community type of tasks need a greater and more expensive organisation, and more, more expensive and expert personnel. It is above question that the magnitude of the public costs and the size of the governmental personnel cannot increase limitless. The procedure has to be slowed down, a solution has to be found to stop it or turn it back. The society requires the preserving and the expansion of the list of public needs, but at the same time the society requires the minimising and the rationalising of the costs, and the increasing of the efficiency (Lórinč, 2005, p. 452).

It is not sure that the examination of the historical aspect will serve as a solution for the previous questions, but I think it is worth to examine the whole system of the public administration and the elements of public administration system from a historical point of view. This is very much true regarding those elements of the public administration system that are historically permanent, that are kept by the public administration system after many changes. These elements may prove to be unchangeable or very hard to change.

2. HISTORICAL ELEMENTS OF A PUBLIC ADMINISTRATION SYSTEM

2.1. Tendencies of the public administration

The history of the public administration system of a country is of course unique and distinctive. Unambiguously this is the reason why the public administration system of a country is also unique and distinctive.

The formation of the bourgeois state made it possible for the public administration system to evolve and become mature. The differentiation of the state activities and the theoretical circumscription were the two basis of the individualisation of the public administration. Until the 18th century the European scientific theory and practice had mostly the same concept of public administration and state administration: the activity of the state through and together with organs, authorities and offices designed for this purpose (Mezey, 2003, p. 382). As Lorenz von Stein said public administration is nothing else than the active constitution. (Koi, 2014, p. 278). That is why the history of the state concept is the basis of the history of the public administration theory according to von Stein (*Die Geschichte des Staatsbegriffes bildet daher die Grundlage der Geschichte der Verwaltungslehre*) (Stein, 1865, pp.6-11).

The functions and the tasks of the state determine the tasks, the activity and the system of the public administration as well. The classical functions of the state are the home defence, foreign affairs, keeping up the rule of law and the public order that derive from the sovereignty of the

state and that must not be set aside. In the last 150 years the social, the economic and the cultural function of the state institutionalised. It meant that with the new functions the state acquired many new tasks. The procedure accelerated in the decades after the Second World War, and the circle of the state functions and state tasks continuously expanded until the end of the 1970s. Let me mention some examples for illustrating this expansion procedure. In the OECD-countries the ratio of the state expenditures and incomes reached 40% of the GDP, but in some countries (such as Sweden, the Netherlands, Belgium, France) this ratio exceeded 50%. Only the ratio of the social insurance allowances alone reaches and exceeds 20% in the European countries from the 1970s. The number of public servants is five times more than it was in the time of the Second World War; the public sector became extraordinary in size. In some OECD states the ratio of the people employed in the public sector, in organisations directly or indirectly connected to the state, was above 25%. The ratio of the business organisations in the public sector was between 10% and 20%; in some countries the ratio was even higher. The public sector had an especially significant role in infrastructural services and sometimes in the financial sector and the industrial production as well. The previously mentioned procedures determined primarily the tasks, the functions and the institutional framework, so the organisational system of the public administration. The expansion of the state tasks, the institutionalisation of the state functions demanded and required primarily the organisational activity of the public administration system. The organisations in the public sector induced the expansion of the public tasks and the more differentiated organisational structure of the public administration. When evaluating this strong role of the public administration the modern state is many times called the state of public administration (Fazekas-Ficzere, 2004, pp. 50-51).

The expansion of the state functions and tasks is present among the state functions in the field of sovereignty. The environmental conditions of the modern society, the process of globalisation creates and continuously keeps social conflicts, anomalies and dangerous situations. The handling of these requires a differentiated organisational structure and an increasing staff of public servants (Fazekas-Ficzere, 2004, pp. 51-52).

2.2. The internal historical elements in the public administration

In the operation of the public administration system there are some features that are relatively stable and that were relatively stable during the great tendencies in the development of the public administration. These elements of course may vary from state to state, but surely there are some that can be considered as universal historical elements of public administration. In this subchapter I am trying to collect these elements. These historical elements provide a high level of security in public administration system even in case of political and legal changes. That is why we can call them “elements of our administrative heritage” (Rixer, 2014, p. 55).

2.2.1 Tradition

Tradition is the first element is the list of the elements of the administrative heritage. This type of tradition is above the effective and itemised law, and it is kept alive by the memory of the society. This tradition from the point of view of public administration can be found in deep structural continuity (Hankiss, 1986, p. 92, referenced by Rixer, 2014, p. 61). Rixer said that this tradition can also be found in the attitude and self-image of the public administration staff and in the social expectations placed on the public administration (Rixer, 2014, pp. 61-62). Not debating with him I think that the self-image or the self-picture of the public servants has a greater significance. That is why I have raised this element, and as an emphasis I made it an individual element of this administrative heritage list.

2.2.2. Language

The linguistic environment in which and the language with which the public administration system has to work is unambiguously determining and decisive. The language creates a framework that is highly regulated by the grammatical rules that make the language appropriate for legal usage. The language itself determines some characteristics of the public administration as well. And if we are talking not about the general language, but the professional, the expert language of the public administration, the effect of the language is even higher. “Language, expert terminology/dogmatic continuities, and their role in influencing scientific-professional, scientific-ethical directions are impossible to overrate” (Rixer, 2014, p. 61). We have to keep in our mind that the successful communication is a crucial element of a successful organisation, and above question it applies to the organisation of the public administration as well.

In case of the language of the public administration the translation is surely problematic. And this is point where the historical point of view of the public administration has to appear. The language of the public administration is traditional at least in a way that the legal regulations applied to the public administration where adopted earlier. The language of a 20 years old act may be slightly different than the everyday spoken language. If we examine a 50 years old regulation, we will surely find that there is a huge gap between the two languages. This is one of the reasons why the translation is a problem, because even between the languages of the two times ‘translation’ is required. The second reason of the problems of translation in the sphere of public administration is the different development of the public administration systems in different countries. Even if the world tendencies – regionally – were similar, the individual development may have resulted in individual solutions and achievements. It may be and it surely is a problem, that there are no equivalents of the public administration terminology of different countries. This is mostly because of the different development.

According to the UNESCO the number of languages existing today can only be estimated. The number varies, but it is somewhere between 6,000 and 7,000 (not counting a far larger number of dialects and local variants). Also according to the UNESCO evidences indicate that there is a critical relationship between individuals’ opportunity to use their mother tongue in a full range of cultural, scientific and commercial areas, and the socio-economic well-being of their respective language communities. “People whose mother-tongue is not (or not sufficiently) developed from the point of view of terminology and special purpose languages (SPL) or who are denied the use of their mother-tongue in education and training, for accessing information, or interacting in their work places, tend to be disadvantaged” (UNESCO, 2005, pp. v-vi).

There have been many initiatives aimed at drawing attention to the importance of terminology in development. For example at the regional level the European Charter for Regional or Minority Languages, which includes terminology aspects stressing the value of multiculturalism and multilingualism, is an excellent example. The charter recognizes that the protection and encouragement of minority languages is quite compatible with maintaining the status of official languages (Charter, 1992, pp. 1-3).

The “UNESCO Guidelines for Terminology Policies. Formulating and implementing terminology policy in language communities” address decision makers in different positions at various levels, who – for a variety of purposes – want to design, plan and implement a terminology policy, which is geared towards a conscious, systematic and controlled approach to the creation, maintenance and use of terminology in/for defined user communities (UNESCO, 2005, pp. v-vi).

2.2.3. Permanently present institutions

In case of the institutions permanently present in the public administration system I am using Rixer’s definition. So these are the “institutions which are permanently present in itemised law, those specific administrative solutions, which are stable and – in some cases – returning

elements of legal history” (Rixer 2014 p. 62). This element of the list is the easiest to find. These institutions are present in the nowadays public administration and these institutions were also present somewhere in the past. Of course these institutions are unique and different in each country. But I think some similarities may be found among the countries. For example the territories or the levels of the public administration may last for a long time.

2.2.4. Self-picture of the public servants in the public administration system

This element of the historical heritage of the public administration has two main bases. The first one is the person in the staff of the public administration who forwards the picture of a public servant, and the second one is person – also in the system of the public administration – who receives and accepts this picture. The elements of the picture of a public servant are almost impossible to collect. There are parts that are written in formal legal regulations, inner rules, codes, organisational rules, statutes. There are parts that are oral, and come from the conversations – directly or indirectly – between the public servants. And lastly there are parts that are neither written, nor oral, these are never said or written. These elements are inherited by the succeeding public servant from the ancestor public servant.

2.2.5. Effects of the former public administration reforms

It is important to say that – in my view – there can only be three types of previous public administration reforms: the first is the public administration reform that was only planned, and never tried to put into practical; the second is the public administration reform that was tried to be realised, but happened to be unsuccessful, short-lasting; the third is the reform that was successfully done. All of these three types have effects on the future public administration reforms.

When planning a new public administration reform, the decision makers and the preparers of the reform plan must be aware of the former public administration reforms. It is crucial to analyse the reasons of success or the reasons of failure in the previous reforms. It must be checked whether the reason of the failure was in connection with a historical element of the public administration reform.

2.2.6. Constitutional surroundings

As in the list we are talking about the internal historical effects of the public administration, by constitutional surroundings I do not mean the formal constitutional situation of the country. It is rather the effect of the formal constitutional surroundings on the public administration. It seems to be obvious that the public administration operates differently in a dictatorship and in a democracy, the public administration works differently in a constitutional monarchy and in a parliamentary republic.

2.3. The external historical effects

When we are talking about the external historical effects on the public administration system, we may think of two levels. The first level is the one outside the public administration system, but still inside the country. The second circle of the effects comes from abroad, from a different country. Obviously both types of external circumstances have effect on the public administration and both circumstances have to be handled in public administration reforms.

An example for the first type is the balance between the political and the professional impacts on the public administration. Formally it is hard to regulate and manage. The second type of external effects is formally easier to handle. An example for this is when a country enters into an international cooperation through an international treaty, like the European Union.

3. GROUPING AND THE WEIGHT OF THE HISTORICAL ELEMENTS IN THE PUBLIC ADMINISTRATION SYSTEM

In this chapter I am going to characterise the above mentioned historical elements of the public administration system. At first it seems to be easy to make two groups of the six elements upon their changeability. The question to be asked: Is the given element changeable through organic development or is it changeable upon the will of the government? Two groups of three elements can be made. The tradition, the self-picture of the public servants and the effects of the former public administration reform are the ones that are hard to change. These may be changed through organic development, if they are changeable. It is obvious that the tradition can only be changed after a long time, by constantly different circumstances that differ from the ones that were the bases of the appeared tradition. The self-picture of the public servants is changeable through the transition of the generations of public servants. The new incomers to the public service may have a different self-picture as public servants. Actually the effects of the former public administration reforms are not changeable. These effects become only paler and more distant with the lapse of time. The other three historical elements, the language, the permanently present institutions and the constitutional surroundings are easier to change with a single act. The institution in the present public administration system can be easily changed, erased and altered by the will of the government through a legal act. The constitutional surroundings are also formally changeable upon the will of the government by the act of the legislative or constituent power. For me the most interesting historical element – from this point of view – is the language. The official language of a state, the language of the public administration, the use of minority languages are as easy to change as enacting new laws. To determine the weight of each historical element I have made up a simple measurement system. The weight of the historical element is higher, if the change of it needs the cooperation of more people or the change affects more people. I made a list from the weightiest to the least weighty. In this list the first, so the weightiest is the language. If we talk about the official language or the language of the public administration, the change in it surely affects all people in country. The change in the official language needs the active cooperation of all the people in the country. I have put the traditions to the second place. The change of the traditions still affects all the country's people, but it does not need their active cooperation. It is enough to accept it indirectly, by implication. On the third and the fourth places there are the permanently present institutions and the constitutional surroundings. Their change affects the lives of most of the people in a country, and the changes do not require any active cooperation from the people. The fifth and the sixth places on this list are for the self-image of the public servants and the effects of the former public administration reforms. They affect the activities of the public servants and the change of them does not require the cooperation of the people.

4. EXAMPLES IN HUNGARY

Hungary can only keep up with the developed states, if the Hungarian public administration is also competitive. The competitiveness of the Hungarian public administration means that it is similar to the member states of the European Union in the organisation, working methods and personnel of the public administration. Competitiveness is crucial, because the European Union is a complicated organisation system, in which the EU bureaucracy and the public administration of the member states prepare the decisions, execute them and after check the execution in a mutually cooperative way. In this system Hungary is only able to have the appropriate level of cooperation, if the Hungarian public administration is in harmony with the organisational structure and working methods of the European Union and the member states, and the staff of the public administration – together with the politicians – is able to represent the interest of the country in different procedures (Somogyvári, 2006, p. 30).

4.1. The Hungarian constitutional and legal circumstances

The Hungarian legal system is part of the ‘Western’ legal systems and the continental legal family. There are some who say that the Hungarian legal system belongs to the so-called post-Socialist law family, in so far as operational mechanisms typical of the members of this family of law can be seen (Fekete, 2004, p. 5). It is important to say that in the Hungarian law system the written law has primacy over case law. The laws regulate the relations of life in an abstract way, they form a closed system. The functions of the legislator and of the law enforcer are sharply divided. As part of the continental legal system, the Hungarian legal system does not recognise binding precedents (Szalma, 2011, p. 41).

Besides the position of the Hungarian legal among the world’s legal system it is important to highlight a specialty in the Hungarian Fundamental Law. The National Avowal part of the Fundamental Law (which is functionally the constitution) says that “We honour the achievements of our historical constitution“ and later in Article R paragraph (3) “The provisions of the Fundamental Law shall be interpreted in accordance with their purposes, the National Avowal contained therein and the achievements of our historical constitution.” These two resolutions in the Fundamental Law mean that the traditional law is going to have a different role than it had in the past. The traditional or historical approach is still subject to scientific debates.

4.2. The examples in previous Hungarian public administration reforms

I have chosen three previous public administration reforms to show the importance of the historical elements in the reforms.

The first one is – I think – among all other public administration reforms is of the greatest dimension. This is the change of the official language and the language of the public administration from Latin to Hungarian in 1844. It was a great achievement of the Hungarian reform movement of the first half of the 19th century. King Ferdinand V sanctioned Act II of 1844 on the Hungarian language and nationality after a fifty-year long struggle. By the regulations of Act II of 1844 all act had to be adopted in Hungarian, the language of the Parliament became the Hungarian, all schools had to use the Hungarian as a teaching language and the authorities had to communicate with the people in Hungarian. Of course the change did not happen as quickly as lightning, and even a few years later there were petitions to the government written in Latin, but this change met the needs of the people. As it was accepted by all the people, such a huge and weighty change in the historical element of the public administration was successful.

The second example was only a plan of a future public administration reform in 1939. It was prepared by Zoltán Magyary. He showed that the main blocks of shaping the effective public administration system are the unevenness of the territorial division and the confusion of the public administration competencies. He thought that the public administration system has to be unified. There has to be no governmental/state and local/territorial public administration. The territorial division of the public administration was the main question of this planned reform. As the territorial division of the country is a very traditional element of the Hungarian public administration system and the Second World War interrupted the planning, this theory never came to life (Csizmadia, 1976, p. 395).

The third example of the Hungarian public administration reforms is in connection with the socialist dictatorship between 1949-1989. It was the introduction of the soviet-type council-system in 1950. This change was done through Act I of 1950 on the local councils. This meant a huge change in the public administration system, the former bourgeois-type of public administration was changed to the soviet-type. But – as a positivity in the bad – this public administration ‘reform’ took one historical element into consideration: the traditional county-system in Hungary. The first counties and the bases of the county-system were created by the

first Hungarian king, Saint Stephen I. Nowadays the county-system is part of the Hungarian public administration, and the counties represent an individual level in the system. So this very traditional element of the public administration was still kept by the socialist dictatorship (Csizmadia, 1976, p. 445). The introduction of the council-system was successful, but it was not kept after the transition in 1990.

4.3. Examples in the Magyary Programme

The Magyary Programme is a public administration development technology (Magyary Programme, 2012, p. 6). Among many others it consults partly the above discussed traditional elements of the public administration reforms. It talks about the tradition from a cultural perspective, but as a circumstance that needs to be taken into consideration when planning the reform of the public administration (Magyary Programme, 2012, p. 4). The Magyary Program has annual issues meaning that the previous issues are consulted in the later ones. It means that the Magyary Programme does not miss to take account of the former public administration reforms – or at least of the closest reforms (Magyary Programme, 2012, pp. 9-11). The Magyary Programmes started after the adoption of the constitution of Hungary, the Fundamental Law. For me it means at least the reform plan takes into consideration the changes in the constitutional surroundings. The Programme has reform plans based on the new regulations of the Fundamental Law (e.g. in case of the municipalities, public administration court) (Magyary Programme, 2012, pp. 12-16). The Programme has a massive part concerning the staff of the public administration system with at least mentioning the self-image of public servants (Magyary Programme, 2012, pp. 65-70).

According to the above the Magyary Programme seems to be aware of the importance of the historical element of a public administration reform. Taking the historical point of view into consideration is one the main goals of the programme.

5. CONCLUSION – THE IMPORTANCE OF THE HISTORICAL ELEMENTS IN THE PUBLIC ADMINISTRATION

Considering the above it is obvious that the traditional elements in the public administration have great roles in the public administration reforms, and the traditional elements in the reforms have a huge influence on the success of the reform.

I have shown that the historical elements of the public administration reforms have different weights and different affect on the lives of people in a country. In order to make a successful public administration reforms these differences must be taken into consideration. This approach was present in the public administration reforms in Hungary in the 19th and 20th centuries, as well as in the most recent reforms.

LITERATURE:

1. *Act I of 1950 on the local councils* (act of the People's Republic of Hungary)
2. *Act II of 1844 on the Hungarian language and nationality* (act of the Hungarian Kingdom)
3. Bibó, I. (1986). Jogszerű közigazgatás , eredményes közigazgatás , erős végrehajtó hatalom. In I. Bibó, *Válogatott tanulmányok: 1935–1944.* (Első kötet) (pp. 271-294.) Budapest: Magvető.
4. Csizmadia, A. (1976). *A magyar közigazgatás fejlődése a XVIII. századtól a tanácsrendszer létrejöttéig.* Budapest: Akadémiai Kiadó.
5. *European Charter for Regional or Minority Languages ETS No.148* (1992). Strasbourg: Council of Europe.
6. Fazekas, M., Ficzer, L. (eds.) (2004). *Magyar közigazgatási jog.* Budapest: Osiris.

7. Fekete, B. (2004). A jogi átalakulás határai – egy jogcsalád születése 1989 után Közép-Kelet-Európában. *Kontroll: Jogtudományi folyóirat* 1, pp. 4-21.
8. *Fundamental Law of Hungary*
9. *Guidelines for Terminology Policies: Formulating and implementing terminology policy in language communities.* (2005). Paris: UNESCO
10. Hajdú, Z. (2001). *Magyarország közigazgatási földrajza*. Budapest: Dialóg Campus.
11. Hankiss, E. (1986). *Diagnózisok 2*. Budapest: Magvető.
12. Koi, Gy. (2014). *Lorenz von Stein Verwaltungslehre című fő művének helye a közigazgatástudományban*. In Fekete, B., Horváthy, B., Kreisz, B. (eds.) *A világ mi magunk vagyunk... Liber Amicorum Imre Vörös* (pp. 274-288.). Budapest: HVG-ORAC.
13. Lőrincz, L. (2005). A hatékony állam. *Magyar Közigazgatás*, 2005. 55/8, pp. 449-453.
14. Mezey, B. (ed.) (2003) *Magyar alkotmánytörténet*. Budapest: Osiris.
15. Rixer, Á. (2014). *Traditional Features of Hungarian Public Administration*. *Acta Universitatis Sapientiae Legal Studies*, 2014. 3/1, pp. 55-78.
16. Sárközy, T. (2006). Tézisek a kormányzati szervezetrendszer modernizációjára. *Polgári Szemle*, 2006. 2/3, pp. 2-5.
17. Somogyvári, I. (2006). Javaslat a központi kormányzat hatékony szervezeti felépítésére . In Ágh, A., Somogyvári, I., (eds.) *A közigazgatási reform új perspektívái* (pp. 30-54.) Budapest: Új Mandátum.
18. Stein, L. von. (1865–1868). *Die Verwaltungslehre. Bd. I - VII*. Stuttgart: Cotta.
19. Szalma, J. (2011). A precedensjogról. *Új Magyar Közigazgatás*, 2011. 4/11. pp. 36-42.

NEW ECONOMIC DIMENSION OF THE EURASIAN ECONOMIC UNION

Katarzyna Czerewacz - Filipowicz
Bialystok University of Technology, Poland
k.czerewacz@pb.edu.pl

ABSTRACT

The article aims at determining the current economic dimensions of the Eurasian Economic Union (EAEU) and the EAEU impact on the economic relations of the Member states. The research instruments developed on the basis of the European integration are often not suitable for the measurement of effects in the post-Soviet space. The starting point for the Eurasian RIAs was the collapse of the USSR, the entity the researched countries were members of and not the integration of sovereign states as it was in the case of the EU. So the processes occurring at the researched area are both integrative and disintegrative. The new economic dimensions of the EAEU are: the position of the researched countries in the international division of labor, their participation in global value chains and the ability to create a common advantage in international relations. The latter criterion is researched from the perspective of land threads of the New Silk Road (One Road One Belt) between China and the European Union. The main research hypothesis regarding to the investigated effects of the EAEU is that the common international economic strategy adopted by the EAEU (in relation to the New Silk Road, the EU, China and not only) can be an actual measure of their economic impact strength. The article points out that although the cause of the institutionalization and creation of the EAEU are mainly politically motivated, the effects of their functioning strongly impact on the economy of the participating countries in a positive and negative way. In addition, the article shows that the strength and character of this impact are different for the particular EAEU countries. In this article, the trade of the particular Member States within and outside the EAEU was selected as a research instrument.

Keywords: Eurasian Economic Union (EAEU), international trade, Regional Integration Agreements (RIAs).

1. INTRODUCTION

The economic transformation of the post-Soviet countries is partially based on RIAs (Regional Integration Agreements). Starting from the Commonwealth of Independent States (CIS) and ending on the Eurasian Economic Union (EAEU), the initiatives were to give driving factors for the economic development of the participating countries. Most of the integration measures taken in the area of the CIS ended in failure, however this did not stop the creators of the EAEU from consistently forming a new structure whose scope and nature go beyond the earlier initiatives.

International economic integration in the post-Soviet area raises a lot of controversy and questions. According to skeptics, each successive RIA has only a political and declarative dimension without any economic effects (Trenin 2002, 2011). Many people see them in the context of strengthening Russia's position in the region (Dragneva and Wolczuk, 2014) and the policy of creating a multipolar world (Makarychev and Morozov, 2011). In turn, A. Libman and E. Vinokurov, describing the integration processes taking place in this area use a formulation of holding-together regionalism. In this way, they emphasize that integration is to help maintain many economic connections of the Soviet period (Vinokurov and Libman, 2012). According to other researchers (Khitakhunov, Mukhamediyev, Pomfret, 2016) Russia sees the EAEU as a symbol of its dominance and importance in the region. In turn, an economic dimension of this structure is important to Kazakhstan, Kyrgyzstan and Belarus. On the other

hand, in the case of Armenia, apart from economic issues, safety and an ability to ensure the integrity of the territory thanks to the EAEU are also important.

The reason for controversies concerning the economic effects of RIAs in the post-Soviet area includes huge economic, political, geographical and structural disparities between the countries (Table 1). Part of the post-Soviet countries has huge resources of raw materials (Russia, Kazakhstan, Azerbaijan, Turkmenistan, Uzbekistan), which are the foundation of their exports. Other countries are dependent on the supply of raw materials necessary for the production and operation of the national economy, which makes them dependent on wealthy neighbours. As all the post-Soviet countries export mainly raw materials, primary products and resources based products, they are seeking to improve their position in the international division of labor and GVC. For this reason, between the researched countries, both interbranch complementarity and competition can be observed. The research of trade integration as part of the economic integration between the countries of the EAEU seems to be justified because of the stage of integration processes between them but, considering geographical disparities and a disproportion in resources and factors of production, causes problems with interpretation.

Table 1: Main macroeconomic indicators of the EAEU compared to other countries of the CIS (IMF, 2016)

Country	Area (thousands km ²)	Population (mln)	GDP (billion USD)	GDP per capita USD
Armenia	29 800	3.5	12.15	3 506
Białoruś	207 600	9.2	69.71	7 539
Kazachstan	2 724 900	16.7	271.20	16 200
Kirgistan	198 500	5.7	8.27	1 436
Rosja	17 098 200	140.0	2658.90	18 928

Another problem that arises from the research into trade integration within the EAEU is the wealth of each country. As the countries integrating within the EAEU are, on the one hand, middle-income countries (Russia) and, on the other hand, low-income ones (Kyrgyzstan, Armenia), on the basis of theory, other integration effects will be beneficial to them (Marinov, 2015). For small and poorest countries, the increase of intraregional trade connections stemming from the Customs Union can be favourable (Lipsey, 1960, Marinov, 2015), and according to Vinera trade creation increases a country's welfare (Viener, 1950). That is why the article examines both the changes in the volume of trade as well as the changes in the share of the EAEU countries in the trade of the Member States.

The phenomenon of international regional integration is understood as the amalgamation of the countries' economies (Mattli, 1999) into a mutual economic region (Machlup 1977) and the removal of barriers between the actors (Balassa, 1973). Regional integration understood this way is a phenomenon favorable to all the participating countries (Bożyk and Misala, 2003), although these benefits will not be the same. An array of the sources of these benefits varies depending on the stage of integration as well (El-Agraa, 1999). On the other hand, in the case of the countries transforming their economies, consolidating their economic backwardness through isolation from the global economy may be a trap. (Krein in and Plummer, 2003). For this reason, the degree of their openness to international economic relations can be a measure of success.

2. TRADE INTEGRATION OF THE EAEU MEMBER STATES

The market integration which took place in the Soviet era was a centrally controlled process. The division of production processes and directions of trade did not always correspond to geographical and structural determinants of the individual republics. Within the Soviet Union,

almost all the trade turnover of many republics was limited to the internal area of the USSR. After the collapse of the Soviet Union and the creation of the CIS, the countries diversified their trade connections and established economic relations with other parts of the world. It was a difficult period for them to build their relationship with the global economy.

On the one hand, the EAEU countries are mutually complementary for structural reasons, but also due to the connections generated by the Soviet Union. On the other hand, after the collapse of the Soviet Union, new attractive opportunities for economic cooperation (China, EU, USA, Turkey) appeared for all the states. At the level of trade, the process of diversification of trade connections and directions began in 1991. The neighborhood of economic powers, China and the EU, has deepened trade disintegration of the area. However, as the post-Soviet states - since the inception of the CIS - have been striving for trade integration within established free trade agreements and customs unions, a trade aspect of the relationship between the countries researched seems to be highly significant for understanding the phenomena occurring in the area.

So far, the EAEU has reached the highest degree of trade integration in the post-Soviet region. It has integrated three countries: Russia, Belarus and Kazakhstan in the form of the Customs Union and created the framework for the creation of common market in the area of the EAEU. Due to a great variation in economic, geographic, commodity and population potential, the consequences of the membership in the EAEU for each country will be different.

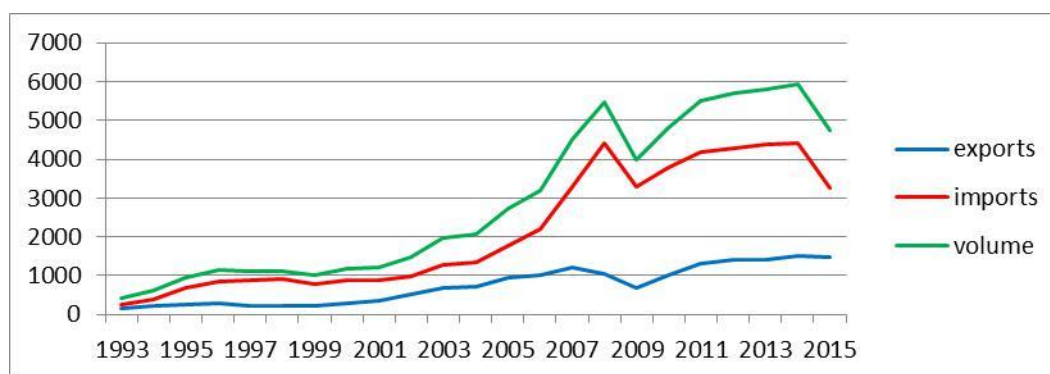


Figure 1: Armenia's trade in the years 1992-2015 (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quarterly 2016)

The directions of changes in the volume of trade turnover show how strongly it is linked economically with Russia and throughout the post-Soviet area. The periods of economic crises in Russia resulted in the deterioration of the economic situation in Armenia, as evidenced for instance by the period of 2014-2015 (Figure 1).

In the case of Armenia, it is very difficult to speak about the effects caused by its membership in the EAEU. It can be evaluated only in a few years. Armenia joined the EAEU in 2015. The decision to strengthen its relations with Russia and the EAEU was taken in 2014. The country did not participate in the EurAsEC before, it was only a member of the CIS. However, some indications of the cause of integration of Armenia with the EAEU can be noticed.

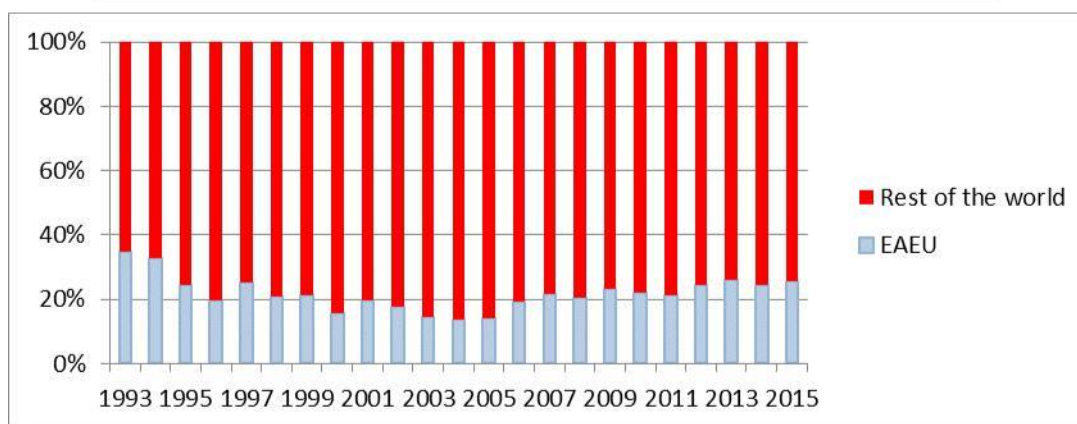


Figure 2: Armenia trade integration with the EAEU and the rest of the world (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quaterly 2016)

The EAEU countries, in the researched period, decreased their share in export of Armenia gradually, from 40% in 1993 to 11% in 2004. In the subsequent years, the share of the CIS countries not participating in the EurAsEC underwent further reduction (except for 2007). However, in 2011-2013, the share of the EurAsEC¹ countries in the export of Armenia started to rise again .

The share of the EAEU countries in the imports of Armenia decreased in the period 1993-2000 and the fluctuations were large and the share of these countries ranged from 15 to 32%. In 2009-2013, the situation normalized and the share of the EurAsEC in the imports of Armenia oscillated around 24-27%. The states of the EurAsEC decreased their share in the trade turnover of Armenia but after 2006 this trend was reversed and the share of the EurAsEC / EAEU countries increased significantly (Figure 2).

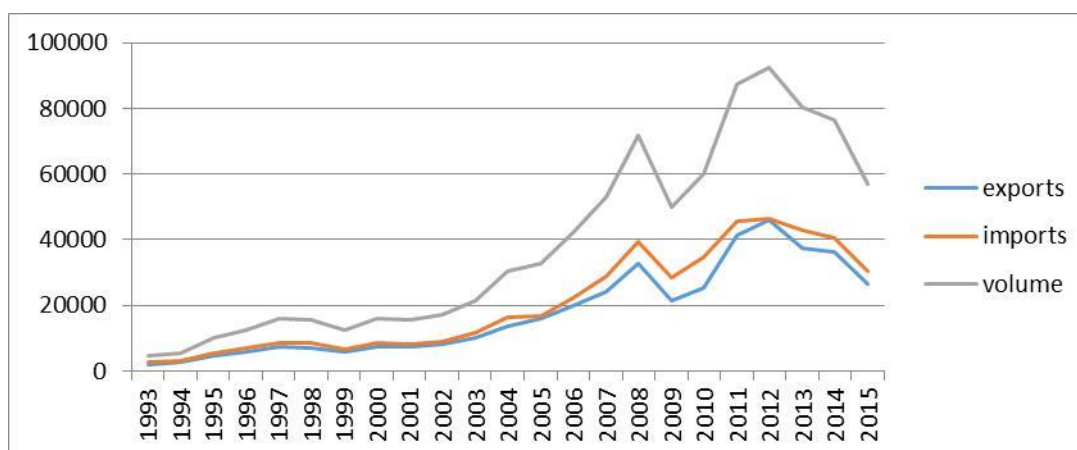


Figure 3: Belarusian trade in the years 1992-2015 (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quaterly 2016)

¹ Since the Eurasian Economic Union was established with the transformation of the Eurasian Economic Community (EurAsEC) in the periods before 2015, discussing the researched area in the article, it is abbreviated as EurAsEC, and only discussing the period from 1 January 2015 the EAEU.

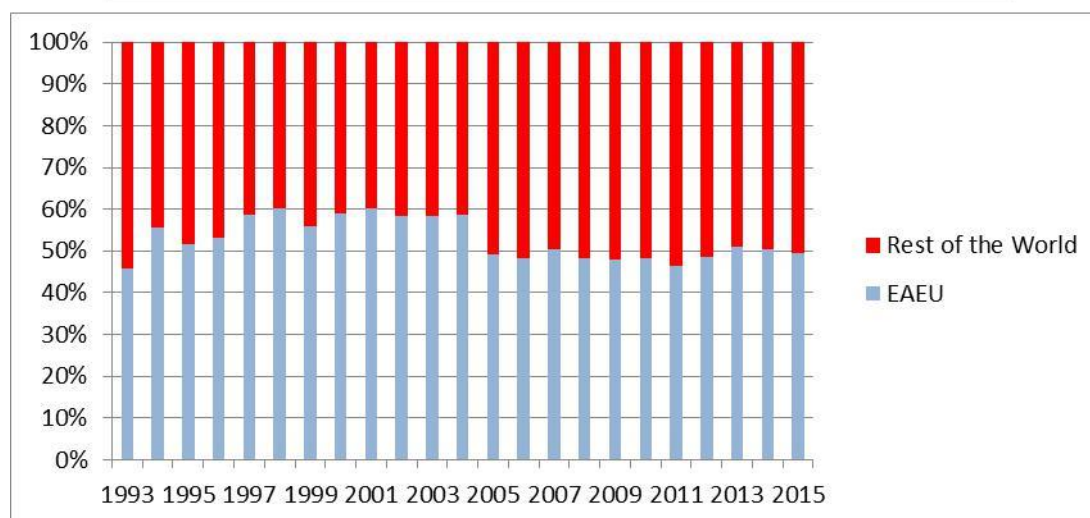


Figure 4: Belarus trade integration with the EAEU and the rest of the world (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quarterly 2016)

Belarus is the most integrated country with the Russian Federation in the CIS area. It participates in all the Russian initiatives in this area and the level of trade integration with the EAEU is the highest among the researched countries. The economic situation in Belarus as well as the balance and volume of foreign trade turnover of the country are closely related to the economic situation in the Russian market (Figure 3).

The most important direction of the Belarusian exports is the Russian Federation (45-50%). The share of the other countries of the EAEU in the Belarusian exports ranged from 5% to 15% in 2012-2015. Throughout the researched period, the share of the imports from the EAEU countries to Belarus fluctuated at around 60-65% (with the exception of 1993). The Belarus imports from the EurAsEC is in fact the imports from Russia. The other countries provided a maximum of 10% of the goods during the researched period (Figure 4).

The trade integration of Belarus with the EAEU is primarily the trade integration with Russia. The country has maintained a very high share in the trade turnover of Belarus over the researched period. The share of the other countries of the EAEU is marginal.

Starting from 2013, when the Russian-Ukrainian conflict began, going through the years 2014-2015 when there were reciprocal sanctions in relations between Russia - Western Countries, the increase of trade integration of Belarus with the countries from outside the EAEU was expected. This was to be mainly the result of the use of the Russian sanctions on Western products in order to increase their exports to Russia and not entirely legal but often used in Belarus re-exports of western goods to Russia under the Belarusian brands. Figures 3 and 4 show, however, that the bad situation affected the Belarusian market strongly enough that the positive effects in the form of exports growth, trade growth did not appear. There was also no increase of integration into the global economy.

Kazakhstan, since the collapse of the Soviet Union is in favor of the integration of Central Asia and/or part of the post-Soviet area. The country has repeatedly presented its own integration scenarios in the area. The setting up of the EAEU overlapped, however, with a number of negative phenomena for Kazakhstan and a significant decline in trade as such (Figure 5).

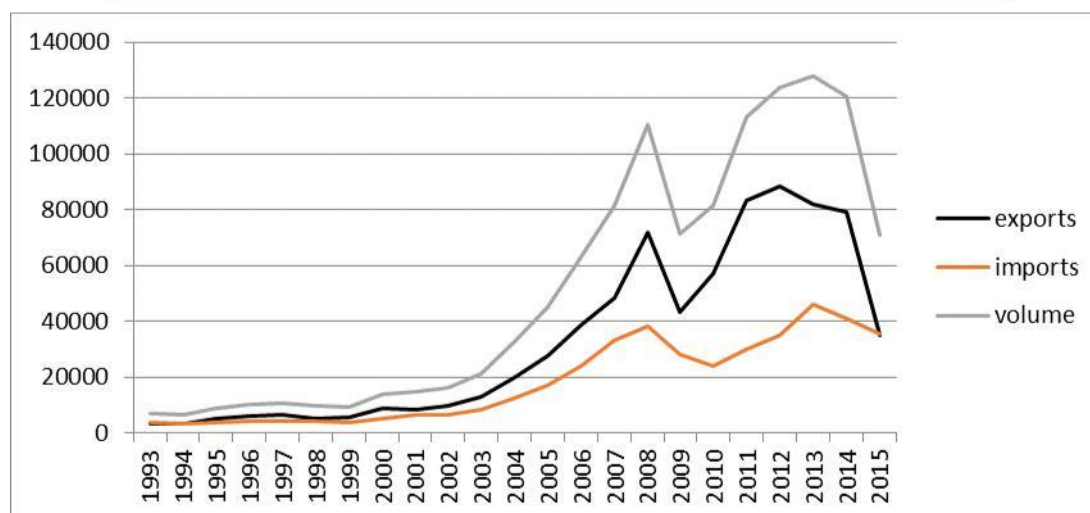


Figure 5: Kazakhstan's trade in the years 1993-2015 (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quarterly 2016)

The reasons for such a drastic decline in trade turnover of Kazakhstan were at least three:

- the bad economic situation of Russia, the weakening of the ruble and the necessity to weaken Kazakhstan's own currency,
- the decline in energy commodity prices (crude oil) which are the main items of the Kazakh exports,
- the adverse changes in the Kazakh customs tariff imposed by the Customs Union. In the framework of the Customs Union Kazakhstan had to increase its rates of duty as much as 45%.

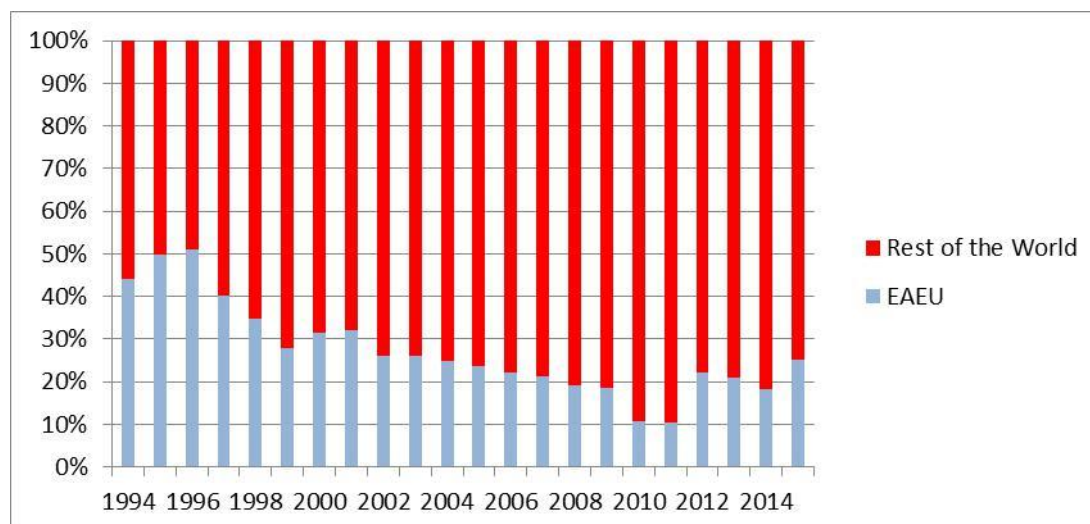


Figure 6: Kazakhstan trade integration with the EAEU and the rest of the world (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quarterly 2016)

In Kazakhstan, there were also potential positive developments that could spread throughout the EAEU countries as a result of mutual sanctions between the Russian Federation and the Western Countries in recent years. The Kazakh exports to Russia has not increased so as the re-exports of the missing goods on the Russian market has not appeared.

Until 2010-2011, the degree of trade integration of Kazakhstan with the countries of the present EAEU reduced in favor of economic ties with China and the EU. In recent years, the share of

Kazakhstan's trade with Russia increased significantly, causing the return of the Russian Federation has become the most important trading partner of Kazakhstan ahead China by a hair (Figure 6). Nevertheless, the European Union taken as a whole still remains the most important destination for Kazakhstan, although its share has decreased in the last two years.

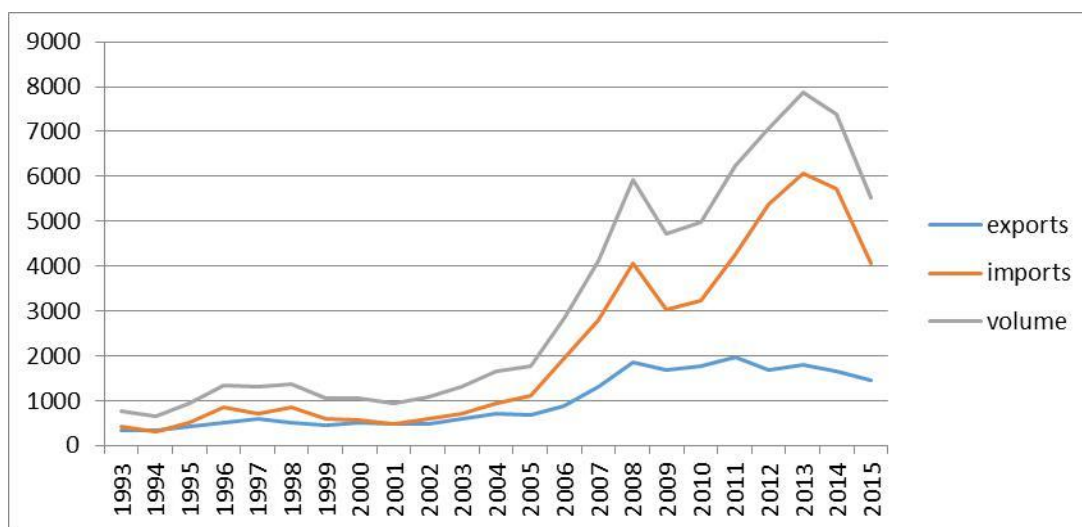


Figure 7. Kyrgyzstan's trade in the years 1993-2015 (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quaterly 2016)

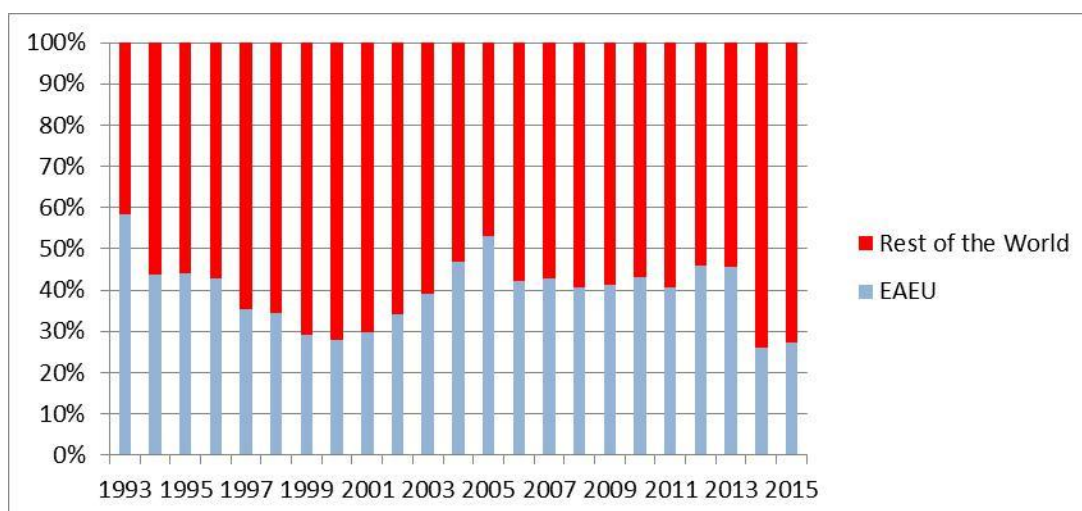


Figure 8: Kyrgyzstan trade integration with the EAEU and the rest of the world (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quaterly 2016)

The volume of trade turnover of Kyrgyzstan in the last two years has decreased as in the other researched countries (Figure 7). The deterioration of the economic situation in Russia and Kazakhstan has strongly affected the economy of Kyrgyzstan.

Although Kyrgyzstan has decided on the membership in the EAEU, trade integration with the countries of this structure in the last two years has decreased significantly (Figure 8). This is largely due to the impact of the Chinese economy, which plays a dominant role in the external relationship of Kyrgyzstanu. One can even assume that the membership in the EAEU is to be a kind of alternative to the Chinese power.

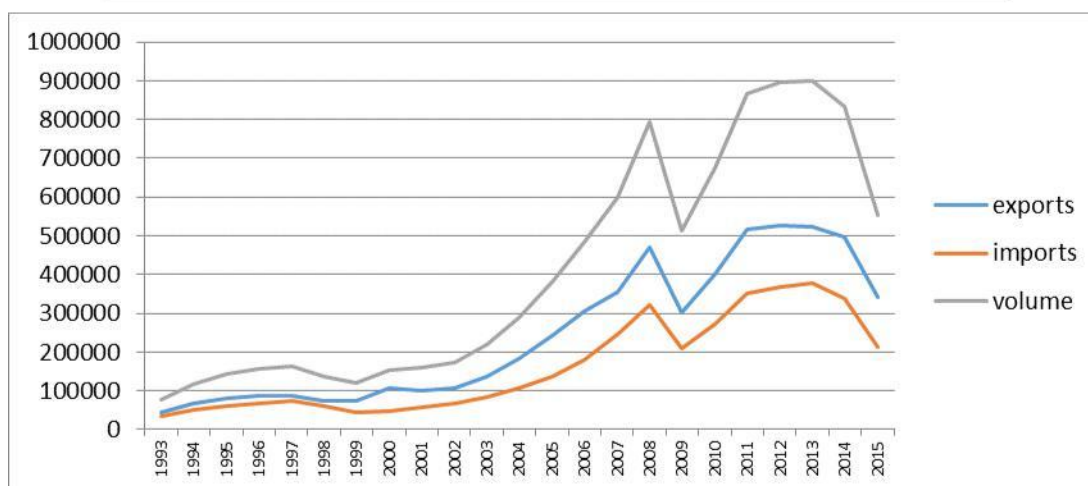


Figure 9: Russia's trade in the years 1993-2015 (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quaterly 2016)

A dramatic decline in the Russian trade turnover in recent years has been a result of the conflict with Ukraine, an embargo in the mutual relations with the Western countries and a drastic decrease in oil prices (Figure 9). All this has had a negative impact on the Russian economy and prevents the assessment of the impact of the EAEU on its external relations, the more that the states of the EAEU has not belonged to the most important directions of Russia's cooperation for many years.

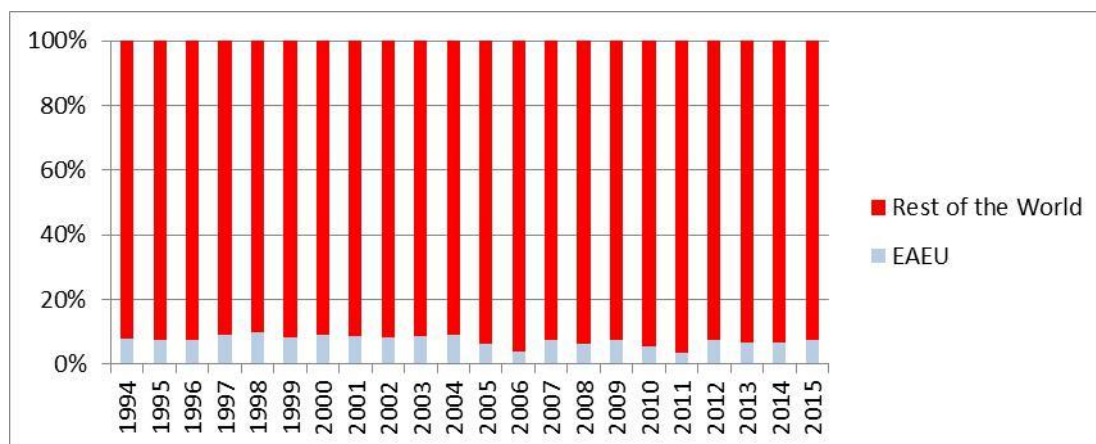


Figure 10: Russia trade integration with the EAEU and rest of the world (Own calculation based on: International Monetary Fund. Yearbooks 1996, 2000, 2004, 2006, 2010, 2011, 2012, 2013, 2014, 2015, Quaterly 2016)

The degree of the trade integration of Russia with the countries of the EAEU is the lowest among all the researched countries (Figure 10). Until 1998, 20% the Russian trade turnover concerned the CIS countries, then it decreased. The EAEU share was half the share of the CIS in the particular researched years. The main problem for the future of the EAEU countries is the structure of trade turnover with the European Union. The UE imports from Russia are mainly mineral products (78.2%) while Russian imports from the EU are mainly: machinery and appliance 31.6%, transport equipment 16.2%, products of the chemical or allied industries 14.2% (European Commission, 2015a). In the case of Kazakhstan, its exports to the EU is even more focused on mineral products, which comprise 93.5% of total exports. Kazakhstan imports from the EU: machinery and appliance 33.5% , transport equipment 17.7%, products of the

chemical or allied industries 17.2% (European Commission, 2015c). Belarus exports to the EU mineral products 37.5%, products of the chemical or allied industries 16.6%, and base metals and articles thereof 15.1%. Belarussian imports from the EU are mainly: machinery and appliance 34.0% and transport equipment 15.3% (European Commission, 2015b). Russia and Kazakhstan are afraid of being only a resource based and primary products. Oil and gas are strategic products but one day they can be replaced by other sources of energy. All the countries of the EAEU are providers of low-processed products and recipients of mid- and high-tech ones. Over the last twenty years between the EU and the countries of the EAEU have not developed any significant intrabranh relations. China is today the most important economic partner for almost all Central Asian countries (in the EAEU for Kyrgyzstan). Kazakhstan, has a quick chance to join this group of countries. But the growth of Chinese position as a trade, investment partner and a source of capital is so fast that is making those countries afraid about their future economic independence. In this case, integration with Russia is a kind of alternative and economic diversification of foreign relations.

3. CONCLUSION

Comparing the changes in the trade volume of the EAEU countries it can be seen how strong the dependencies between them are, even if we assume that this is largely remaining dependent on the Russian economy. The second conclusion that arises is similar exports and imports reactions of the researched countries on external factors, although the differences in economic, geographical and structural potential here are enormous. The beginning of the functioning of the Eurasian Economic Union coincided with the war in Ukraine, the Russian-Ukrainian conflict and mutual sanctions between Russia and the Western countries. In addition, already in 2014, oil prices fell drastically, causing slower economic growth in the the EAEU countries dependent on the raw material exports. All this affects the fact that it is very difficult to extract and assess the impact of the EAEU on external relations of the Member States. The approach of the EAEU Member States to integration itself is quite different. Russia sees the EAEU as a symbol of its dominance and importance in the region. In turn, for Kazakhstan, Kyrgyzstan and Belarus it is an important economic dimension of this structure. On the other hand, for Armenia, apart from the economic issues, its safety and the ability to ensure the integrity of the territory thanks to the EAEU are also important. It should be noted, however, that the EAEU can fulfill two very important functions. Firstly, it can be very important platform for the cooperation with the EU as soon as Russia's relations with this structure have normalized. After all, the European Union is willing to continue the inter-regional dialogue (eg. in the framework of the ASEM with the ASEAN). Until today, the EU and the post-Soviet countries (except for Lithuania, Estonia, Latvia) have not developed any forum of mutual cooperation. The EAEU may be the missing piece to such a dialogue here. Secondly, the EAEU can be a great instrument for dialogue with China within the framework of the New Silk Road giving the Member States a stronger position in the negotiations with China.

ACKNOWLEDGEMENT: *The presented research is part of the grant I am realizing entitled: "Economic consequences of regional integration processes in the area of the Commonwealth of Independent States." awarded on the basis of Decision DEC-2011/03 / B / HS4 / 05/930 by the National Science Centre of Poland funds.*

LITERATURE:

1. Balassa, B. (1973). The Theory of Economic Integration. London: Allen and Unwin.
2. Bożyk, P., Misala, J. (2003). Integracja ekonomiczna [Economic integration], Warsaw: Polish Economic Publishing House.

3. Dragneva, R., Wolczuk, K. (2014). Eurasian Economic Integration: , Institutions, Promises and Faultlines. In D. Cadier, The Geopolitics of Eurasian Economic Integration. London LSE: IDEAS Report.
4. El-Agraa, A.M. (1999). Regional Integration. Experience, Theory, and Measurement, New York: Palgrave Macmillan.
5. European Commission, 2015a. European Union, Trade in goods with Russia Retrived 15.02.2016 from http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113440.pdf.
6. European Commission, 2015b. European Union, Trade in goods with Belarus Retrived 15.02.2016 from http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113351.pdf.
7. International Monetary Fund. Statistics Dept. (1996, 2000, 2004, 2006, 2010, 2012, 2014, 2015). Direction of Trade Statistics, Yearbook 1995, 1999, 2003,2005, 2009, 2011, 2013, 2014, International Monetary Fund.
8. Khitakhunov A., Mukhamediyev B., Pomfret R. (11.02.2016). Eurasian Economic Union: present and the future perspectives, Economic Change and Restructuring, Springer.
9. Kreinin, M.E., Plummer, M.G. (2003). Economic Integration and Development: Has Regionalism Delivered for Developing Countries? Cheltenham, UK, Northampton, MA, USA: Edward Elgar Publishing.
10. Libman, A. and Vinokurov, E. (2012). Holding-Together Integration: 20 Years of the Post-Soviet Integration. London: Palgrave Macmillan.
11. Lipsey, R. G. (1960). The theory of customs unions: A general survey. The Economic Journal 70 (279): pp. 496-513.
12. Machlup, F. (1977). A history of thought on economic integration. New York: Columbia University Press.
13. Makarychev, A., Morozov, V. (July-September 2011). Multilateralism, Multipolarity, and Beyond: A Menu of Russia's Policy Strategies. Global Governance: A Review of Multilateralism and International Organizations: Vol. 17, No. 3, pp. 353-373
14. Marinov, E (2015). Economic Determinants of Regional Integration in Developing Counties. International Journal of Business and Management, Vol. III(3), pp. 22-39.
15. Mattli W. (1999). The Logic of Regional Integration. Europe and Beyond, Cambridge: Cambridge University Press.
16. Trenin, D. (2002). The End of Eurasia: Russia on the Border Between Geopolitics and Globalization, Washington D.C: Carnegie Center.
17. Trenin, D.V. (2011). Post-Imperium: A Eurasian story. Washington D.C: Carnegie Endowment for International Peace.
18. Viner, J. (1950). The Customs Union Issue. New York: Carnegie Endowment for International Peace.
19. World Economic Outlook IMF. (2016). Retrived 15.05.2016 from <https://www.imf.org/external/pubs/ft/weo/2016/01/weodata/index.aspx>

IS IGNORANCE OF POTENTIAL CAREER PATHS A DISINCENTIVE FOR STARTING A CAREER IN THE MARITIME SECTORS?

Katarzyna Skrzyszewska
Gdynia Maritime University, Poland
k.skrzyszewska@wpit.am.gdynia.pl

Ivona Milic Beran
University of Dubrovnik, Croatia
imberan@gmail.com

ABSTRACT

The purpose of this article is to examine the level of knowledge of young people planning to start a job at sea concerning the importance of seafarers work for the global economy (particularly with regard to the European Union) and for the national economy. The authors maintain that the knowledge of such a specific sector as the sector of the maritime economy increases the probability of finding a job in line with the education. Additionally the national economy can benefit from the employees with well-planned career paths in the maritime sectors. This is particularly important nowadays, when shortages of seamen affect especially the developed countries, including the members of the European Union. To achieve the goal of the research – the questionnaire method was used. The study was conducted at two European universities, which educate future officers for the needs of the maritime economy: Gdynia Maritime University in Gdynia (Poland) and the University of Dubrovnik (Croatia). The respondents were students of navigation and marine engineering. The point of reference for the assessment of students' knowledge was developed on the basis of the desk research of the most important benefits that the development of the maritime economy based on seamen's employment brings to the EU economy and both national economies: Polish and Croatian. The most important conclusion pointed out is a general lack of awareness of the importance of seafarers for the national economy among Polish students. A slightly better situation is among Croatian students. The conclusions of the research confirmed that there is a necessity to change the approach of decision-makers to the issue of promoting maritime labour on the university level, as well as on the level of local and state authorities. Young people not realising the importance of work of seafarers and ex-seafarers do not know much about possible career paths, which are being opened by work at sea. And this is just work for shipping, rather than shipping itself, which brings bigger economic benefits for the economy. With extensive maritime education and long-standing traditions and still the largest group as far as the number of officers is concerned (among the EU countries), Poland and Croatia should skilfully exploit this competitive advantage, especially in the face of increasing shortages of officers on the sea labour market.

Keywords: maritime high education, seafarer labour market, shortages of officers.

1. INTRODUCTION

Europe growth is based on the strategic plan Europe 2020. Its objective is sustainable, smart and inclusive development (KOM, 2010, p. 5). Marine resources seem to correspond to each of those challenges; sustainable development does not only help to achieve balance on the land through freeing up land transport by sea short shipping, but also addresses issues related to the resolution of conflicts between different “participants” of economic activity based on the sea (tourism, energy, mining of minerals, safety, etc.). Smart development is based on the latest state-of-the-art technologies used both in traditional marine industries (transportation, shipping, fisheries) and the newly emerging field called Blue Growth, which forces advances in

technology and solutions and thus makes possible its operation in difficult conditions (aquafishery, seabed mining, offshore oil and gas, biotechnology). The issues related to social inclusion are connected, in turn, with a wide range of skills and competences required from people employed in maritime sectors. From highly specialised (as listed in the IMO Conventions, legal regulations of individual countries) to simple tasks that do not require education or experience - simple physical works, which are numerous in the surrounding sectors and in the maritime sectors themselves. They allow activating people who are at present outside the labour market and these who are long-term unemployed. But in order to develop activities based on marine resources it is necessary to have adequate human resources with competences enabling them to perform shipping (Kizielewicz, 2015, p. 187). Training such people and gaining next competences by them require time and dedication. It necessarily involves a kind of vocation. Therefore, those who decide to undertake studies to enable operation at sea should be aware of disadvantages associated with the pursuit of a sailor career. On the other hand, awareness and knowledge of opportunities offered by the maritime economy to people with “sea experience” should be a sufficient motivator to take up this challenge.

2. MARITIME ECONOMY - MAIN TYPES OF ACTIVITIES AND THEIR IMPORTANCE IN CHOSEN ECONOMIES

The maritime economy in Europe plays a significant role – it is reflected both by volume of employment and gross value added created by sectors included in this economy. In 2015 employment in the EU's maritime economy was estimated as 5.4 million jobs, while GVA was € 500 billion. It is estimated that in 2020 employment will increase to 7 million and GVA to € 590 billion (COM, 2012, p. 3). The maritime economy consists of traditional maritime sectors and five sectors included in the group of so-called Blue Growth (Fig. 1).

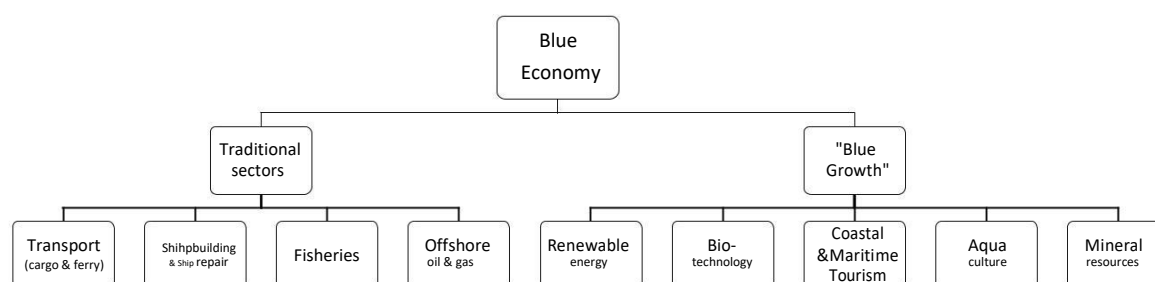


Figure 1: The main activities of the Blue Economy
(http://ec.europa.eu/maritimeaffairs/policy/blue_growth/infographics/)

These maritime sectors contain different forms of activities (e.g. “transport”: deep-sea shipping, short-sea shipping, passenger shipping, inland waterway transport). The maritime policy of the EU distinguishes 27 specific maritime economic activities (ECORYS, 2012, p.14). These activities create with other activities, not associated with the sea, different value chains. There are six functions (based on value chains) with high potential of creating the socio-economic value: (i) maritime trade and transport, (ii) food, nutrition and health, (iii) energy and raw materials, (iv) living, working and leisure in coastal regions and at sea, (v) coastal protection and nature development, (vi) maritime security (ECORYS, 2012, p. 13). What connects all the activities grouped in sectors (Fig. 1.) is their interdependence. This is a result of common operation in the land-sea interface and it determines growth opportunities of each of the aforementioned sectors. It demands responsible and sustainable management of marine resources by different users (COM, 2012, pp. 4-5; Kizielewicz, 2016, p.198).

2.1. Seafarers as an important factor of the Polish maritime economy

The Polish coastline is 770 km long (Rocznik statystyczny ...). Inhabitants living in the coastal regions constitute just over 10% of the whole population – they generate GDP per capita on the level of 91% of the average national value. Gross value added generated by coastal regions is less than 10% of the national GVA produced per year (EC, 2013, p.3). Taking into account the size of employment and the value of GVA, the Polish maritime economy is based primarily on traditional maritime sectors (fisheries, shipbuilding and ship repair) - but they are mature sectors. The fastest increase in GVA is observed in passenger ferry services and offshore oil and gas, while the sectors with the greatest development potential are yachting and marinas (Tab. 1.).

Table 1: Sets of top 7 maritime economic activities ranked in order of size/ growth/ future potential (EC, 2013, p. 14)

Top 7 current size	Top 7 recent growth	Top most future potential
Fish for human consumption	Passenger ferry services	Offshore wind
Shipbuilding and ship repair	Offshore oil and gas	Yachting and marinas (leisure boat building)
Coastal tourism	Cruise tourism	Offshore oil and gas
Water projects	Environment. monitoring	Marine aquaculture
Shortsea shipping	Marine aquaculture	Environmental monitoring
Yachting and marinas	Fish for human consump.	Shipbuilding (excl. leisure boats) & ship repair
Traceability and security of goods supply chains	Yachting and marinas	Blue biotechnology
		Coastal tourism
		Protection of habitats

All kinds of activities listed in Table 1. create demand for seafarers work. In addition, service activities, without which the above mentioned activities could not be developed, are also based on people with experience of work at sea. With regard to Polish human resources - it is difficult to estimate the number of seafarers, because maritime administration does not keep the electronic register of seamen. The consequence is a large span between the data from different sources. According to Manning 2014. Annual Report drawn up by Drewry Maritime Research, the number of Polish officers is about 29.5 thousand, and ratings - about 10.5 thousand people (Drewry..., 2014, p.55). But according to the EU, the total number of Polish sailors is a little higher than 22.5 thousand, of whom officers are 80% (less than 18 thousand people) and ratings - 20% (less than 5 thousand people) (EC, 2011, p. 11). The consequence of the lack of accurate and reliable information about the level of employment is inability to accurately assess income generated by seafarers. The vast majority of this income is spent in the country, which affects consumption and investment demand, at least on the local scale. With regard to Polish seamen, their income transferred to the country oscillates between € 1 and 2 billion per year (Marynarska wizja, 2014, p.4; KIS priorytetem ..., 2015).

2.2. Seafarers as an important factor of the Croatian maritime economy

The Croatian coastline is a little over 6 thousand km long (almost 30% of the coastline is a line of the mainland, the remaining 70% - of islands) (Stat. Ijetop. Repub. Hrv., 2015). Coastal regions are inhabited by 1/3 of the whole population, and they generate GDP per capita on the level of 98% of the average national value (EC, 2014, p.3). Coastal tourism and shipbuilding and ship repair are the sectors with the largest number of employees and the largest GVA generated during the year (Tab. 2.). At the same time coastal tourism with cruise tourism are the activities, which were assessed as the activities of the highest growth potential. These two activities are also mentioned among the four sectors with the fastest growth. What can be worrying is the fact that generally the maritime economy of Croatia is based on demand

generated by tourism. So little diversification of sources of demand (and potential demand) for services provided by the Croatian maritime economy is a major threat to its development.

Table2: Sets of top 7 maritime economic activities ranked in order of size/ growth/ future potential (EC, 2014, p. 12)

Top 7 current size	Top 7 recent growth	Top most future potential
Coastal tourism	Marine aquaculture	Coastal tourism
Shipbuiding and ship repair	Passenger ferry services	Cruise tourism
Fish for human consumption	Cruise tourism	Passenger ferry services
Shortsea shipping	Coastal tourism	Shortsea shipping
Water projects	Fishing for human consump.	Yachting&marinas (leisure boat building)
Passenger ferry services	Shipbuiding and ship repair	Marine aquaculture
Cruise tourism	Fishing for animal feeding	Shipbuilding (excl. leisure boats)&Ship rep.

Croatian sailors are employed both in the fleet of the national and foreign ship owners. Their role in the economy is significant not only because of the income they generate, but also because of the effects that tourism, which is mainly based on the marine environment, produces. The number of Croatian sailors is much more accurately assessed than the number of the Polish sailors, because of the electronic register of seafarers – the database kept by the maritime administration. The register lists 18 thousand seafarers, who, together with unregistered sailors are a group of about 20 - 22 thousand people. The reason for this difference is the fact that a part of seafarers is not officially registered (Marinov *et al*, 2015, p.64). Officers account for about 60% and ratings for about 40% of all Croatian seamen (Zorovic, 2013). Croatian sailors represent approximately 2.3% of economically active population in the national economy (EUROSTAT). They are treated as the "best export product" - their yearly income is estimated at € 1 billion (Zorovic, 2013).

3. CHANGES IN MARITIME HUMAN RESOURCES

These days, both researchers and practitioners emphasise the employees' key role in quality of services and their contribution in the overall effectiveness of an organisation (Øgaard, 2006; referenced by Grobelna, Marciszewska, 2016a, p. 138). That is why human resources are considered as the basis to create the competitive advantage by shipping companies (Progulaki, Theotoas, 2010, p.163). Nowadays, the main problem, which affects shipping, is the growing shortage of officers in the seafarer labour market (Skrzeszewska, 2015, p. 980). The consequence may be, among other things, reduced involvement in work and less loyalty to the current shipowners/ managers (Caesar *et al*, 2013, pp. 1-18; Nguyen *et al*, 2014, pp. 217-242; Bhattacharya, 2015, pp. 295-318). In addition, a factor adversely affecting quantity and quality of human resources in shipping is the perception of the industry as difficult and demanding, which is not conducive to recruitment of young people for the studies undertaken to become officers in merchant service, in the future (Ships ..., 2000, p. 127).

In the countries of Central and Eastern Europe, a seafarer was the profession of great prestige in the days before the transformation. It was associated both with the limited access to the profession, which provided opportunities to go abroad and with obtaining higher than average earnings. With the progressive economic and political transformation, the conditions that were previously a strong determinant encouraging young people to undertake hard studies lasting 5 years, but allowing them to obtain the right to practice the profession of marine navigator, engineer, electrical engineer officer etc. have begun to change. The opening of borders, expansion of Western corporations, which offered relatively high salaries to graduates of higher education, meant that the motivating factors for work at sea have lost their significance. Additionally, the replacement of generation has begun - the so-called Baby Boomers (born

1946-1964) began to finish their careers at sea and they should be replaced with new generations. Generation X (born 1965-1977) "began to seek a better work / life balance" (Cahoon, Haugstetter, 2008, p. 6). The next generation, Generation Y (1978 - 1994) has definitely different expectations in relation to work - its conditions, expected wages etc. (Grobelna, Marciszewska, 2016b, pp. 95-97). Generation Y are "(...) well educated, creative thinkers, ambitious, impatient, arrogant, disengaged, technologically adept, disrespectful, having an international perspective and demanding a greater work/life balance than previous generations" (Cahoon, Haugstetter, 2008, p. 6). Demanding work at sea, away from the family and the loved ones, is not as attractive to this generation as it was for the previous generations. The so far benefits of this work – an opportunity to travel and learn about other cultures are no longer considered an incentive to take trouble of acquiring education and skills. The growing maritime economy, with constantly emerging new types of economic activities will look for people with experience of work at sea, not only to work on ships. Employees with experience at sea are needed to manage enterprises in the maritime sector. Soon, the traditional maritime sectors as well as Blue Growth will significantly increase demand for highly skilled people to work offshore at the sea-land interface, without having to leave home for a long time.

4. METHODOLOGY AND THE RESEARCH

RESULTS 4.1. The procedure of research

The research was carried out among students of the selected merchant service fields in Polish and Croatian universities. The studied population consisted of students of the Faculty of Marine Engineering at Gdynia Maritime University - GMU (the largest and oldest of the three maritime universities in Poland) and students of the Maritime Department at the University of Dubrovnik – UD (one of the four universities educating seafarers). The survey was the method the Authors selected. The tool was a questionnaire that examined several issues. One of them was the process of choosing studies connected with a job at sea. The results were presented in the paper (Skrzeszewska, Milić Beran, 2016, p. 315). Another issue investigated among students was knowledge of the maritime economy, and particularly the role played by sailors. Students were asked to express an opinion concerning significance of seafarers in the global economy and the national economy. They had an opportunity to justify their choice - give reasons for their opinion.

The aim of this study was to determine the level of students', potential future naval officers, awareness of: (i) a possibility of continuing their career after completion/ cancellation of work at sea, (ii) the importance and prestige of the profession of a sailor. 160 questionnaires for students of GMU and 110 questionnaires for students of UD were prepared. The students of Gdynia Maritime University completed 153 questionnaires (response rate - 95.6%). At the University of Dubrovnik students submitted 106 correctly completed questionnaires (response rate - 96.3%).

4.2. Analysis of the responses

Students were asked to rate (valid/ invalid) importance of seafarers in the global economy and the national economy and to describe strength of their assessment (definitely/ rather). Students of both universities pointed out that work at sea is important for the global economy (98% of answers). However, with regard to the national economy they did not only give a smaller number of responses (95% of the respondents in Croatia, 90% - Poland), which means that some students do not have opinion on this subject, but the responses were more diverse - 24% of Croatian students and 35% of Polish students indicated the lack of importance of maritime labour in the national economies.

Table 3: Importance of the maritime economy for the global/ national economy (own elaboration)

	The importance of the maritime economy for:									
	global economy					national economy				
	definitel y yes	rathe r yes	rathe r no	definitel y not	total	definitel y yes	rathe r yes	rathe r no	definitel y not	total
UD	71	29	2	0	102	52	25	20	4	101
GM	104	41	2	0	147	41	50	47	1	139
Total	175	70	4	0	249	93	75	67	5	240

NB: NUD=106, NGMU=153; *Not all respondents gave answers

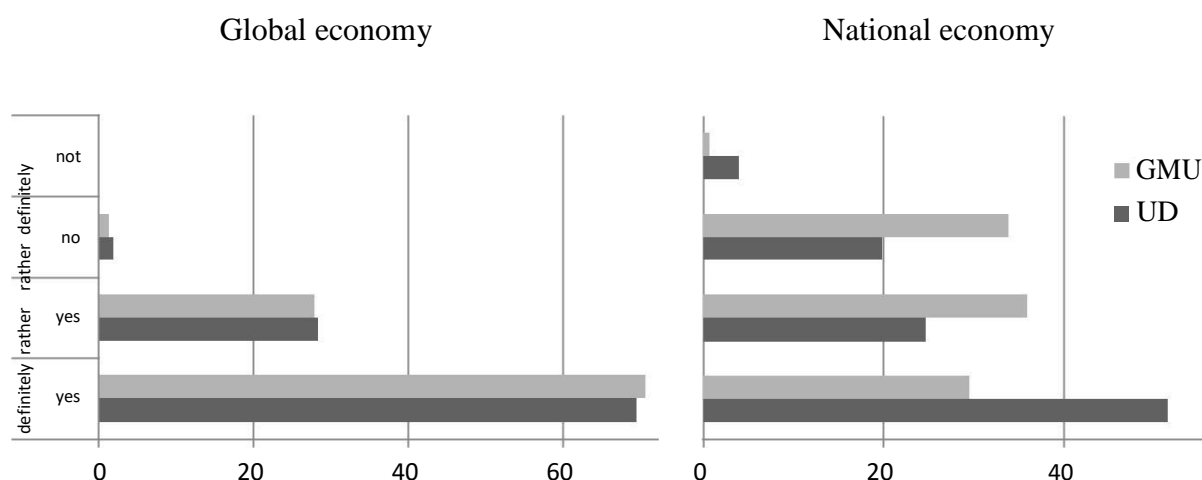


Figure 2: Importance of the maritime economy for the global and national economy from the viewpoint of students of maritime universities / departments [%] (own elaboration)

In view of the above results, we posed two hypotheses:

H1: Ranking the role of seafarers work in the world economy is not significantly different among GMU and UD students.

H2: Ranking the role of seafarers work in the national economy is not significantly different among GMU and UD students.

The chi-square test examined differences in ranking the role of seafarers work in the world economy and the national economy among students in Gdynia Maritime University and the University of Dubrovnik.

To test the hypothesis 1, the chi-square test was used to state whether there is a significant difference in ranking importance of seafarers work in the world economy by students from GMU and UD (test results are shown in Table 4.). The empirical value of 0.152 is less than the size of the chi-square test that the two degrees of freedom and $\alpha = 0.05$ is 5.991 ($p = 0.927$). Despite the above distribution, the chi-square test showed that there is no significant difference in ranking importance of seafarers work in the world economy by students from GMU and UD.

To test the hypothesis 2, the chi-square test was used to examine whether there is a significant difference in ranking importance of seafarers work in the national economy by students from GMU and UD. Test results are shown in the following table (Tab. 5.). The empirical value is

16.717 and it is greater than the size of the chi-square test that the three degrees of freedom and $\alpha = 0.05$ is 7.815, ($p = 0.001$). Therefore, it can be concluded that there is a significant difference among students ranking importance of seafarers work in the national economy by students from GMU and UD.

Table 4: Chi-Square Tests [H1]
(own elaboration)

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	,152 ^a	2	,927
Likelihood Ratio	,150	2	,928
Linear-by-Linear Association	,073	1	,786
N of Valid Cases	249		

Table 5: Chi-Square Tests [H2]
(own elaboration)

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	16,717 ^a	3	,001
Likelihood Ratio	16,881	3	,001
Linear-by-Linear Association	6,808	1	,009
N of Valid Cases	240		

The questionnaire also provided space for justifying respondents' choices. The authors specifically did not prepare any set of potential justifications to find out what the students-who are preparing for this job - know about importance of maritime labour. It is surprising that 24.9% of students from Dubrovnik and 15% from Gdynia could not in any way justify their choice (Tab. 6.).

Table 6: Why work of seafarers plays/ does not play an important role in the world economy (own elaboration)

Indicated reasons	Frequency of response (%)	
	UD	GMU
Maritime transport carries the greater part of goods in comparison to other kinds of transport	52.9	66.6
Shipping creates money	19.6	0.0
Modern equipment technologies used in the maritime economy requires people with high qualifications, experience	2.9	15.0
Seafarers are needed in exploration and exploitation of the seas' and oceans' natural resources	0.0	3.4
Total	75.4	85.0

The answers given by students of both universities could be grouped into four sets:

- (i) maritime transport - the most obvious place of employment of seafarers, allows the movement of cargo on the largest scale (in terms of quantity and value), and thanks to mass production of freight and the economies of scale connected with it, these services are the cheapest.
- (ii) maritime transport generates direct, indirect and induced effects – it contributes to creation of jobs and it is a source of income of individuals and to the budget,
- (iii) the maritime economy is based on advanced technical solutions, the state-of-the-art technology, so it demands appropriately trained and experienced human resources – the maritime economy is a kind of driving force in the innovative development of the global economy,
- (iv) in the seas and oceans there are lots of minerals, the seas and oceans are a source of energy - to use these resources it is necessary to hire people on platforms and in the auxiliary fleet – seafarers with specialised competences.

The respondents, who explained importance of seafarers for the national economy, were able to justify their opinions to a lesser extent (Tab. 7.) - almost 33% of Croatian and 38% of Polish students have not expressed their opinion.

Table 7: Why work of seafarers plays/ does not play an important role in the national economy (own elaboration)

Indicated reasons	Frequency of response (%)	
	UD	GMU
Development of the maritime economy influences the development of the national economy	0.0	25.9
Money spent in the country, taxes paid by seafarers, ship owners	37.6	7.9
Croatia is a maritime country	17.8	0.0
Importance for Polish trade	0.0	10.8
Tourism is based on seafarers work	7.9	0.0
Large number of employees	4.0	0.0
Small fleet/ lack of the fleet	0.0	13.7
Seafarers are employed almost exclusively by foreign ship owners	0.0	3.6
Total	67.3	61.9

Importance of maritime labour for the national economy is far more difficult to justify: students of Croatia as the most important argument pointed out income of seafarers and the state budget (among Poles this argument was on the 4th place). In turn, Polish students as the most important reason for treating sailors' work as important indicated the fact that the maritime industry is a part of the national economy; therefore the development of maritime sectors has a positive effect on the whole economy. It can be assumed that Croatian students had the same thing in mind when they wrote: "Croatia is a maritime country" and "Tourism is based, to a significant extent, on the seafarers work" (25.7% of total responses). Those who thought that work at sea is not important for the national economy, justified their opinion (only GMU students) by saying that Poland does not have (or has a very small) fleet of commercial vessels (students mistakenly identified their own fleet with the fleet registered under the national flag). The second reason was the fact that most of the employed seafarers were hired by foreign shipowners – they did not work in Polish enterprises.

Generally, Croatian students are more aware of the role of sea and maritime economy in the national economy, although Polish students have greater knowledge how to use sea resources. In the face of growing shortages of well-educated seafarers from Western Europe (even in the traditional maritime countries), Poland and Croatia still have young people willing to study at maritime universities/ departments. Yet, they are not fully prepared to pursue this career path, they do not even realise opportunities which are brought by the maritime industry (especially the 5 of "Blue Growth").

5. CONCLUSION

The maritime economy is treated as a resource itself and the environment for many new innovative activities supporting implementation of the Europe 2020 strategy. Development of these activities requires human resources with appropriate qualifications and experience - seafarers or ex-seafarers. The investigated role of maritime activities in the national economies showed that potential of the Croatian maritime economy lies primarily in tourism, whereas much of the future of the Polish maritime economy is seen in intelligent and specialised sectors. This will require highly skilled people, especially technically, who like challenges. Work on the sea-land interface will be interesting for the younger generation, which avoids monotony. It will not require from young people to part with their family and friends for months. Young

people do not see, however, what opportunities it gives them to acquire skills, knowledge and qualifications of merchant officers. While they understand importance of the maritime economy for the world, they do not see it so clearly for their own countries.

Poland and Croatia are currently the countries, which supply the greatest number of the EU seamen. Seafarers are treated (at least in Croatia) as "the best export commodity." In view of the increasingly noticeable lack of officers, particularly in Western Europe, including the traditionally maritime countries, Poland and Croatia should make every effort to use their well-developed research and teaching base to attract young people to the profession of a sailor. The growing new blue sectors will require more and more human resources with experience at sea. Their innovative and pioneering attitude as well as potential to undertake challenges in taming the seas and oceans fit well the expectations of Generation Y towards employers and future jobs. For now, this generation sees the work of a sailor as contribution to value creation in the transport chain - due to overcoming the distance important for the world economy, but less significant for the national economies. So, is it really important to care about education which is halted? As far as the authors are concerned in the days of free movement of people, this is one of the securest ways, in which the money spent on maritime education will pay off and will create an opportunity to gain the competitive advantage in the maritime economy.

LITERATURE:

1. Bhattacharya, Y. (2015). Employee Engagement as a Predictor of Seafarer Retention: A Study among Indian Officers, *The Asia Journal of Shipping and Logistics*, 2015(Vol. 31, No. 2), pp. 295-318.
2. Caesar, L., Cahoons, S., Fei, J. (2013). Breaking the psychological contract and managing expectation: Developing solutions for the shortage of ship officers, *Proceedings of the IAME* (pp. 1-18). Paris: IAME.
3. Cahoon, S., Haugstetter, H. (2008). *Shipping, Shortages and Generation Y*, Retrieved 30.06.2016 from http://www.he-alert.org/filemanager/root/site_assets/standalone_article_pdfs_0605-/he00760.pdf
4. COM(2012). *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Region "Blue Growth. Opportunities for marine and maritime sustainable growth"*, COM(2012) 494 final.
5. Drewry Maritime Research (2014). *Manning 2014. Annual Report*. London: Drewry Shipping Consultants Ltd.
6. EC (2011). *Study on EU seafarers employment* (Final report). MOVE/C1/ 2010/148/SI2.588190.
7. EC (2013). *Study on Blue Growth, Maritime Policy and EU strategy for Baltic Sea Region: Annex 1.8: Country Fiche Poland*. Mare/2012/07.
8. EC (2014). *Studies to support the development of sea basin cooperation in the Mediterranean, Adriatic and Ionian, and Black Sea. Annex 2.6: Country Fiche Croatia*. MARE/2012/07.
9. ECORYS (2012). *Blue Growth. Scenarios and drivers for Sustainable Growth from Oceans, Seas and Coasts* (Third Interim Report). Amsterdam/ Brussels.
10. EUROSTAT. Retrieved 28.06.2016 from <http://ec.europa.eu/eurostat>
11. Grobelna, A., Marciszewska, B. (2016a). Undergraduate students' attitudes towards their future jobs in the tourism sector: challenges facing educators and business. In D. Vasilenko, N. Khazieva (eds.), *Proceedings of the 4th International Conference on Management, Leadership and Governance* (pp. 138-145). Saint Petersburg: ACPI UK.
12. Grobelna, A., Marciszewska, B. (2016b). Work motivation of tourism and hospitality students: implications for human resource management. In C. Bagnoli *et al* (eds.), *Proceedings of the 8th European Conference on Intellectual Capital* (pp. 95-103). Venice: ACPI Ltd. UK.

13. KIS priorytetem polskiej gospodarki morskiej. (2015). Retrieved 05.07.2016 from <http://oficynamorska.pl/2015/kis-priorytetem-polskiej-gospodarki-morskiej/>
14. Kizielewicz, J. (2015). Ethical Standards for Regional Authorities in the Creation of Strategy for Regional Development. In J. C. Lieutenant-Colonel, R. Dias (eds.), *Proceedings of the 11th European Conference on Management Leadership and Governance* (pp.186–193). Lisbon: ACPI Ltd. UK.
15. Kizielewicz, J. (2016). Environmental Governance for Sustainable Cruise Tourism Development by Territorial Authorities and Cruise Ship Owners. In D. Vasilenko, N. Khazieva (eds.), *Proceedings of the 4th International Conference on Management, Leadership and Governance* (pp. 193-201). Saint Petersburg: ACPI Ltd. UK.
16. KOM(2010). *EUROPA 2020. Strategia na rzecz inteligentnego i zrównoważonego rozwoju sprzyjającego włączeniu społecznemu*, KOM(2010) 2020 final.
17. Marinov, E., Maglić L., Bukša, J. (2015). Market competitiveness of Croatian seafarers. *Multidisciplinary Scientific Journal of Maritime Research*, 2015(29), pp.64-66.
18. Marynarska wizja. (2014). *Namiary na Morza i Handel* 2014(02).
19. McCallum, J. (2005). It's all about me. In *the Black*, 2005(June), pp. 28-31 referenced by Cahoon S., Haugstetter H. (2008).
20. Nguyen, T.T. *et al* (2014). Current challenges in the recruitment and retention of seafarers: An industry perspective from Vietnam. *Asia Jour. of Shipping & Logist.*, 2014(Vol. 30), pp. 217-242.
21. Øgaard, T. (2006). Do organizational practices matter for hotel industry employees' jobs? A study of organizational practice. *International Journal of Hospitality Management*, 2006(Vol. 25, No.4), pp. 647–661 referenced by Grobelna, Marciszewska (2016a).
22. Progulaki, M., Theotokas, I. (2010). Human resources management and competitive advantage: An application of resource-based view in the shipping industry. *Marine Policy*, 2010(vol. 34, No. 3), pp.162-175.
23. Roczniak statystyczny gospodarki morskiej. (2015). Retrieved 28.06.2016 from <http://stat.gov.pl/obszary-tematyczne/roczniki-statystyczne/roczniki-statystyczne/rocznik-statystyczny-gospodarki-morskiej-2015,11,8.html>.
24. Ships, Slaves and Competition (ICONS). (2000). Charleston NSW: ICS.
25. Skrzyszewska, K. (2015). Assessment of the Activity to Stop a Decline in the Number of Seafarers in the EU - the Case of Poland. In *Innovation, Leadership & Entrepreneurship Challenges of Modern Economy* (pp.973-988). Dubrovnik: University of Dubrovnik.
26. Skrzyszewska, K., Milić Beran, I. (2016). Maritime Governance – Differences Between Assumptions and Realizations In D. Vasilenko, N. Khazieva (eds.), *Proceedings of the 4th International Conference on Management, Leadership and Governance* (pp. 312 - 320). Saint Petersburg: ACPI Ltd. UK.
27. Statistički Ljetopis Republike Hrvatske. (2015). Retrieved 28.06.2016 from http://www.dzs.hr/Hrv/Publication/stat_year.htm
28. Zorovic, M. (2013). *Assessment of Croatian manpower – what can they offer ? Featured analysis of Croatia as a major European manpower supplier*. Retrieved 10.07.2016 from http://www.zorovic.hr/data/public/documents/manning_training_dubrovnik_2013_mario_zorovic.pdf

THE RELATIONSHIP OF THE MINIMUM WAGE AND UNEMPLOYMENT IN THE SLOVAK REPUBLIC

Peter Sika

*University of Economics in Bratislava, Faculty of National Economy, Department of Social
Development and Labour
peter.sika@euba.sk*

ABSTRACT

Minimum wage raises debate and controversy since its introduction. Proponents reported its justification in particular related to the task of ensuring income to workers, which guarantees them their basic needs. Opponents argue the impacts of rising unemployment. Legislative and institutional setting of the lower limit for wages in the economy does not allow the wages of certain employees to decline to the level of equilibrium wages in the event of adverse economic activity, which may cause barriers in employing particular risk groups in the labor market. The modification of the minimum wage is a serious problem, since it represents the fundamental elements of the macroeconomic and macro-regulation in the country, the impact on the revenue policy, price policy, pension policy, as well as their own employees and employers and other groups. The aim of this paper is to examine the correlation between the increase in the minimum wage and the unemployment rate in the Slovak Republic with a focus on specific groups in the labor market and regional differentiation. Our contribution contains a justification of the existence and function of the minimum with a proposal for its modification, while it also focuses on the future shape of minimum wages in Slovakia within the changed socio-economic conditions. Consumption and investments are the driving force of the economy but the investment is to some extent driven by the anticipated consumption. Only household consumption accounted for a significant upward impetus to the Slovak economy, which would not be possible without increasing the employment and wage growth.

Keywords: *Minimum wage, Unemployment, Regional differentiation.*

1. INTRODUCTION

One of the tools the governments are using to prevent workers for being compensated by low salary is the institute of minimum salary. The justness and amount of minimum salary is becoming more and more often the subject of various political conflicts. From the researchers point of view minimum salary is the subject of research especially in terms of its existence and effect on employment in the country. It is necessary to understand that this is a very sensitive topic, since on one hand it affects endangered social groups, who will apply themselves in the labor market, however their long-term applicability is very uncertain and at the same time it is related to costs for the work force from the employers 'point of view in the context of the productivity of their work.

The goal of regulating the minimum salary level is to protect the workers from very low compensation of their work and insufficient securing of basic living needs. Is the regulation of the labor market by the means of interference with the salary development actually desired?

Would the actual unemployment rate be high if there wouldn't be any minimum salary? We will try to answer these questions in this paper.

2. MINIMUM SALARY AND ITS FUNCTIONS

The minimum salary history began in New Zealand, when it was introduced in 1894 for the first time. Subsequently in the 20th century it spread to European countries and to the American continent. Currently we can state that minimum salary exists in certain forms in many countries of the world and meets set goals, which include especially the reduction of income poverty. But

the advent of neoliberalism more than 30 years ago came with the thesis that “minimum salary destroys jobs“, which led not only to weakening of minimum salaries, but it also drastically worsened the salary development all around the world (Ondruš, 2015, p. 3).

The minimum salary in Slovakia is regulated by the Law No. 663/2007 Coll. on Minimum Salary. This law regulates the provision of minimum salary to an employed employee or in similar working relationship to ensure minimum level of income for an employee carrying out work. The valorization of minimum salary takes place at the social partners level. In case there is no agreement about minimum salary, then the directive method of government will make the decision.

Table 1: Regimes of minimum salary in the European Union countries (Schulten, 2014)

Regime of minimum salary	Law	Collective or tripartite negotiation
<i>Universal</i> (uniform national lower level of salaries)	FR, LU, NL, IE, UK, HR, LT, LV, RO, SI, CZ, HU, GR, MT, PT, ES	BE, DE, BG, EE, PL, SK
<i>Sectorial</i> (lower level of salaries set specifically for sectors or job groups)	CY	DK, FI, SE, AT, IT

Note: * if there is no agreement on the tripartite level, the minimum salary will be set by the legislator

In order to maintain the originally set level of minimum salary, it is necessary to increase the value based on criteria set in advance. Australia and New Zealand began with the indexation of minimum salary simultaneously in 1914. The European countries have a differentiated process of increasing the value of minimum salary. Schulten (2014) distinguishes the following models of increasing the value of minimum wage.

Table 2: Models for adjusting minimum salary (Schulten, 2014)

Automatic indexation	Collective negotiation	Consultations	Unilateral decision of the government
FR, BE, NL, LU, MT, SI	BG, DE, EE, PL, SK, supplemental for BE	UK, PT, ES, HU, HR, LT, LV, supplemental for FR, LU, NL, SI	GR, IE, RO, CZ

Indexation of minimum salary in the European Union countries depends mainly from the development of consumer prices in the country, since this development considers the purchasing power of the income of employees. Other criteria include the development of average salary in the economy. This criterion considers also the development of the employer's capacity to pay. In a situation of economic prosperity (low inflation, growth of economy and salaries) this indexation allows low-skilled workers to participate in the benefits of economic prosperity in the country as well. Last but not least, the indexation depends also on the productivity of work, employment and also from minimum income, as well as political decision.

From 1.1.2016 the minimum wage in Slovakia is set by the government regulation as 405 € for one month for an employee compensated with a monthly salary, or 2.328 € for each hour worked by the employee.

Table 3: Overview of the development of gross minimum income and average nominal salary in the Slovak Republic

Year	Minimum salary (MS)		Average nominal monthly salary (AS) in €	Kaitz index (MS/AS) in %
	€/month	valid from		
1993	81.33	01.10.1993	178.55	45.55
1995	81.33	01.01.1995	238.83	34.05
2000	146.05	01.10.2000	379.41	38.49
2005	229.04	01.10.2005	573.39	39.94
2010	307.70	01.01.2010	769.00	40.01
2011	317.00	01.01.2011	786.00	40.33
2012	327.20	01.01.2012	805.00	40.65
2013	337.70	01.01.2013	824.00	40.98
2014	352.00	01.01.2014	858.00	41.03
2015	380.00	01.01.2015	883.00	43.04
2016	405.00	01.01.2016	-	-

Slovak minimum salary is affecting a relatively small number of employees. According to the data of the Trexima, s.r.o. Company, the share of employees working for minimum salary is only 1.52% (Trexima, 2015). If we take the 5% interval around the legally established level of minimum salary we can state, that in Slovakia there are about 7% of employees with a standard work contract for gross salary, which is very close to minimum salary. Minimum salary is earned more frequently by employees younger than 24 years, since they do not have sufficient practical experience. The highest share of employees receiving minimum salary is in the service sector, especially in the field of accommodation and catering services, administrative services and also in trade and construction. The differential can be seen also from a regional perspective, where as many as 9% of workers in the Prešov region receives an income at the level of minimum salary.

According to OECD in developed economies the share of minimum salary on average salary is in the interval from 27% to 51% and on median salary from 37% to 68%. However it is significantly higher in the underdeveloped regions of Slovakia, where e.g. in the Prešov region it reaches 66% (IFP, 2016, p. 3).

Minimum salary should according to M. Barošová (1999) in general fulfill the economic and social-protective function:

The economic function consists is based on the fact that minimum salary is essentially (Barošová, 7-8/1999):

- legally secured lowest reward for work,
- lower limit for salary differentiation,
- salary basis determining the low level of direct labor costs,
- protection against the possibility of economic damping.

Social-protective function consists in:

- it is socially guaranteed lowest reward for work, which covers needs,
- prevents "squeezing" of the level of salaries below the limit of reproductive costs of the work force,
- protects against unemployment and insolvency.

For the minimum salary to fulfill the protective function, its amount must be set at the optimum level, which is around the level of minimum salary determined by the labor market, which is not deformed. This labor market cannot be a local market with a monopoly employer or a market dominated by unfair salary competition. Minimum salary set like this is salary, for which

low-skilled workers are willing to work and also employers are willing to pay. The willingness of an employee to work for minimum salary depends on living costs as well as from how the social system in the country is set. The price of the work, for which the employer is willing to pay is determined especially by productivity of the worker and profitability. So in an undistorted market environment the setting of minimum salary by the law would not even be necessary, since the market would not allow the setting of a lower market than the market minimum salary. However in each economy there are sectors, or groups of people, where setting a legal minimum salary always makes sense.

Minimum salary set lower than set by the market itself ceases to fulfill protective function, which has a negative effect on the living standard of the employees. An employer, who has a strong dominant position at the labor market, can afford to pay lower salary than is beneficial to him. In case of the opposite situation, where the minimum salary is set higher than set by the market, a situation can happen, which leads to negative effect on the economy, even to squeezing out mainly low-skilled work force from the labor market, or its substitution for a more productive work force with higher skill level.

Fulfilling the protective function of the minimum salary and decrease of poverty in a country has to be considered a priority when increasing minimum salary in Slovakia. The results of several studies prove that the number of people in so-called “new poverty” increased in Slovakia during the last 10 years. It is poverty, in which despite the fact that the person is working, he or she is not capable to get his or her family out of poverty despite his or her salary.

Current calculation shows that under today’s minimum salary, it is really not worth working for minimum salary for some adults (parents), because even when compliant with the allowed working time, it is simply not possible, even theoretically, to get themselves, or their families, out of danger of poverty. The analytical center of the Ministry of Labor, Social Affairs and Family of the Slovak Republic carried out a calculation in 2015, the results of which are contained in the following table. It proves that e.g. a household with one (working) adult and two children is the victim of today’s low level of minimum salary and in addition to income from minimum salary it is dependent on further state aid in the form of social benefits, in order to get above the poverty risk line in terms of income. The subsistence minimum for such family is 517.12 €/month and the poverty risk line is (EU SILC, 2014) 715 €. However income of this type of family reaches only 428.95 € and this sum already contains two items, which represent the form of social income from the state - tax credit and child benefit. A solution isn’t even when one parent is working for minimum salary and the other (unemployed) participates on smaller community services, where the “reward” for this is not even a salary, but a state benefit. (Ondruš, 2015, p. 23)

Table 4: Model calculations of total income of a family (Analytical center MLSAF SR, 2015)

Income/Type of family	1 for MS and 2. unemployed	1 for MS and 2. Community service
Work income (net)	339.09	339.09
Tax benefit	42.82	42.82
Child benefit	47.04	47.04
Income total	428.95	428.95
Material needs benefits and allowances	92.75	155.82
Total income ¹	521.70	584.77

Notes:

* 1. type of family: 2 parents + 2 children, 1 parent employed for MS

2. type of family: 2 parents + 2 children, 1 parent employed for MS, 2. Parent works community

service ¹ Income from work increased by all claims on social benefits

3. EFFECT OF MINIMUM SALARY ON UNEMPLOYMENT IN TERMS OF THEORY AND EMPIRICAL LITERATURE

In terms of economic theory the most used model depicting the effect of minimum salary on unemployment seems to be the classic competitive model. The basis of the model is the rising job offer curve on part of employees and decreasing demand for work on part of employers. In case of minimum salary regulated by legislation, which is set above the natural salary level, there is an increase job offer on part of employees, however there is also decrease of demand on part of employers, which is justified by increasing salary costs. Minimum salary regulated in this way causes decrease of employment, which can be also reflected in increase of unemployment, if other factors don't begin to act, which affect the creation of jobs.

Conclusions of the classical model are indirectly confirmed also by the Neokeynesian theory of salary rigidity (Mankiw, 2010). It states that in times of recession, when actual salaries should decline, there is a blocking of functionality of the price mechanism (e.g. though collective contracts, decreasing salaries and also by union pressure) in the labor market, which prevents decrease of salaries. This causes increase of involuntary employment until the time when actual salaries don't drop to the level demanded by the market (whether by decreasing the nominal salary or its depreciation by inflation). If we apply this theory to minimum salary, based on the theory of rigidity of salaries it must also cause involuntary unemployment, since thanks to the administrative barrier it is not possible to legally pay lower salary, not even in case of negative development in the labor market (Dinga, Ďurana, 2013, p. 8).

Many studies on reciprocity between the minimum salary and employment, almost up to the mid 1990's supported the idea of undesired effect between the salary regulation and employment. The turning point came in the research of the economists, David Card and Alan Krueger, who argued that evidence linking minimum salary and job losses are weak. And what is more important, they offered new analyses proving that minimum salary, at the levels in USA, does not have a negative effect on employment, it can even increase it.

The research of Barry Hirsch, Bruce Kaufman and Tatiana Zelenska (2011) came to the conclusion that the increase of minimum salary had major effect on increasing the income situation, but no negative effect on employment.

Except the impact of minimum salary on employment, Zavodny (2000) in her thesis also explored working hours of teenagers. In her research she's using two forms of minimum salary as the explanatory variable: actual minimum salary is specified as minimum salary tied to the index of expenses for personal consumption; relative minimum salary is the share of minimum salary on average salary. The author came to conclusions that minimum salary reduced employment of teenagers; in relative for its change didn't have statistically major effect on employment. In impact on length of working time the author discovered a slight increase in working hours, however in relative form its increase didn't effect the working time.

Neumark and Waschera (2007) came to the conclusion that a 10% growth of minimum salary causes decrease of teenager unemployment of 1 - 3%. They also discovered that increase of minimum salary causes teenagers to leave the work force, since the effect on unemployment was significantly lower for the majority than on employment.

The impact of major increase of minimum salary during 1999 - 2002 on employment in Slovakia and the Czech Republic was examined by Eriksson and Pytlíková (2004). The results of their study point to certain, albeit not major, losses of jobs.

Examined studies do not show a clear view of impact of minimum salary on employment level, in some cases they even discover a positive effect (Card and Krueger, 1994; Dolado et al., 1996; Schmitt, 2013). In case of existence of a negative impact, it is related especially to low-skilled work force and youth (Dolado et al. 1996; Abowd et al. 1999; Currie and Fallick, 1996; Neumark and Wascher, 2007), who do not have almost any work experience.

No or modest impact of the effect of minimum salary on employment is probably caused also by the fact that the majority of entrepreneurs prepare themselves for this adjustment of the minimum salary level, since the valorization of minimum salary takes place sufficiently long enough before its effect. The elimination of economic impacts takes place especially by the means of adjusting their entrepreneurial margin, reducing salaries of other employees, reducing social benefits, and last but not least also including increased salary expenses in prices of goods and services.

OECD emphasizes that “empirical studies prove that suitable increase of minimum salary does not lead to wane of jobs and on the other hand state that it can increase the productivity of work of employees“. While the majority of studies focus on short-term impact of increase of minimum salary on employment, discoveries about long-term effect prove that the direction of changes in employment is not decisive (OECD Employment Outlook, 2015, p. 47). OECD Employment Outlook 2015 provides also more details on impact of minimum salary in developing economies (which include also the Slovak one). Empirical findings prove that in general, increases of minimum salary have no impact, or only a very small negative impact on employment in these economies (OECD Employment Outlook, 2015, p. 47). (Ondruš, 2015, p. 39).

*Table 5: The effect of minimum wages on employment: What meta-analyses show
(OECD Employment Outlook, 2015, p. 47)*

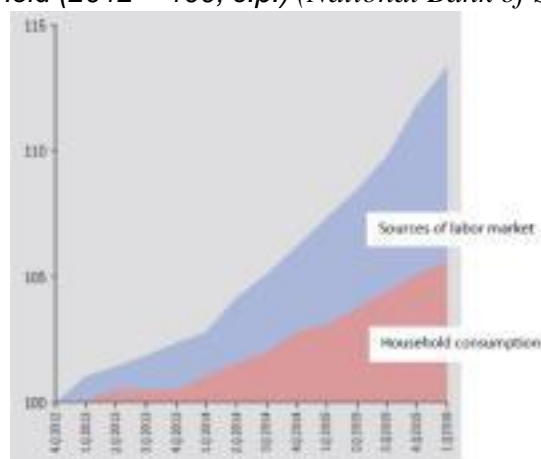
Study	Number of studies covered	Country coverage	Impact on employment	Impact on youth employment
Doucouliaos and Stanley (2008)	64	United States	Little or no impact	Negative, but small
Boockmann (2010)	55	15 industrial countries	Negative, but varies across countries	
Nataraj et al. (2014)	17	15 low-income countries	Ambiguous	
Leonard, Stanley and Doucouliaos (2014)	16	United Kingdom	No impact	
Belman and Wolfson (2014)	23	Mostly United States	Small negative impact	
Chletsos and Giotis (2015)	77	18 developed and developing countries	No impact	More negative, but not always significant
Broecke, Forti and Vandeweyer (forthcoming)	74	10 major emerging economies	Little or no impact	More negative, but still very small

4. WHAT'S THE EFFECT IN THE SLOVAK REPUBLIC?

Minimum salary is not only fulfilling a social function, but it is significant also in maintaining economic growth. Low salaries dampen consumption and thus economic growth. Especially when we look on the structure of consumption of Slovak households, according to which the majority of expenses (30%) goes to housing. Since the current housing policy shifted the responsibility of satisfying the accommodation need to individuals under non-existence of a rental market. Households are less willing to move for work, because if the household is burdened by a loan, it is not capable to pay its commitment to the creditor (Vidová, 2015, p. 37, 159). Increase of salaries causes demand for goods and services, which ensures economic

growth, since especially low-income families use almost all of their income for immediate consumption. Based on the report on economy of the Slovak Republic from June 2016 published by the National Bank of Slovakia we can state that private consumption grew by 0.6% quarter on quarter (similarly like towards the end of last year). It has been oscillating around this dynamic for the past 1.5 years. Thus far households haven't accelerated the growth rate of consumption, although resources from the labor market have been creating significant space for it for longer time.

Chart 1: Cumulative growth of resources from the labor market and consumption household (2012 = 100, c.p.) (National Bank of Slovakia, 2016, p. 8)



2016 also sees continuing growth of employment, even though it slowed down in the private sector when compared to last year. The number of employees in the Slovak Republic has been growing significantly for several consecutive years. Employment growth is aided by economic growth, which reached the level of 3.4%.

*Table 6: The number of employees in the Slovak Republic in thousands of people
(Statistical Office of the SR, 2016)*

	2012	2013	2014	2015
Number of employees	1 968.9	1 967.1	1 999.3	2 056.6

Previous data show positive development of employment in general. Increase of minimum salary in Slovakia did not prevent increase of the number of workers in the Slovak Republic. Neither the sectorial view allows to find decisive proof about the fact that increasing minimum salary leads to liquidation of job. According to the data from the Information system about price of work, managed by the Trexima Company, sectors with the highest share of workers (employees) working for minimum wage are administrative and support services (10.29%), accommodation and catering services (9.81%), professional, scientific and technical activities (4.24%), construction (3.85%), wholesale and retail (3.36%). We have determined a negative trend in the number of workers in these sectors only in construction (decrease by 7%) and accommodation and catering services (decrease by 5.7%). In our opinion the decrease of employment in construction is not directly related to the level of minimum salary, but it is dependent on the number of orders the constructions companies receive. Another proof is that in the first quarter of 2016 construction has been growing for the third consecutive quarter after a longer post-crisis period of decline, respectively stagnation.

Development of unemployment in the Slovak Republic can also be added to the arguments, since it clearly shows decreasing tendency despite the fact that there is increase of minimum

salary. The unemployment rate decreased also in the first quarter of 2016, when compared to the end of the year it decreased by 0.3 percentage point to 10.2%.

It is apparent that increase of minimum salary has in Slovakia a statistically small negative effect on employment. Increase of minimum salary by 5% means increase of risk of being unemployed on average by 1% compared to all employees with earnings above the level of the new minimum salary in the following year (IFP, 2016, p. 8).

5. PROPOSAL TO ADJUST MINIMUM SALARY IN THE SLOVAK REPUBLIC

There has been a discussion in Slovakia for several years about adjusting the mechanism of valorization of minimum salary. In long-term the current system is unsustainable, since it does not consider regional or sectorial disparities, and it is not linked with the situation in the labor market. While according to the Statistical Office of the Slovak Republic the average salary in the Bratislava region is 1 140 €, then in the Prešov region it is only 653 €. Currently following changes can be implemented: introduce regional or departmental minimum salary, or completely abolish minimum salary.

Regional minimum salary (pros and cons):

- Would require the definition of the term “region“. In the territory of the Slovak republic, a region could be considered a self-governing region, counties or other geographically-economic groupings,
- Could introduce better job possibilities to the less developed regions of Slovakia,
- Could attract new investors to regions,
- Would increase flexibility of employers when determining salary,
- Would be valued based on the unemployment rate in given region, or based on the development of the regional gross domestic product,
- Would require increased control on part of the Labor Inspectorate to avoid differences between work performed according to the contract and actually performed work,
- Could deepen economic differences between individual regions,
- Could significantly encourage mobility of the work force, not only domestic, but foreign as well,
- Would cause increase of costs of the social system,
- Would require increase of administrative-financial burden.

Sectorial minimum salary (pros and cons):

- Would require a higher level of including employees in collective negotiations,
- Would balance salary conditions in companies within a sector,
- Could cause issues with size of companies operating in the same sector,
- Could cause decrease of investments in innovation,
- Would not cause increase migration for work as regional minimum salary.

Abolition of minimum salary (pros and cons):

- Would not be suitable is the Slovak labor market is unstable, which could be misused by some companies,
- Would not be presently applicable in Slovak legislation, since we are bound by international legislation, which is superior to our legislation.

6. CONSLUSION

Research conducted thus far about the effect of minimum salary on employment did not come to clear results confirming the negative effect of increasing minimum salary in the context of employment. If this effect was confirmed in the negative sense, it was usually in specific

categories of employees and low-income employees. It is necessary to state also the fact the research also came to positive effect, which is reflected especially in increasing living standards and decreasing poverty of the workers.

However it is true that such quick increase of minimum salary, currently underway in Slovakia will not be possible without impact on the economic potential of individual regions. Because of this reason it will be necessary to look for a new model of valorizing minimum salary, for which several scientific studies will have to be carried out, which will focus their attention on the pros and cons of these models, so they wouldn't affect employment negatively.

ACKNOWLEDGEMENT: *The paper is the solution of the research project VEGA 1/0002/16 Socio-economic aspects of housing policy in the context of migration workforce.*

LITERATURE:

1. Abowd, J. M., Kramazar, F., Margolis D. N. (1999). *Minimum Wages and Employment in France and the United States*. (Working Paper 6996). USA: National Bureau of Economic Research. Retrieved from <http://www.nber.org/papers/w6996>.
2. Barošová, M. (1999). *Východiská a funkcie minimálnej mzdy a prístupy k jej valorizácii*. Bratislava : Výskumný ústav práce, sociálnych vecí a rodiny, 1999.
3. Barošová, M. (1999). Funkcie minimálnej mzdy a prístupy k valorizácii. In. Výskumný ústav práce, sociálnych vecí a rodiny, *Práca a sociálna politika* (7-8). Bratislava: Ministerstvo práce, sociálnych vecí a rodiny SR. ISSN 1210-5643.
4. Card, D., Krueger, A. B. (1994). *Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania*. USA: American Economic Review. Retrieved from <http://www.nber.org/papers/w4509>.
5. Currie, J., Fallick, B. C. (1996). The Minimum Wage and the Employment of Youth Evidence from the NLSY. In. University of Wisconsin Press, *The Journal of Human Resources*, Vol. 31, No. 2 (Spring, 1996), pp. 404-428.
6. Dinga, J., Ďurana, R. (2013). *Minimálna mzda – účinný nástroj na zvyšovanie nezamestnanosti*. Bratislava: INESS. Retrieved from http://www.iness.sk/media/file/pdf/publikacie/Minimalna%20mzda_Final.pdf.
7. Dolado, J., Kramarz, F., Machin, S., Manning, A., Margolis, D., Teulings, C., Saint-Paul, G., Keen, M. (1996). *The Economic Impact of Minimum Wages in Europe*. In. *Economic Policy*, Vol. 11, No. 23 (Oct., 1996), pp. 317-372.
8. Eriksson, T., Pytliková, M. (2004). *Firm-level Consequences of Large Minimum-wage Increases in the Czech and Slovak Republics*. Labour, Vol. 18, No. 1, pp. 75-103, March 2004. Retrieved from <http://ssrn.com/abstract=516146>.
9. Hidas, S., Žúdel, B. (2016). *Malý vplyv zvyšovania minimálnej mzdy na nezamestnanosť*. (Ekonomická analýza 34). Bratislava: Inštitút finančnej politiky. Retrieved 10.07.2016 from <http://www.finance.gov.sk/Default.aspx?CatID=10571>.
10. Hirsch, B., Kaufman, B. E., Zelenska, T. (2011). *Minimum Wages Channels of Adjustment*. (IZA Discussion Paper No. 6132), Bonn: Institute for the Study of Labor. Retrieved from <http://ftp.iza.org/dp6132.pdf>.
11. Mankiw, N. G. (2010). *Macroeconomics* (7th edition). New York: Worth Publishers. ISBN: 978-1429218878.

12. Národná banka Slovenska (2016). *Správa o ekonomike SR*. Bratislava: Národná banka Slovenska. ISSN 1339-9608 (elektronická verzia). Retrieved from http://www.nbs.sk/_img/Documents/_Publikacie/SESR/2016/protected/SESR_0616sk.pdf.
13. Neumar, D., Wascher, W. (2007). *Minimum Wages and Employment*. (IZA Discussion Paper No. 2570), Bonn: Institute for the Study of Labor. Retrieved from <http://ftp.iza.org/dp2570.pdf>.
14. OECD (2015). *OECD Employment Outlook 2015*. Paris: OECD Publishing. ISBN 9789264239531. Retrieved from http://dx.doi.org/10.1787/empl_outlook-2015-en.
15. Ondruš, B. (2015). *Minimálna mzda - empirické zistenia kontra ideologické mýty*. Bratislava: Ministerstvo práce, sociálnych vecí a rodiny Slovenskej republiky. Retrieved from <https://www.employment.gov.sk/files/slovensky/uvod/informacie-media/aktuality/analyza-mm.pdf>.
16. Schmitt, J. (2013). *Why does the Minimum Wage Have No Discernible Effect on Employment?* (Working paper), Washington: Centre for Economic and Policy Research. Retrieved from <http://cepr.net/documents/publications/min-wage-2013-02.pdf>.
17. Schulten, T. (2014). *Minimum Wage Regimes in Europe ... and What Germany Can Learn from Them*. (FES Working Paper), Berlin: FriedrichEbert-Stiftung, ISBN 978-3-86498-806-6. Retrieved from <http://library.fes.de/pdf-files/id-moe/10558.pdf>.
18. Trexima Bratislava, spol. s r.o. (2015). *Informačný systém o priemerných zárobkoch, Štatistické ukazovatele zárobkov a miezd na Slovensku*. Bratislava: Trexima Bratislava, spol. s r.o.
19. Vidová, J. (2015). *Investičné procesy a ich vplyv na investície do bývania*. Bratislava: Vydavateľstvo EKONÓM. 182 s. ISBN 978-80-225-4090-2.
20. Zavodny, M. (2000). *The Effect of the minimum wage on employment and hours*. Labour Economics, No. 7 (2000), pp. 729-750. Retrieved from http://ecademy.agnesscott.edu/~mzavodny/documents/LabourEconomics_minwage_000.pdf.
21. Zákon NR SR č. 663/2007 Z. z. o minimálnej mzde v znení neskorších predpisov.
22. www.slovak.statistics.sk

DETERMINANTS OF EFFECTIVE TAX RATE

Luka Mladineo

*The University Department of Professional Studies, Split, Croatia
lmladine@oss.unist.hr*

Toni Susak

*The University Department of Professional Studies, Split, Croatia
tsusak@oss.unist.hr*

ABSTRACT

Taxes are wide spread phenomenon which affects every aspect of life. Almost every person (regardless of their legal designation – natural or legal) has to pay different types of taxes depending on activity that is involved in. In world of business, taxes and how companies handle them is one of the crucial factors of their success. It is important to apply knowledge about taxation so that company can pay optimal amount of taxes or in other words, minimal amount of taxes in certain situation. In this paper, focus will be directed at corporate income tax which companies have to pay if they report profits for the current year in their financial statements. Corporate income tax is one of the traditional tax revenues of the state and for companies is perhaps the biggest direct tax liability. Amount of corporate taxes paid can also be reduced (or even increased) by indirect effect through reported income because accounting standards are relatively flexible and they establish a framework within which companies can operate and choose their accounting policy. The aim of this paper is to statistically analyse determinants of effective tax rates (ETR) for corporate tax because corporate taxes are paid at same rate but ETR can differ significantly due to tax exemptions prescribed by tax laws. Sample was formed using companies listed on stock exchanges.

Keywords: *Determinants, Effective tax rate, Corporate income tax, Croatia, Slovenia.*

1. INTRODUCTION – CORPORATE INCOME TAX IN EUROPEAN COUNTRIES

Corporate income tax, one of the most important direct taxes with personal income tax, is of high importance for a company. Therefore, companies have to successfully manage their profit tax. Corporate income tax rate of 20% in Republic of Croatia has not changed since 2001. It is 0,48 p.p. lower than average value in European countries, 2,9 p.p. lower than average value in European union countries and 3,63 p.p. lower than average global value.

Table following on the next page

Table 1. Corporate tax table for selected European countries

Location	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Austria	25	25	25	25	25	25	25	25	25	25	25
Bosnia and Herzegovina	10	10	10	10	10	10	10	10	10	10	10
Bulgaria	15	10	10	10	10	10	10	10	10	10	10
Croatia	20	20	20	20	20	20	20	20	20	20	20
Czech Republic	24	24	21	20	19	19	19	19	19	19	19
Greece	29	25	25	25	24	20	20	26	26	29	29
Hungary	16	16	16	16	19	19	19	19	19	19	19
Macedonia	15	12	10	10	10	10	10	10	10	10	
Montenegro	9	9	9	9	9	9	9	9	9	9	9
Poland	19	19	19	19	19	19	19	19	19	19	19
Romania	16	16	16	16	16	16	16	16	16	16	16
Serbia	10	10	10	10	10	10	10	15	15	15	15
Slovakia	19	19	19	19	19	19	19	23	22	22	22
Slovenia	25	23	22	21	20	20	18	17	17	17	17
Europe average	23.7	22.99	21.95	21.64	21.46	20.81	20.42	20.6	19.68	20.12	20.48
EU average	24.83	23.97	23.17	23.1	22.93	22.7	22.51	22.75	21.34	22.25	22.9
Global average	27.5	26.95	26.1	25.38	24.69	24.5	24.4	23.71	23.64	23.87	23.63

Source: KPMG Official website. *Corporate tax rates table*, available at:

<https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html>

When analysing corporate tax rates of countries from Central – East Europe from 2006. to 2016., corporate tax rate in Croatia, as previously mentioned, didn't change over time and it is 20%. Same situation is in Austria with tax rate of 25%, Poland with tax rate of 19%, Bosnia and Herzegovina with tax rate of 10% and in Montenegro with tax rate of 9%. Slovenia lowered it's corporate tax rate over this period (from 25% in 2006. to 17% in 2016.) as well as Czech Republic (from 24% in 2006. to 19% in 2016.) and Macedonia (from 15% in 2006. to 10% in 2016.), while Slovakia increased corporate tax rate (from 19% in 2006. to 22% in 2016.) just like Hungary (from 16% in 2006. to 19% in 2016.) and Serbia (from 10% in 2006. to 15% in 2016.). Greece experienced volatility of corporate tax rate similar to volatility which this country faced regarding economic situation (lowered it's corporate tax rate from 29% in 2006. to 20% in 2012. and then increased it again to 29% in 2016.).

Figure following on the next page

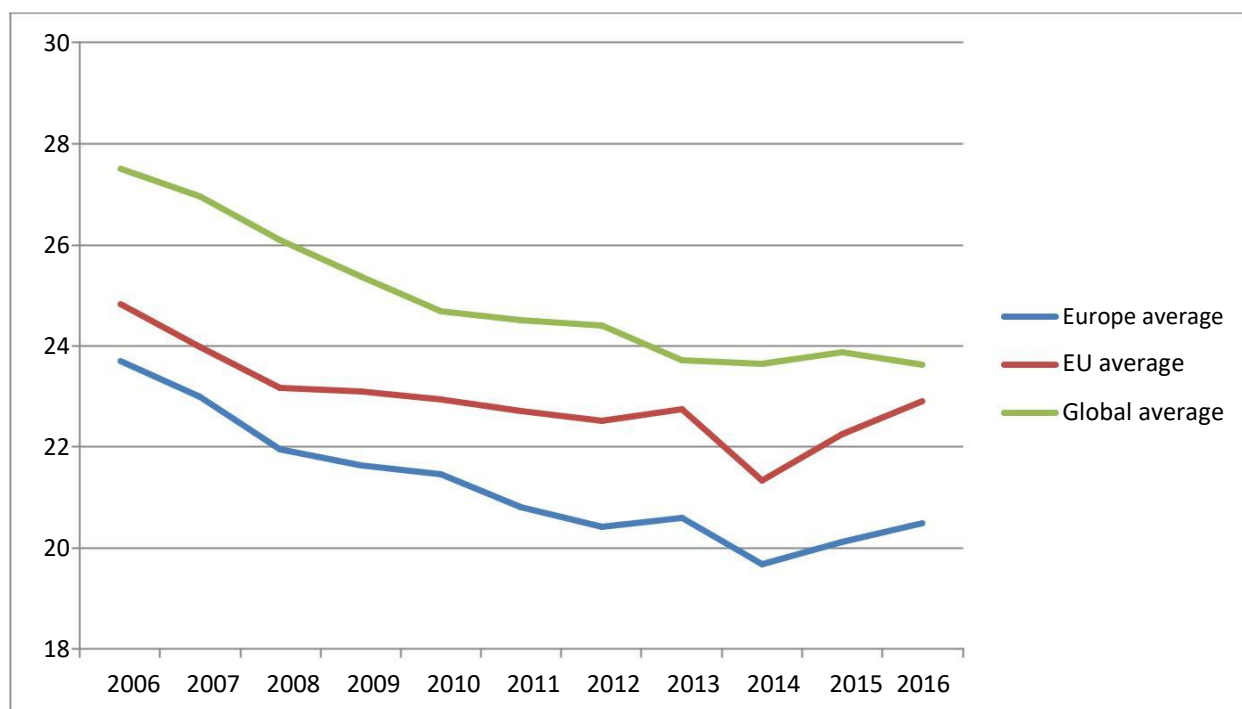


Figure 1. Longitudinal average tax rates in Europe, European union and worldwide

Source: KPMG Official website. Corporate tax rates for 2013-2016, available at: <https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online.html>

Taxpayers are companies or another legal or natural persons that reside in the Republic of Croatia, which are permanently and independently engaged in an economic activity for the purpose of deriving a profit, an income or a revenue or other assessable economic benefits. Tax base of corporate income tax are profits determined according to the accounting regulations as the difference between revenues and expenditures before the profit tax assessment, increased and reduced in accordance with the provisions of the *Profit Tax Law*. In the tax revenue structure, corporate income tax is the direct tax with most significant share in national budget revenues.

Table 2. Corporate income tax share in total national budget revenues in the Republic of Croatia 2007. – 2014.

Year	National budget revenues (000 000 HRK)	Corporate income tax (000 000 HRK)	Share of corporate income tax in Σ national budget revenues
2007.	108.321	8.816	8.14%
2008.	115.773	10.564	9.12%
2009.	110.258	9.439	8.56%
2010.	107.466	6.407	5.96%
2011.	107.069	7.288	6.81%
2012.	109.559	7.697	7.03%
2013.	108.585	6.365	5.86%
2014.	114.044	5.657	4.96%

Source: Authors' calculation according to the annual reports published by the *Croatian Ministry of Finance* (2007. – 2014.)

In the **Table 1.**, the share of income tax expense in relation to the total budget revenues is presented. It is evident that the revenues from income tax are highest in 2008. when the economy of Republic of Croatia was affected by economic slowdown which have had

repercussion on business activities of companies. Their relative values have significantly declined, but absolute values haven't because there was an increase in the VAT rate in Croatia while the corporate tax rate did not change in the meantime.

2. PREVIOUS RESEARCHES

Mostly, as determinants of effective tax rate previous researches included company size, profitability, leverage, ownership and assets mix. Also, there were management power, intensity of inventories, capital intensity, loss carry-forward provisions, industry, R & D expenditure etc. Pu et al. (2015.) founded that "CFOs' power, institutional environment and their interactions will largely affect corporate effective tax rates". Delgado et al. (2014.) founded different explanatory variables depending on the value of effective tax rate - size, intensity of inventories and profitability for companies with lower effective tax rates and debt for companies that have higher value of effective tax rate. Lazar (2014.) founded following effects on dependent variable – capital intensity, leverage, and loss carry-forward provisions (negative effect), company size and labour intensity (no effect) and profitability (positive effect). Wang et al. (2014.) did not found significant impact of the »Big four« auditors and international ownership on effective tax rates, but they founded that industry, asset mix, leverage, size, and state ownership have affected effective tax rates. Fernandez – Rodriguez and Martinez – Arias (2014.) founded in their cross – country research that only significant explanatory variable is inventory intensity (in most countries positive) but on the other side firm size, leverage, capital intensity and profitability are not significant in all countries and their signs differ from country to country. Lazar (2011.) founded negative relationship between difference of effective tax rate and the statutory tax rate and return on assets (profitability ratio). Davidson S., Heaney, R. (2012.) have founded the non-linear relationship between effective tax rates and corporate size and confirmed the *Political cost hypothesis* which implies higher tax burden for larger companies. Mahenthiran S., Kasipillai, J. (2012.) highlighted the importance of government ownership, management power, and total accruals. Omer et al. (1993.) founded that "size is a valid proxy for *Political costs* and provides additional evidence in support of the political cost hypothesis". Zeng T. (2010.) founded negative relationship between concentrated share ownership and effective tax rates and positive relationship between government-related largest shareholders and effective tax rates. Fernandez-Rodriguez E., Martinez-Arias A. (2012.) analysed characteristics of each company but also the governmental tax policy which can also be perceived as determinant of effective tax rates. Their results indicate a nonlinear relationship between ETR and analysed variables (size, leverage, and capital intensity). Noor R. et al. (2008.) have founded negative statistical relationship between effective tax rates and leverage, greater investments in fixed assets, extensive foreign operations and return on assets, but also positive relationship between size and effective tax rate. Janssen (2006.) included company size, capital intensity, extent of foreign operations, company performance, leverage and being a public company as determinants. Yao – Chih (2012.) concluded that "all large firms don't enjoy the political power" and corroborated that hypothesis. Harris and Feeny (1999.) founded significant relationship between effective tax rate and following explanatory variables - interest payments, research and development expenditure, foreign ownership, stock – market listing, number of subsidiaries.

Table 3. *Some recent researches on effective tax rate determinants*

Financial ratio	Sign	Relationship with effective tax rate	
		Positive	Negative
Capital intensity	+ / -	Delgado et al. (2014.) Y. Wang et al. (2014.) Fernandez-Rodriguez E., Martinez-Arias A. (2012.) Zeng T. (2010.)	Lazar (2014.) Noor R. et al. (2008.)
Company size	+	Delgado et al. (2014.) Y. Wang et al. (2014.) Omer et al. (1993.) Zeng T. (2010.) Fernandez-Rodriguez E., Martinez-Arias A. (2012.) Noor R. et al. (2008.)	
Leverage	+ / -	Delgado et al. (2014.) Y. Wang et al. (2014.) Fernandez-Rodriguez E., Martinez-Arias A. (2012.)	Lazar (2014.) Zeng T. (2010.) Noor R. et al. (2008.)
Profitability	+ / -	Delgado et al. (2014.) Lazar (2014.) Fernandez-Rodriguez E., Martinez-Arias A. (2012.)	Zeng T. (2010.) Noor R. et al. (2008.)

Source: Authors' creation

3. REGRESSAND VARIABLE - EFFECTIVE TAX RATE

In Republic of Croatia corporate tax is paid at flat rate which means that every company pays this tax at the same rate of 20% regardless of other characteristics. But this doesn't mean that taxes paid by certain company can be calculated by multiplying net profit before taxation with flat tax rate. There are also other factors that need to be taken into account (*exempli gratia* statutory tax exemptions, accumulated loss etc.). Effective tax rate is defined as the ratio between total corporate tax expenses and the financial result before taxes. Accordingly, in *Thomson Reuters* database which was used in this research, effective tax rate is defined as total income tax for the fiscal year divided by the same period income before taxes and it is expressed as percentage.

4. DETERMINANTS INCLUDED IN RESEARCH

4.1. Capital intensity (Abbreviation: CAP_INT)

Capital intensity is measured as the *Tangible Assets to Total Assets ratio* of a company. Although there are many researches which prove opposite like Delgado et al. (2014.), Y. Wang et al. (2014.), Fernandez-Rodriguez E., Martinez-Arias A. (2012.) and Zeng T. (2010.), it is logical to assume negative relationship with effective tax rate because there are various accounting provisions which are flexible and offer possibilities of increasing amortization costs (*exempli gratia* amortization rates in Republic of Croatia are prescribed by *Profit Tax Act*, but there is also provision in same *Act* which enables a company to double the legal amortization rates which will be recognized as tax base reduction).

4.2. Size of a company (Abbreviation: SIZE)

Size of a company is measured as natural logarithm of total assets of a company. It is very controversial because of opposing theories and results in it's background and, accordingly, it is complex to predict the sign of this determinant. There are two theories – *Political costs theory*

and *Political power theory*. According to the *Political costs theory*, positive relationship with effective tax rate variable is expected because of more significant control of governmental bodies but according to *Political power theory*, relationship will be negative because large companies are more resourceful in tax reduction (fiscal planning, accounting policies etc.) (Delgado et al., 2014., p. 489.).

4.3. Leverage (Abbreviation: LEV)

Leverage is measured as *Debt to Equity ratio* and it indicates the nature of asset financing sources. Leverage ratio actualizes various questions. For instance, how will a company be perceived by investors in terms of financial stability. Capital and financial structure of a company is directly related to business continuity (bankruptcy status) and in this sense it is strongly advisable that share of own financing sources prevails over share of debt (Bubić and Šušak, 2015.). Other important issue is related to taxation because there is different tax treatment of equity and debt. It has to be highlighted that this ratio can extremely vary depending on industry.

4.4. Profitability (Abbreviation: PROF)

Profitability ratios are often considered as ratios with deficient and limited informative value because of their susceptibility to manipulation and embellishment. It is an accrual value which can be influenced by skilled usage of flexible accounting standards provisions. As a measure of profitability *Pretax Return on Assets* will be used. Theoretically, higher profits should lead to higher corporate taxes, but some researches have proven opposite like Zeng T. (2010.) and Noor R. et al. (2008.).

5. HYPOTHESES

According to remarks stated in previous chapters, hypotheses are established as following:

Hypothesis 1 – capital intensity statistically significant affects effective tax rate and the relationship is negative.

Hypothesis 2 – size of a company statistically significant affects effective tax rate.

Hypothesis 3 – leverage statistically significant affects effective tax rate and the relationship is negative.

Hypothesis 4 – profitability statistically significant affects effective tax rate and the relationship is positive.

6. STATISTICAL METHODOLOGY, SAMPLE AND RESULTS

In this research *multiple regression* will be applied to analyse which determinants significantly contribute to independent value prediction and sign of that relationship (is it positive or negative). Also, it will be examined how precise the model formed of several predictors predicts the value of dependent variable (*effective tax rate*). According to the results of statistical analysis, theoretically established hypotheses will be accepted or declined. Sample consists of 59 listed companies from *Republic of Croatia* and *Republic of Slovenia*. Required number of observations is minimum two per predictor value for multiple regression models for conducting unbiased estimation of coefficients but in order to have higher statistical power it is better to have larger ratio (Austin and Steyerberg, 2015.). Also, “Stevens (1996, p. 72) recommends that

for social science research, about 15 subjects per predictor are needed for a reliable equation” (Pallant, 2007., p. 142.). Previous recommendation was applied in this research.

Table 4. Correlations and collinearity statistics

	Correlations			Collinearity Statistics	
	Zero-order	Partial	Part	Tolerance	VIF
(Constant)					
SIZE	-0,099	-0,057	-0,051	0,987	1,013
LEV	-0,192	-0,257	-0,238	0,961	1,040
PROF	-0,359	-0,381	-0,370	0,933	1,072
CAP_INT	0,132	0,045	0,040	0,955	1,047

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

Firstly, it is important to confirm that there is no multicollinearity problem, i.e. to be sure that variables are not highly intercorrelated. **Table 4.** provides correlations between predictor variables and dependent variable and also with multicollinearity statistics. Aforementioned data can be used to analyse multicollinearity issue. As it can be seen, there is no multicollinearity between variables included in multiple regression model.

Table 5. Multiple regression model summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
0,441	0,195	0,134	15,69%

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

Model summary in **Table 5.** shows how much variance of the regressand variable is explained by the multiple regression model. *R* value is 0,441, R^2 value is 0,195 and *Adjusted R²* value is 0,134.

Table 6. ANOVA table

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	3153,056	4	788,264	3,203	0,020 ^b
Residual	13043,967	53	246,113		
Total	16197,023	57			

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

Table 7. Coefficients

Variables	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95,0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
(Constant)	26,521	9,900		2,679	0,010	6,665	46,378
SIZE	-0,585	1,417	-0,051	-0,413	0,681	-3,428	2,258
LEV	-1,363	0,705	-0,243	-1,933	0,059	-2,778	0,052
PROF	-1,771	0,590	-0,383	-3,000	0,004	-2,956	-0,587
CAP_INT	1,411	4,323	0,041	0,326	0,745	-7,260	10,081

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

Multiple regression model can be formed as follows:

$$\text{ETR} = 26,521 - 0,585 \cdot \text{SIZE} - 1,363 \cdot \text{LEV} - 1,771 \cdot \text{PROF} + 1,411 \cdot \text{CAP_INT}$$

Explanation of abbreviations:

- ETR – Effective tax rate multiple regression model,
- SIZE – Size of a company,
- LEV – Leverage,
- PROF – Profitability,
- CAP_INT – Capital intensity.

Table 7. is used to determine contribution of every variable individually in predicting regressand variable. Highest contribution to the prediction of dependent variable is made by profitability ratio – *Return on Assets* (- 0,383), which is followed by leverage ratio – *Debt to Equity* (- 0,243). *Return on Assets* makes statistically significant contribution to the dependent variable at 5% significance and *Debt to Equity* makes statistically significant contribution to the dependent variable at 10% significance. Other variables included in model are not statistically significant at 10%. Size, leverage and profitability have negative effect on effective tax rate and capital intensity is the only variable with positive effect.

7. CONCLUSION

Although statutory tax rate is flat tax, due to tax law provisions, in practice companies pay different effective tax rates (due to tax exemptions, previous financial year losses etc.). The aim of this study was to determine the relationships of four determinants, which have been chosen as most frequent variables in previous researches, and compare it with available theoretical information on determinants of effective tax rate.

Table 8. *Hypotheses status (Accepted / Rejected)*

No	Hypothesis	Status
1.	<i>Hypothesis 1 – capital intensity statistically significant affects effective tax rate and the relationship is negative.</i>	REJECTED
2.	<i>Hypothesis 2 – size of a company statistically significant affects effective tax rate.</i>	REJECTED
3.	<i>Hypothesis 3 – leverage statistically significant affects effective tax rate and the relationship is negative.</i>	ACCEPTED
4.	<i>Hypothesis 4 – profitability statistically significant affects effective tax rate and the relationship is positive.</i>	REJECTED

Source: Authors' creation

Explanatory variables *capital intensity* and *size of a company* are not statistically significant which leads to rejection of *Hypothesis 1* and *Hypothesis 2*. *Profitability* variable is statistically significant, but its impact differs from one established in *Hypothesis 4* and it is negative. *Leverage* variable corroborates presumption established in *Hypothesis 3* and it is statistically significant at 10% significance threshold. Accordingly, *Hypothesis 3* is accepted. Negative value of the only statistically significant variable implies that highly leveraged companies have benefited from tax law provisions which favour debt over equity.

LITERATURE:

1. Austin P.C., Steyerberg E.W. (2015). *The number of subjects per variable required in linear regression analyses*. June 2015., Vol. 68(6): 627-636
2. Belak V. (2014). *Analiza poslovnje uspješnosti*. RRiF Plus d.o.o. Zagreb
3. Bubić J., Šušak T. (2015). *Detecting optimal financial and capital structure: The case of small and medium enterprises (SME) in Republic of Croatia*. 10th International Scientific Conference on Economic and Social Development, Miami, 2015.
4. Danlin Pu, Yun Hong, Ming – Hsien Hsueh (2015). *Chief Financial Officers' Power, Institutional Environment, and Corporate Effective Tax Rate: Evidence from China*. Emerging Markets Finance & Trade., Supplement 1, Vol. 51, p. 196-213.
5. Davidson S., Heaney R. (2012). *Effective tax rates and the political cost hypothesis: a re-evaluation of Australian evidence*, Australian Tax Forum. 2012, Vol. 27 Issue 1, p79-105.
6. Delgado F., Fernandez – Rodriguez E., Martinez – Arias A. (2014). *Effective Tax Rates in Corporate Taxation: a Quantile Regression for the EU*. Engineering Economics, Vol. 25 Issue 5, p. 487-496.
7. Fernandez-Rodriguez E., Martinez-Arias A. (2014). *Determinants of the Effective Tax Rate in the BRIC Countries*, Emerging Markets Finance and Trade, Supplement 3 May-June 2014, v. 50, pp. 214-28
8. Fernandez-Rodriguez E., Martinez-Arias A. (2012). *Do Business Characteristics Determine an Effective Tax Rate? Evidence for Listed Companies in China and the United States*, Chinese Economy, November-December 2012, v. 45, iss. 6, pp. 60-83
9. Harris M.N., Feeny S. (1999). *The Determinants of Corporate Effective Tax Rates: Evidence from Australia*, Melbourne Institute Working Paper No. 21/99
10. IBM Corp. (2013). *IBM SPSS Statistics for Windows*, Version 22.0., Armonk: NY: IBM Corp.
11. Janssen B. (2006). *Corporate effective tax rates in the Netherlands*, De Economist 153:47–66
12. KPMG Official website. *Corporate tax rates for 2013-2016*, available at: <https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online.html>
13. KPMG Official website. *Corporate tax rates table*, available at: <https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html>
14. Lazar, S (2011). *Effective corporate income tax rate in Romania: A microbackward looking approach*, Annals of the University of Oradea, Economic Science Series, Vol. 20 Issue 2, p. 361-366.
15. Lazar, S (2014). *Determinants of the Variability of Corporate Effective Tax Rates: Evidence from Romanian Listed Companies*, Emerging Markets Finance and Trade, Supplement 4 July-August 2014, v. 50, pp. 113–31
16. Mahenthiran S., Kasipillai J. (2012). *Influence of ownership structure and corporate governance on effective tax rates and tax planning: Malaysian evidence*, Australian Tax Forum. 2012, Vol. 27 Issue 4, p. 941-969.

17. Noor R., Mastuki N., Bardai B. (2008). *Corporate effective tax rates: A study on Malaysian public listed companies*, Malaysian Accounting Review. 2008, Vol. 7 Issue 1, p. 1.-20.
18. Omer T., Molloy K., Ziebart D. (1993). *An Investigation of the Firm Size—Effective Tax Rate Relation in the 1980s*, Journal of Accounting, Auditing & Finance. Spring93, Vol. 8 Issue 2, p. 167-182.
19. Pallant J. (2007). *SPSS Survival Manual*, McGraw-Hill
20. *Profit Tax Law*. Official Gazzette 177/04, 90/05, 57/06, 146/08, 80/10, 22/12, 148/13, 143/14, 50/16
21. Republika Hrvatska, Ministarstvo financija (2007). *Godišnje izvješće 2007.*, available at: <http://www.mfin.hr/hr/godisnjaci-ministarstva/>
22. Republika Hrvatska, Ministarstvo financija (2008). *Godišnje izvješće 2008.*, available at: <http://www.mfin.hr/hr/godisnjaci-ministarstva/>
23. Republika Hrvatska, Ministarstvo financija (2009). *Godišnje izvješće 2009.*, available at: <http://www.mfin.hr/hr/godisnjaci-ministarstva/>
24. Republika Hrvatska, Ministarstvo financija (2010). *Godišnje izvješće 2010.*, available at: <http://www.mfin.hr/hr/godisnjaci-ministarstva/>
25. Republika Hrvatska, Ministarstvo financija (2011). *Godišnje izvješće 2011.*, available at: <http://www.mfin.hr/hr/godisnjaci-ministarstva/>
26. Republika Hrvatska, Ministarstvo financija (2012). *Godišnje izvješće 2012.*, available at: <http://www.mfin.hr/hr/godisnjaci-ministarstva/>
27. Republika Hrvatska, Ministarstvo financija (2013). *Godišnje izvješće 2013.*, available at: <http://www.mfin.hr/hr/godisnjaci-ministarstva/>
28. Republika Hrvatska, Ministarstvo financija (2014). *Godišnje izvješće 2014.*, available at: <http://www.mfin.hr/hr/godisnjaci-ministarstva/>
29. Stevens J. (1996). *Applied multivariate statistics for the social sciences (3rd edn)*. Mahway, NJ: Lawrence Erlbaum
30. *Thomson Reuters Financial Database* (2016)
31. Y. Wang, Campbell, M., Johnson, D. (2014). *Determinants of Effective Tax Rate of China Publicly Listed Companies*, International Management Review, Vol. 10 Issue 1, p. 10. – 20.
32. Yao – Chih H. (2012). New evidence on determinants of corporate effective tax rates, African Journal of Business Management Vol. 6(3), pp. 1177-1180
33. Zeng T. (2010). *Ownership Concentration, State Ownership, and Effective Tax Rates: Evidence from China's Listed Firms*, Accounting Perspectives. Dec2010, Vol. 9 Issue 4, p. 271-289.

THE INFLUENCE OF HIGHER EDUCATION ON PRODUCTIVITY: AN ANALYSIS OF TURKEY AND THE EUROPEAN UNION COUNTRIES

M. Ozan Saray

Inonu University, Malatya, Turkey
ozan.saray@inonu.edu.tr

ABSTRACT

Rising productivity has been a key factor for the growth of the countries in the world whether they are developed or developing. The policy makers try to overcome basic macroeconomic problems such as unstable growth, unemployment and insufficient investment capacity with the help of increasing productivity. It is widely accepted that each economy in the world must provide a skilled work force in order to build and maintain productivity. In this context, the aim of this paper is to empirically examine the contribution of higher education level on labour productivity in European Union countries and Turkey, which is a candidate country of European Union membership. Within this scope a panel data estimator applied for 28 European Union countries and for Turkey between 2004-2013 time span. The results of Driscoll-Kraay estimator shows education level has a significant and positive effect on labour productivity. The results of analyse also suggest that innovation variable has a significant and positive influence on productivity.

Keywords: *Labour productivity, education, panel data*

1. INTRODUCTION

It is important to describe relationship between education and labour productivity. An increase in education quality is a vital factor in labour productivity increase and for maintaining the current level. The seminal paper of Lucas (1988) added human capital as an important variable in labour productivity. For Lucas (1993) human capital is one of the main engines of growth. And since these works, it is known education has a direct effect on labour productivity. Accordingly, in most countries governments support/encourage human capital as a preferential policy. On that sense, this paper, aiming to examine effect of higher education level on labour productivity between European Union (EU) countries and Turkey. The data comprise of 29 countries between 2004-2013 periods. I found a positive relation of higher education on productivity for the sample. And in other significant result, primary education shows up a negative effect on productivity. This can be attachable with the decreasing rate of primarily educated labour force in EU countries and in Turkey. While higher educated labour force ratio increasing; primarily educated labour force diminishing. Lastly, there could be found no relation between secondary education level and labour productivity. This paper organised in five sections. The following section introduces the relation between education and productivity. Section 3 gives a short review of literature while Section 4 informs about model and analyse results. And, section 5 concludes.

2. EDUCATION & PRODUCTIVITY RELATIONSHIP: EUROPEAN UNION AND TURKEY

Higher education can be seen as a crucial determinant of improving human capital. The quality of human capital can be greatly enhanced productivity is a widely accepted belief, for a long time (Schultz, 1961; Becker 1962; Arshad & Ab Malika, 2015). Highly educated workers can easily adapt to new technologies, and increase international competitiveness (Arshad & Ab Malika, 2015; Corvers, 1997). If level of education grows, it is widely accepted, the

productivity of labour will increase so workers will produce more output. This “*physical units*” may measurable with input/output per worker (or input per hours worked) (Corvers, 1997: 976).

Innovation may be added to this relationship . In this sense knowledge -based economy (or innovation) with education can be representable as a blast of productivity (German-Soto & Gutiérrez, 2015). Thus, for Mayhew & Neely (2006: 448) innovation and education are two of the five “drivers of productivity growth”. The others are physical investment, enterprise and competition.

In this paper I used patent applications to the European patent office (EPO) by priority year. The average patent applications between 2004-2013 time span can be seen in Figure 1:

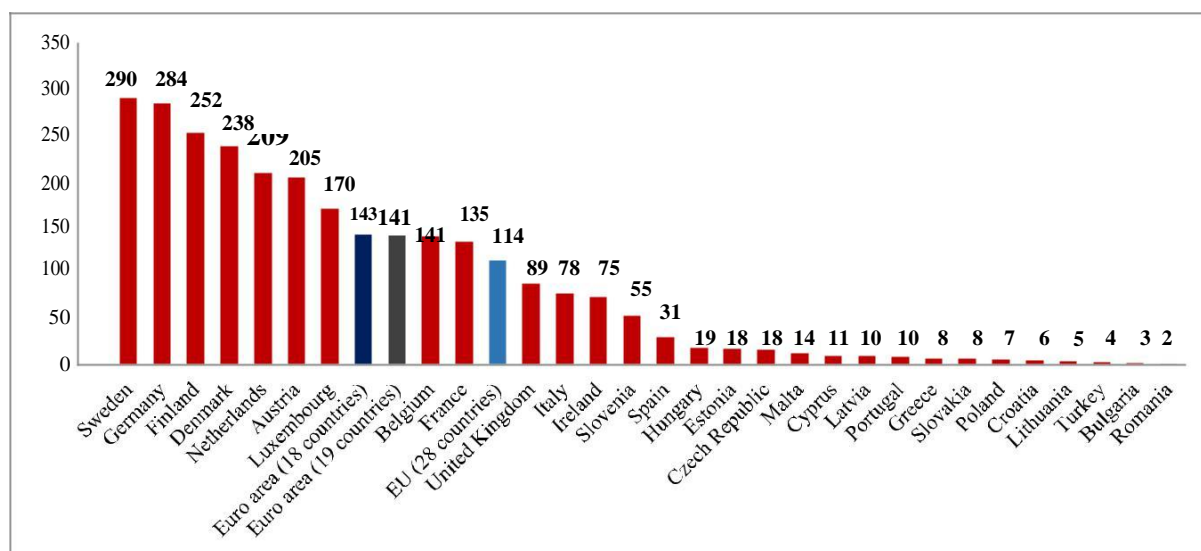


Figure 1: Averages of patent applications (between 2004-2013 periods) to the European patent office (EPO) by priority year per million inhabitants (Eurostat, 2016)

Figure 1 shows while the average of EU-28 countries is 114 patent applications per 1 million inhabitants Sweden, Germany, Finland, Denmark, Netherlands, Austria, Belgium and France are the countries which are above the average. Sweden is the leader country of this list with number of 290 patent applications per 1 millions and Romania which bring up the rear with a number average 2 applications per 1 million inhabitants. Bulgaria, Turkey, Lithuania, Croatia, Poland, Slovakia, Greece, Portugal, Latvia, Cyprus, Malta, Czech Republic, Estonia, and Hungary are the countries that are quite far from the sample.

Figure following on the next page

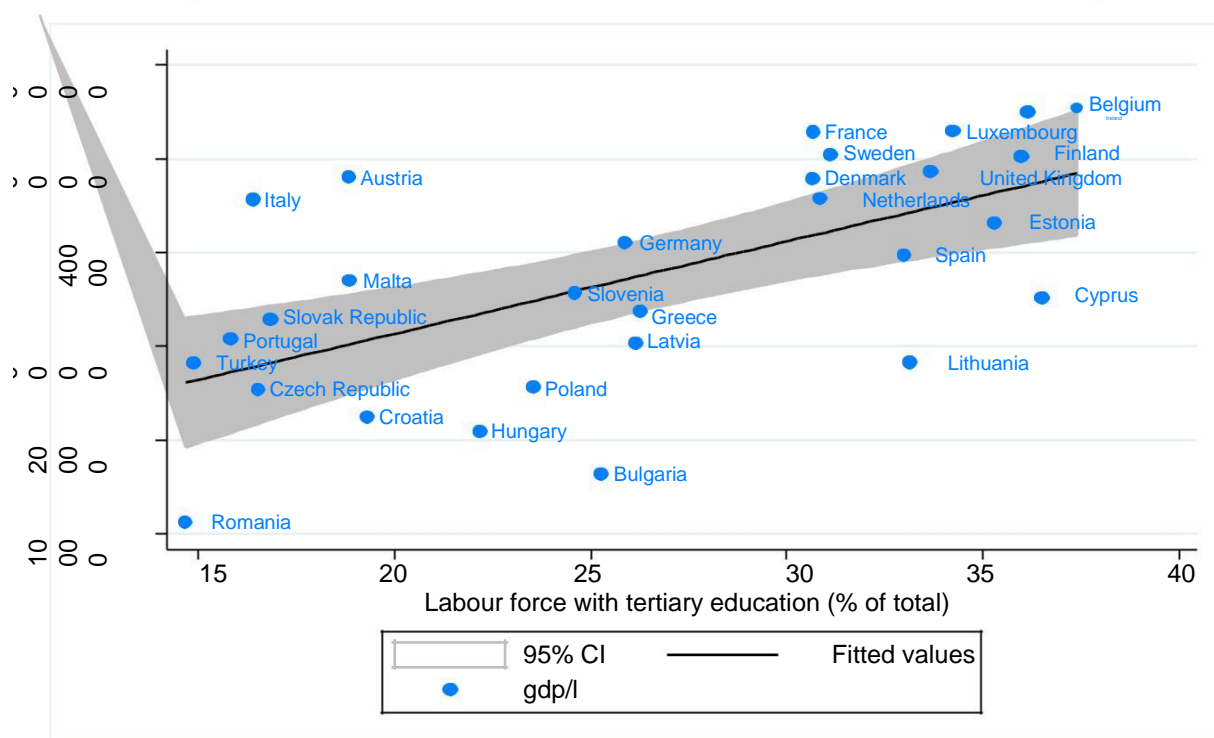


Figure 2: Education variable (labour force with tertiary education) with productivity (GDP per person employed) between 2004-2013 periods (Compiled from WDI Online Statistics (2016) by the writer).

From Figure 2 it can be clearly observed the relationship between education and productivity for selected countries. Belgium, Ireland, Luxembourg and Finland, are the bare examples of this relation. Romania has the lowest tertiary educated labour force ratio and lowest productive country in the whole sample. 12 of the countries are fitted with the line; which are Turkey, Czech Republic, Portugal, Slovakia, Slovenia, Greece, Germany, Netherlands, Spain, Estonia, United Kingdom and Finland.

Figure following on the next page

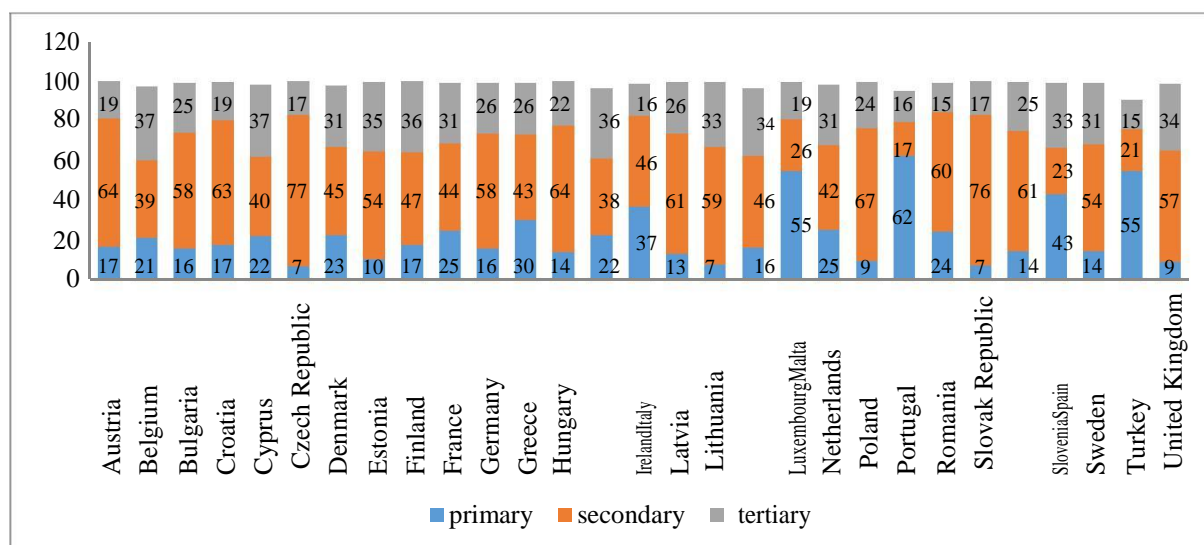


Figure 3: Educational dimension of labour between 2004-2013 time span (Primary, secondary and tertiary education % of total labour force). (Compiled from WDI online database (2016)).

As seen from Figure 3 Portugal, Turkey and Malta's labour market dominantly existing from primarily educated labour force respectively with 62 %, 55.8 % and, 55 % averages. Czech Republic and Slovakia's labour market dominated by whole slew of secondarily educated labour force with an average of 77 % between 2004-2013 periods. Poland, Austria, Hungary, Croatia, Latvia, Slovenia, Romania, Lithuania, Bulgaria, Germany, United Kingdom, Estonia and Sweden are the countries whose labour forces predominantly existing from secondarily educated labour force. These averages are low in Portugal (17 %), Turkey (21 %), Spain (23 %) and Malta (26 %). The proportion of tertiary education in total labour force while lowest for Romania and Turkey with 15 % average and for Portugal and Italy with 17 % average it is highest for Belgium and Cyprus with a 37 % average and for Ireland and Finland with 36 % average.

Figure following on the next page

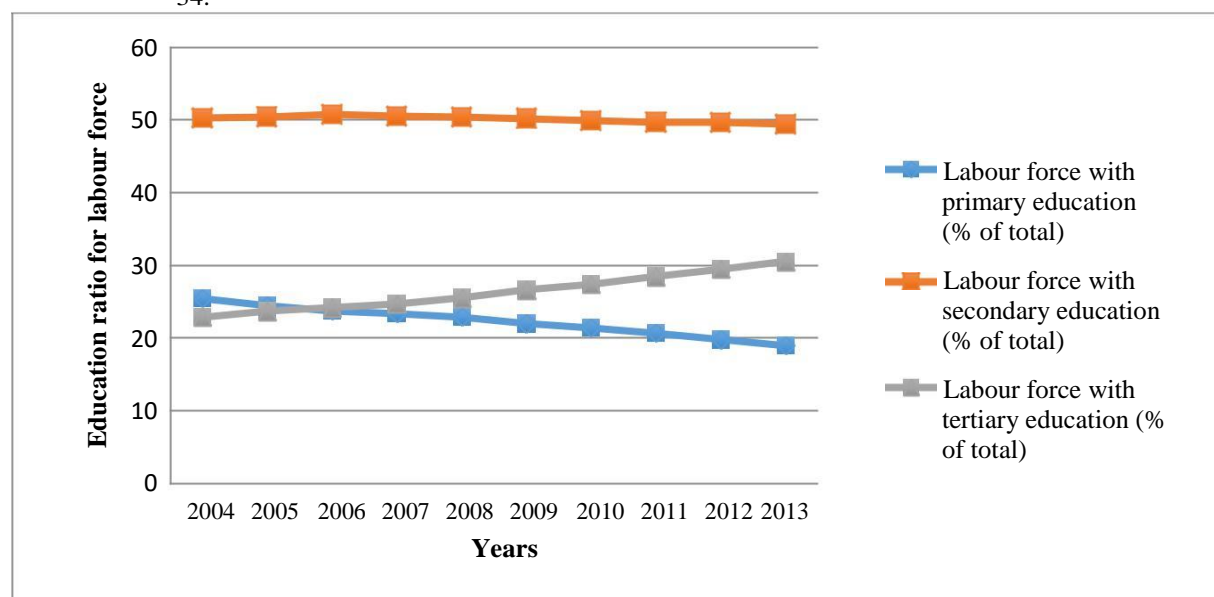


Figure 4: Educational dimension of labour averages for all countries between 2004-2013 periods (Compiled from WDI online database 2016).

And Figure 4 gives the tendency of labour force education for all samples between 2004-2013 periods. While labour force with high education soaring; secondarily educated workforce remains stable. It may clearly observed primarily educated labour force ratio decreasing. The average was 25.5 % for 2004 and it diminished to 19 % for 2013. And raw data, which I collected, shows this data sharply decreasing for all countries (except Denmark). For Denmark labour force with primary education was 18.2 % for 2004 and it is increased to 21.4 % for 2013 (WDI Online, 2016).

3. A SHORT REVIEW OF LITERATURE

For a long time education had seen as a crucial determinant of improving human capital. Benhabib & Spiegel (1994) found that there have weak correlations between human capital (education) and productivity growth for 1965-1985 periods. At first, they implied a standard Cobb-Douglas function and they found negative and/or not significant results for most of the samples. Immediately after, they took human capital effect on total factor productivity growth hereby; they found positive and significant results.

In one of the most recent studies, Arshad & Ab Malik (2015) investigated the effect of education (and health status) on labour productivity for Malaysia. They used panel data estimation method for 14 states in 2009-2012 periods. They found an expected positive effect of secondary and tertiary education variables on productivity however they couldn't found any significant effect of primary education variable.

German-Soto & Gutiérrez (2015) analyzed the contribution of education (schooling years and expenditures) and innovation on increasing labour productivity of Mexico between 1994-2012 time span. Their analyze covers 31 states and capital city. They also found a positive relationship in richer states between education and productivity while in poorer states these variables did not significant for productivity.

Sun et al. (2016) test the effect of three different type of research & development (R&D) activities for 23 OECD countries in 1996-2010 time periods. They found that, while applied research and experimental development variable has a positive effect on total productivity

growth, basic research variable is not significant in the immediate period. Basic research has a significant positive effect with two or three period lags.

4. MODEL, DATA & ESTIMATION RESULTS

In this paper I used panel-data estimation method to determine the effect of education on productivity. The study comprises EU-28 countries and a candidate country Turkey for the 2004-2013. Panel-data estimation methods known as the tests that, give the ability to observe both time and cross-section series. Within this scope I build an equation which is below:

(1)

In Table 1, I gave the data sources:

Table 1: Variables, data source and explanations

Variables	Expected Effect	Explanation	Data Source
<i>y</i> : Productivity per employee	Dependent variable	GDP per person employed (constant 1990 PPP \$)	WDI Online Database (2016)
: Physical capital	(+)	Gross fixed capital formation (% of GDP)	WDI Online Database (2016)
: Proxy variable for innovation	(+)	Patent applications to the European patent office (EPO) by priority year per million inhabitants	Eurostat Database (2016)
: Primary education variable (Proxy variable for human capital)	(+/?)	Labour force with primary education (% of total)	WDI Online Database (2016)
: Secondary education variable (Proxy variable for human capital)	(+)	Labour force with secondary education (% of total)	WDI Online Database (2016)
: Higher(tertiary) education variable (Proxy variable for human capital)	(+)	Labour force with tertiary education (% of total)	WDI Online Database (2016)

To take GDP per person employed is a common approach in this kind analyzes (Temple, 2001; Pritchett, 2001; Belorgey et al. 2006; Arshad & Ab-Malika, 2015) and physical capital can be measured by gross fixed capital formation. It is a widely accepted argument that schooling can create a productivity effect rather than other viewpoints of labour market organisation (Temple, 2001: 906). So, I took primary, secondary and tertiary educated labour force proportion of total labour force. Many researchers like German-Soto & Gutiérrez (2015) and AlAzzawi (2012) took patents as a proxy variable for innovation. In this analyse I adopted the same approach.

Before running regression I applied some specification and diagnostic tests. These are tests for autocorrelation, heteroskedasticity and cross-sectional dependence. Specification and diagnostic tests can be seen from Table 2:

Table following on the next page

o
d
if
i

e
d
e
h
w
r
g
a
t

ak
p
u
s
Test
resul
ts of
Drisc
oll-
Kraa
y
estim
ator

175238 (.0453552)***
CONS 10.07615
(-2028215)** Number of
Observations 288

s
t

66
62
59
36
8
w
m
B
f
The
it
secondary
Table 3
educa
which

able 2 shows that the model in equation (1) suffers from heteroskedasticity (Modified Wald Test), auto-correlation and cross-sectional dependence.¹ The chi-square (²) of Modified Wald test for groupwise heteroskedasticity signs the presence of heteroskedasticity. To test for auto-correlation Modified Bhargava et al. Durbin-Watson Test and Baltagi-Wu locally best invariant (LBI) tests was implemented. Both test values are less than two, this value means a presence of autocorrelation (Levie ve Autio (2007: 17). I ran Pesaran's (2004) and Friedman's tests for to determine cross-sectional dependence. Both tests also show presence of cross-sectional dependence.

taking into account all of these, I analyze the model with Driscoll-Kraay estimator. Driscoll-Kraay estimator serves a solution for heteroskedastic, autocorrelated and cross-sectionally dependent panel data (Hoechle, 2007: 285). Here are the results of this estimator:

Driscoll-Kraay estimator

175238 (.0453552)***
CONS 10.07615
(-2028215)** Number of
Observations 288

Notes: Driscoll-Kraay standard errors are reported in brackets. ***, ** and * are significance at 1%, 5% and 10%. All the variables are in natural logarithms. The variable of physical capital is positive as expected but not significant. And labour force with primary education is also significant, but contrary to the expectations, it is negative. This may be possible; countries are moving to a capital-intensive production form rather than a labour-intensive one, so the quality of labour effects growth more than quantity of labour. Innovation variable is significant and positive as expected. It seems a great correlation between patents application and productivity. Therefore the general decrease in primary education data may cause a negative coefficient. Secondary education variable seems positive from Table 3 but not significant. High (tertiary) education variable was the most important variable in Turkey as expected Hausman test result shows to a large extent of fixed effect. So, I only settle with fixed effects for specification tests.

can be affecting to productivity directly. This variable shows a significant and positive result as expected. Therefore it wouldn't be wrong to say the higher education has an important effect on productivity.

5. CONCLUSION

The influence of higher education on productivity has become important in the new knowledge-based economic age. Within this manner, in this paper, I tried to determine the effect of higher education on productivity for EU countries and Turkey between 2004-2013 periods. The results of Driscoll-Kraay estimation procedure shows that, higher education has an important positive effect on productivity. Also, analyse shows that, innovation (patent application per million) has a positive effect on productivity, as expected. Physical capital variable and secondary education variables show a positive effect, but these variables aren't significant. Contrary to expectations primary education variable shows negative coefficient.

These results imply that higher education and innovation are the important determinants of productivity. Consequently governments try to increase level of higher educated labour force instead of low skilled (primarily educated) to adapt for the new knowledge-based economy age.

ACKNOWLEDGEMENT: *I would like to thank to Dr. Ferda Yerdelen Tatoğlu for great help in econometric problems, discussion and comments.*

LITERATURE:

1. AlAzzawi, S. (2012). Innovation, productivity and foreign direct investment-induced R&D spillovers. *The Journal of International Trade & Economic Development*, 21(5), 615-653.
2. Arshad, M. N., Ab Malik, Z. (2015). Quality of human capital and labor productivity: A Case Of Malaysia. *International Journal of Economics, Management and Accounting*, 23(1), 37-55.
3. Becker, G. S. (1962). Investment in human capital: A theoretical analysis. *The journal of political economy*, 9-49.
4. Belorgey, N., Lecat, R., Maury, T. P. (2006). Determinants of productivity per employee: An empirical estimation using panel data. *Economics Letters*, 91(2), 153-157.
5. Benhabib, J., Spiegel, M. M. (1994). The role of human capital in economic development evidence from aggregate cross-country data. *Journal of Monetary economics*, 34(2), 143-173.
6. Corvers, F. (1997). The impact of human capital on labour productivity in manufacturing sectors of the European Union. *Applied Economics*, 29(8), 975-987.
7. Eurostat (2016), Patent applications to the European patent office (EPO) by priority year. Retrieved 04/02/2016 from <http://ec.europa.eu/eurostat/web/products-datasets/-/tsc00009>
8. German-Soto, V., Gutiérrez F., L. (2015) Contribution of education and innovation to productivity among Mexican regions: A dynamic panel data analysis. *Theoretical Economics Letters*, 5, 44-55.
9. Hoechle, D. (2007). Robust standard errors for panel regressions with cross-sectional dependence. *Stata Journal*, 7(3), 281-312.
10. Levie, J., Autio, E. (2007, October). Entrepreneurial framework conditions and national-level entrepreneurial activity: Seven-year panel study. In *Third Global Entrepreneurship Research Conference*.
11. Lucas, R. E. (1988). On the mechanics of economic development. *Journal of monetary economics*, 22(1), 3-42.
12. Lucas, R. E. (1993). Making a miracle. *Econometrica: Journal of the Econometric Society*, 61(2), 251-272.

13. Mayhew, K., Neely, A. (2006). Improving productivity—opening the black box. *Oxford Review of Economic Policy*, 22(4), 445-456.
14. Pesaran, M. H. (2004). General diagnostic tests for cross section dependence in panels. University of Cambridge, Faculty of Economics, Cambridge Working Papers in Economics No. 0435.
15. Pritchett, L. (2001). Where has all the education gone? *The world bank economic review*, 15(3), 367-391.
16. Schultz, T. W. (1961). Investment in human capital. *The American economic review*, 1-17.
17. Sun, X., Wang, Y., Li, M. (2016). The influences of different R&D types on productivity growth in OECD countries. *Technology Analysis & Strategic Management*, 1-13.
18. Temple, J. R. (2001). Generalizations that aren't? Evidence on education and growth. *European Economic Review*, 45(4), 905-918.
19. WDI Online Database (2016) World DataBank. Retrieved 01/03/2016 from <http://databank.worldbank.org/data>.

POSTED WORKERS IN THE LIGHT OF THE PRINCIPLE “SAME PAY FOR THE SAME WORK AT THE SAME PLACE”

Kosjenka Dumancic

Faculty of economics and business,
Zagreb kdumancic@efzg.hr

ABSTRACT

*The European Union internal market is being fulfilled by exercising the fundamental economic freedoms that guarantee the free cross-border movement of people, goods, services and capital. While the free movement of people guarantees to any natural person who is a national of a Member State of the European Union to work and be employed in another Member State under the same conditions as nationals of that State, in the light of freedom to provide services the possibility to work in another Member State as a posted worker was established. The free movement of workers is limited by the workers' rights arising from the social systems coordination rules as defined in Regulation 1408/07 and Regulation 88/2004. These Regulations are generally based on the principle *lex loci laboris* by which the workers' rights are defined by the Member State law where the work is performed, with the exception of the posted workers. The applicable law to posted workers is that of their home Member State from which workers are sent to perform a service for their employer. In this sense, the possibility to achieve a more flexible cross-border movement of workers is the possibility of posting workers in another EU Member State by an employer in order to provide service while being protected by the home Member State law regarding social and other rights that are defined by their working contract. The right of the employer to post workers in another Member State is governed by the provisions of Directive 96/71/EC which essentially determines the rights of employees to work in another Member State. Posted workers actually represent the realization of the freedom to provide services and freedom of establishment where their rights still remain doubtful in comparison with rights guaranteed by the free movement of workers. The posted workers rules *de facto* represent an exception to the application of the coordination procedure regulated between different social security schemes in the Member States and an exception to the rules for the application of national law of the Member State in which the work is performed. In the paper the author analyses the rights and obligations of workers and employers arising from the Directive 96/71/EC and its amendments introduced by the implementing Directive 2014/67/EU. It is the Directive 2014/67/EU, which was adopted after more than 20 years, that is conceived as a guarantor of protecting the rights of posted workers. The article discusses the scope and possibilities of implementation of the provisions of this directive in practice of the Member States, as well as future developments in this area with a special analysis of the relationship of these directives and directives governing the coordination of social systems in the Member States. Also, the article considers the initiative of the European Commission to amend Directive 96/71/EC in terms of the introduction of the “equal pay for equal work in the same place” principle.*

Keywords: Directive 96/71/EC, Directive 2014/67/EU, EU internal market, freedom to provide services, posted workers.

1. INTRODUCTION

The primacy of the fundamental economic freedoms in European Union internal market has led to the reasoning dominated by completion rules which resulted with high profit interests and bring aside the effects that may pose threatening to the working conditions and working standards (Cremers, 2016, pp. 1). The posted worker regulation is part of the free movement of services, workers and freedom of establishment rules. It also has to be analysed in the light of

rules concerning social security since the rules on social security form part of the national legislation while the free movement is always part of the internal market regulation (Bertola, Mola, 2009). The legal basis for the posting worker rights is regulated by the provisions of Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services (OJ L 018, 21.01.1997, pp. 1–6) which essentially determines the rights of employees to work in another Member State established with the idea of guarantee the rights of posted workers within the territory where the work was provided (Hatzopoulos, 2010).

To overlap the differences between regulation that applies to strictly internal situations and situations connected with cross border movement of workers the rules on posted workers were provoked. Since all the questions that are connected with employee rules are always connected with social security rules the regulation on posted workers has provoked many debates in last decades (Kilpatrick, 2009; De Vos, 2006). The European Commission last proposal, at least to say is controversial, since after the Directive on posted workers introduces the rule on the equal pay for equal work at same place. The idea is that the »employee who is sent by his employer to carry out a service in another member state for a temporary period« will have the same salary as the employee from that state.

2. REGULATORY FRAMEWORK

The fundamental freedom of free movement of worker was established in the first fundamental treaty – Treaty of Rome in 1957 by Articles 48-51. Provisions of the Treaty guarantee to European citizens to go to another member state and to work there under the same conditions as the workers from that member state. In that case the laws of the member state where the worker is working will be applied (*»lex loci labori«*). This right is now guaranteed by the Article 45 of the TFEU (Consolidated version of the Treaty on the Functioning of the European Union, OJ C 326, 26.10.2012, p. 47–390). Article 45 of the TFEU proclaims that the freedom of movement for workers shall be secured within the Union. Such freedom of movement shall entail the abolition of any discrimination based on nationality between workers of the Member States as regards employment, remuneration and other conditions of work and employment. It shall entail the right, subject to limitations justified on grounds of public policy, public security or public health: (a) to accept offers of employment actually made; (b) to move freely within the territory of Member States for this purpose; (c) to stay in a Member State for the purpose of employment in accordance with the provisions governing the employment of nationals of that State laid down by law, regulation or administrative action; and (d) to remain in the territory of a Member State after having been employed in that State. These rules apply to workers that come to another member state to work by their own initiative. In that case workers rely on the same remedies against breaches of their rights, whether through Union member ship or another type of collective representation, individual action or going to court (Cremers, 2016, pp.3).

As regarding the free movement of workers social rights regulation plays important role (Amiya-Nakada, 2010). That was the reasoning for the secondary law regulation in this area. The first Regulation (EEC) No 1408/71 of the Council of 14 June 1971 on the application of social security schemes to employed persons and their families moving within the Community (OJ L 149, 05.07.1971, pp. 2–50) governed social security coordination and it was based on the principle that person moving within the EU are subject to the social security scheme of only one member state, state where the work is performed. This regulation was renewed with Regulation (EC) No 883/2004 of the European Parliament and of the Council of 29 April 2004 on the coordination of social security systems (OJ L166, 30.4.2004.) which confirmed the principle of the application of regulations in the member state where the work is performed.

The exception of these Regulations is the situation of the so-called posted workers. As the basis for the exception the main definition of the posted workers has to be raised here. The posted

workers are the workers that are sent by their employer to another member state to provide service for him. The idea is that it is not their will to go abroad, but they are posted by their employer to another member state to provide service and after accomplishing their task to return to their member state. The free movement of the posted workers is a part of the free movement of services. It sets the right of companies to offer services in another member state and to temporary post workers to supply those services. These rules include safeguards to protect the social rights of posted workers and are brought under the application of the coordination principle for social security in the sense that they remain within their home state regulations instead of the host state social security regime during the posting period (Cremers, 2016, pp.4). The rules on posting workers are defined by the Directive 96/71/EC which regulates different possibilities for posting: the direct provision of services by company under the service contract, posting in the context of an establishment or company belonging to the same group (intra-group posting) and posting through hiring out a worker through a temporary work agency in another member state. Directive sets out the EU regulatory framework to establish a balance between the promoting and facilitating the cross-border provision of services, providing protection to posted workers and ensuring a level-playing field between foreign and local competitors (Explanatory Memorandum, European Commission Proposal for a Directive of the European Parliament and of the Council amending Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, COM (2016) 128 final, Strasbourg, 8.3.2016). In Article 3 of the Directive 96/71/EC main terms and conditions of employment of the host member state which are mandatory to be applied by the service providers from other member states are stipulated. These rules include the maximum work periods and minimum rest periods, the minimum rates of pay, including overtime rates, the minimum paid holidays, the conditions of hiring-out of workers, in particular the supply of workers by temporary employment undertakings; health, safety and hygiene at work; protective measures with regard to the terms and conditions of employment of pregnant women or women who have recently given birth, of children and of young people; equality of treatment between men and women and other provisions on non-discrimination. These provisions apply to all professions and industries when they are laid down by the law regulation or administrative provision of the host member state. Since in some of the member states these provisions are not laid down by the law, regulation or administrative provisions, but by the collective agreements or arbitration awards, in such countries, they apply at least in the construction sector, while member states have right to apply these conditions in other sectors too.

The Directive 96/71/EC coincides with the national social policy frameworks and collectively agreed working conditions. In its grounds the rules on posted workers generally are these of the member state where their employer has its seat, their home member state.

Regarding the social security contribution the employer has to pay in the member state where the workers are normally based for up to two years. During this period they do not pay social security contribution in the member state where they are temporary posted. Regarding the minimal wage requirements the host country rules apply to posted workers. In that regard the companies providing services cross-border have a cost advantage when social security contributions are lower in their home state than in the host country (European Commission, 2016).

The Directive 96/71/EC caused a number of debates and often were criticized as the basis for the social dumping at European Union. This Directive was ruled as a result of domination of economic reasoning and free movement rules over the social policy, labour standards and equal treatment of workers. In this sense the Directive 96/71/EC showed that the priority in that time in European Union was given to competitiveness and free trade rules (Cremers, 2016, pp. 3).

It took more than twenty years before the enforcement directive was proposed by European Commission in 2012. From its entry into force the Directive 96/71/EC caused a lot of controversies and was frequently questioned at the Court of Justice of the European Union. The main controversy was raised while questioning the possibility for posting as a significant option within the framework of »forum shopping« in since that the companies used the possibility to post workers from member states with lower social security rates to member states with higher security rates to make their workers cheaper. According to the rules on freedom to provide services and freedom of establishment for companies which are guaranteed by the Articles 49 and 56 TFEU and confirmed by the Court of Justice of the European Union practice it is on companies to decide from where they will conduct their business. According to that it up to them to establish their company and use the workforce from the countries that have lower social security and other rates (Horak, Dumančić, Šafranko 2012). The rules on free movement are very often in conflict with social security legislation. In order to make posted workers rules more transparent the Enforcement Directive was enacted. The Directive 96/71/EC was intended to establish a legislative framework for working conditions in case of the temporary, commercial activities of (sub)-contractors in another member state. By the time the rules on posting workers have become a way to recruit the »cheap« labour force (Cremers, 2016, pp.8).

When analyzing posted workers rules and their impact on economic integration situation in European Union changed with the “Eastern Enlargement” in 1990s that created the so called a social trilemma between: deep EU economic integration, high social protection and fully autonomous national welfare states (Sapir, 2015). One of the potential solution to social trilemma was the “social dumping” defined as a downward pressure on social conditions due to competition from countries with lower social conditions” which resulted from the imports of services involving posted workers from low wage countries. European Union reacted to that problem by efforts to reduce disparities between national social systems through some measures of social harmonisation, and through redistribution policies to foster economic convergence. Another ways are measures limiting free circulation of posted workers and accepting some social dumping resulting in Court of Justice of the European Union cases (Sapir, 2015).

3. THE REGULATION RULES DEFINED IN DIRECTIVE 2014/67/EU

The Directive 2014/67/EU of the European Parliament and of the Council of 15 May 2014 on the enforcement of Directive 96/71/EC concerning the posting of workers in the framework of the provision of services and amending Regulation (EU) No 1024/2012 on administrative cooperation through the Internal Market Information System (‘the IMI Regulation’) (OJ L 159, 28.5.2014, p. 11–31). The Directive 2014/67/EU doesn’t introduce provisions governing the social security treatments of posted workers. The rules on posting workers remains under the member state where the company has its seat. The main aim of the implementing directive was to clarify the rules used to determine whether or not a posting is genuine and temporary and for that purpose the Directive provides definition to ascertain that the company really operates in the country where it is established and there is no use of false posted workers without application of minimal labour protection of the host member states.

The Enforcement Directive was negotiated for about two years and it should reflect a compromise between different stakeholders representing companies, trade unions, administrative bodies and others. The main goal was to properly protect the rights of posted workers. During the negotiations different issues occurred that provoked further discussion on that topic.

The Directive 2014/67/EU aim is to strengthen the practical application of the rules on posting of workers by addressing issues related to fraud, circumvention of rules and information between the member states. It increases the awareness of posted workers and companies about their rights and obligations, improves cooperation between national authorities in change of

posting, addresses “letter-box” companies that use posting to circumvent the law, defines member states’ responsibilities to verify compliance with the rules on posting of workers, sets requirements for posting companies to facilitate transparency of information and inspections, empowers trade unions and other parties to lodge complaints and take legal and/or administrative action against the employers of posted workers if their rights are not respected, ensures the effective application and collection of administrative penalties and fines across the member states if the requirements of EU law on posting are not respected (European Commission, 2016).

The Enforcement Directive lays down provisions to improve administrative cooperation between national authorities in charge of posting. For instance it provides for an obligation to respond to requests for assistance from the competent authorities in another member state within the two working days in the case of urgent requests for information and within 25 working days in case of non-urgent cases. The Directive also lists national control measures that the Member States may apply when monitoring compliance with the working conditions applicable to posted workers and requires that appropriate and effective checks and monitoring mechanisms are in place and that national authorities carry out effective and adequate inspections on their territory in order to control and monitor compliance with the provisions and rules laid down in Directive 96/71/EC. The due date for transposing directive into the national laws was 18 June 2016.

4. NEW WAVES

According to the available data the number of posted workers in the European Union has increased for almost 45% between 2010 and 2014. In 2014 there were 1.9 million postings in the EU, up from 1.3 million in 2010 and 1.7 million in 2013. The average duration of posting was 4 months. Overall, posted workers represent only 0,7 of total European Union employment. However, there is a strong concentration of postings in some sectors and Member States (European Commission, fact sheet, 8.3.2016). According to the final report of the European Institute for Construction Labour Research from 2011 four different features of posting related cross border recruitment are distinguished: »normal« posting with special subcontractors providing temporary services in another EU member state with well paid skilled workers or qualified staff both belonging to the posting companies’ core workforce; »perfectly legal« posting where the calculation is made between engaging domestic workforce from abroad under the banner of the free provision of services. In this situation the calculation is that a subcontractor can provide basic workforce from a country with low social security payment and he is cheaper than a domestic subcontractor; questionable practice of »legal posting« where the recruited workforce is confronted with deductions for administrative cost, for lodging and transport, tax deductions and the obligatory refunding (after the return back home) of minimum wage payments. These are practices that are in breach of the provisions of the Posting Directive); different types of »fake« posting (Cremers, 2011). To conclude Cremers underlines that the posting has become one of the channels for the cross border provisions of cheap labour in the single market.

As it was described in previous chapter of the paper the Enforcement Directive in 2014 has provided for new and strengthened instruments to fight and sanction circumventions, fraud and abuses in posted workers issues.

In 2016 the European Commission announced its Political Guidelines and confirmed in its Work Programme 2016 as a target the revision of the Directive 96/71/EC. This initiative does not address any issue regulated by the Enforcement Directive. It focuses on issues which were regulated by the Directive 96/71/EC and therefore the revised posting on Directive 96/71/EC and Enforcement Directive are complementary to each other.

During the consultation for preparation of the proposal for the new directive as main problems were defined administrative requirements, paperwork, fees and registration obligations together with lack of clarity of labour market rules in the country of destination, especially among SMSs (Proposal for a directive amending Directive 96/71/EC, European Commission, 8.3.2016.)

Modernised rules on posted worker will contribute to creating transparent and fair conditions for the implementation of the Investment plan for Europe which will provide an additional boost to cross-border service provision and thereby lead to increased demand for skilled labour to be fulfilled. The main question that has to be answered is the rule on the so called issue »equal pay for equal work in the same place«. Stakeholder consultation in Member States was placed.

On one side, Austria, Belgium, France, Germany, Luxembourg, the Netherlands and Sweden have claimed support for a modernisation of the Directive establishing the principle on equal pay for equal work in the same place. These member states suggested that the provisions regarding working and social conditions, most notably including remuneration, should be amended and widened. Also to set up of a maximum duration limit to posting should be considered. On the other hand, Bulgaria, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Slovakia and Romania have argued that a review of the Directive is premature and should be postponed after the deadline for the transposition of the Enforcement Directive. Those states have expressed their concern that the principle of the equal pay for equal work in the same place would be incompatible with the single market as pay rate differences constitute one legitimate element of competitive advantage for service providers. Their position is that posted workers should remain under the legislation of the sending member state for social security purposes and no measure should be taken to revise the linkages between the posting of workers and the social security coordination in this sense.

When comparing different approach of these states it is obvious that the difference between »new« and »old« member states exist in this area. Wages and prices increase with the level of economic development. Also, wages are higher in countries where labour is more productive. Companies in higher-wages countries compete with companies in low-wage countries in three ways as it was underlined by Sapir: importing goods from low-wages countries, importing services (including the posting of workers) from low-wage countries and off-shoring production in low-wage countries (Sapir, 2015).

The proposal for the amendment of the Directive 96/71/EC introduces several changes. The main are: a) when the anticipated or the effective duration of posting exceeds twenty-four months the host member state is deemed to be the country in which the work is habitually carried out. The labour law of that country will therefore apply to the employment contract of that posted worker if no other choice of law was made by the parties. In case a different choice was made, it cannot, however, have the result of depriving the employee of the protection afforded to him by provisions that cannot be derogated from by agreement under the law of the host member state. In order to prevent the circumvention of that rule in case of replacement of a worker regarding the same task, calculation of the duration of posting must take into account the cumulative duration of the posting of the workers concerned. The rule will apply whenever the accumulated duration exceeds 24 months but in order to respect the principle of proportionality only to the workers posted for at least six months; and b) another rule that will be introduced is the rule on minimum wage in Article 3 of the Directive. The first change makes the collective agreements universally applicable within the meaning of the Article 3(8) applicable to posted workers in all sectors of the economy, irrespective of whether the activities are referred to in the annex to the Directive (which currently is the case only for the construction sector). Another change is that it is within the member states competence to set rules on remuneration in accordance with their law and practice. The rules on remuneration applicable to local workers, stemming from the law or collective agreements universally applicable within the meaning of Article 3(8) are also applicable to posted workers. The new obligation is to

publish in the website of the company the constituent elements of remuneration applicable to posted workers. The current Directive only requires that posted workers are subject to the minimum rates of pay. The new proposal foresees that the same rules on remuneration of the host member state apply, as laid down by law or by universally applicable collective agreements. Posted and local workers will therefore be subject to the same rules when it comes to remuneration (European Commission, 2016)

5. CONCLUSION

One of the possible solutions for the posted workers issues in European Union is to encourage social systems to converge. This issue should not just be about the convergence of the social systems but about converging towards a system with the right features. The European Union and member states also need to take into account three future challenges beside the European Union integration and the risk of social dumping: globalization, technological change and ageing of population (Saphir, 2015).

At the moment it is very obvious that the possibility to gain the same price of work at the same place is approaching and that the posting workers rules won't be the "green card" for cheap labour any more. The member states will have to harmonize their rules and prices to the market needs as a whole while the idea is to have the fixed labour price within the Union. This new initiative is clearly visible from the last proposal for the amendments of the Posting Workers Directive.

It will take another few years for the final text of the Directive. Different tendencies within the European Union will certainly play an important role in this process, but according to the situation at the moment the workers protection has its turn over the economic interests.

LITERATURE:

1. Amiya-Nakada, R. (2010). *The Effect of the Judiciary-Introduced Policy Development: Collective Order versus Individual Rights in EU Social and Employment Polic.* Paper prepared for the 12th Biennial Conference of the European Union Studies Association, March 3-5, Boston.
2. Bertola, G., Mola, L. (2009). *Services Provision and Temporary Mobility: Freedoms and Regulation in the EU.* LSE "Europe in Question" Discussion Paper Series, Paper No. 09/2009.
3. CLR News Recruitment Practice in Europe, 1/2011.
4. Cremers, J. (2016). *Economic freedom and labour standards in the European Union.* <http://trs.sagepub.com/content/early/2016/03/08/1024258916635962.full.pdf+html>
5. De Vos, M. (2006). *Free Movement of Workers, Free Movement of Services and the Posted Workers Directive: a Bermuda Triangle for National Labour Standards?.* ERA Forum, Vol. 7. No.3.
6. Euractiv, <http://euractiv.com>
7. European Commission Press Releases, *Revision of the Posting of Workers Directive – frequently asked questions*, Strasbourg 8.3.2016.
8. European Commission Press Releases, *College holds orientation debate on the economic and social dimension of the Single Market*, 6.10.2015.
9. Giesen, R. (2003). *Posting: social protection of workers vs. Fundamental freedoms?* Common Market L. Rev. 40. 143-158.
10. Hatzopoulos, V. (2010). *Liberalising trade in services: creating new migration opportunities?* Research Paper in Law. No. 1/2010.
11. Kilpatrick, C. (2009). *Laval's regulatory conundrum, collective standard-setting and the Court's new approach to posted workers.* E.L. Rev. 34(6), pp. 844-865.

12. Proposal for a directive of the European Parliament and of the Council amending Directive 96/71/EC of the European Parliament and of the Council of 16 December 1996 concerning the posting of workers in the framework of the provision of services, Strasbourg, 8.3.2016. COM (2016) 128 final.
13. Sapir, A. (2015). *Single Market and Social Protection Friends or Foes?* Presentation prepared for an Informal Meeting of Labour Ministers (revised). Available at <http://bruegel.org/wp-content/uploads/2016/03/Sapir-2015-Stockholm.pdf>.

THE ELECTORAL EFFECTS OF HOUSEHOLD ECONOMIC SECURITY IN POLAND

Maria Piotrowska

*Wroclaw University of Economics, Poland
maria.piotrowska@ue.wroc.pl*

ABSTRACT

The 2015 presidential and parliamentary elections changed the political scene in Poland. The incumbent party, the Civic Platform, shortly PO, which won two last parliamentary elections in a row lost power doubly, both in presidential and parliamentary elections. Macroeconomic conditions in 2015 in Poland were quite good. The national economy situation could not explain why voters punished the incumbent so strongly. If economic voting mattered in the 2015 parliamentary election, evaluation of personal (household) economic security could influence the electoral effects. The aim of the paper is to test pocketbook voting, or egotropic effects, in the 2015 parliamentary election in Poland, focusing on differences in economic security of a family perceived by different groups of voters. It is presumed that just heterogeneity in economic voting may be crucial to reveal the importance of pocketbook effects. The research uses an exploratory analysis based on structural equation modeling (SEM) to measure economic security of a household. The questionnaire survey is a source of data for observed variables in SEMs.

Keywords: *economic security, households, pocketbook voting.*

1. INTRODUCTION

The 2015 presidential and parliamentary elections changed the political scene in Poland. The incumbent party, the Civic Platform, shortly PO, which won two last parliamentary elections in a row (2011 and 2007) lost power doubly, both in presidential and parliamentary elections. The Law and Justice, shortly PIS, occurred to be a winner who took everything. PIS won in 14 of 16 voivodships (Poland is divided into 16 administrative units called voivodships), in rural and urban areas, in each age groups and among electors with primary, secondary and tertiary educational level. In general, PIS captured 37,8%, while PO 24,09% voters. Given the PIS electoral success, there were, however, interesting differences in the 2015 electoral outcomes by regions, a place of residence, educational level and age. For example, in the eastern part of Poland PIS received around 50%, PO only 13-17%, while in the western one PIS had only a few percentage point surplus. A considerable difference occurred also among young voters, 26% for PIS and 14% for PO, while high educated voters and voters in large towns were differentiated visibly less (PIS received only by 4 and 3 percentage points more, respectively).

Macroeconomic conditions in 2015 in Poland were quite good, real GDP growth higher than, in average, in Europe, small deflation, one-digit unemployment rate. The national economy situation could not explain why voters punished the incumbent so strongly. The spatial, educational and age differences are less likely to result in polarization in the perception of the macroeconomic situation. If economic voting mattered in the 2015 parliamentary election, evaluation of personal (household) economic security could influence the electoral effects.

The aim of the paper is to test pocketbook voting, or egotropic effects, in the 2015 parliamentary election in Poland, focusing on differences in economic security of a family perceived by different groups of voters. It is presumed that just heterogeneity in economic voting may be crucial to reveal the importance of pocketbook effects. Only some voters could take into account their evaluation of household economic security when they voted against the incumbent, while others were not.

The paper is structured as follows: the section 2 offers a literature survey on egotropic effects; the section 3 covers some information on the main parties; the section 4 presents the research purpose and a main hypothesis as well as research objectives; section 5-7 cover the methodological aspects; an analysis of findings with the discussion is included in section 8; conclusions are presented in the section 9.

2. THE LITERATURE SURVEY

The idea of economic voting is based on the reward-punishment hypothesis that states as follows: when the economy is doing all right, voters will reward the incumbent with their vote; otherwise, voters will punish the incumbent by casting their vote for the challenger. The inspiration for the hypothesis comes from Key (1964, p.568). A voter evaluating her or his personal finances is called a pocketbook voter or an egotropic voter. The theory of pocketbook voting says that when personal or household financial conditions have deteriorated, voters will punish the incumbent. If personal financial conditions have improved, voters will reward the incumbent. Voters can be retrospective, evaluating past events, past performance, and past actions (Key, 1966, p.61; Fiorina, 1978, 1981), or prospective if they focus on that portion of growth likely to persist after the election (Alesina et al, 1993, p.14). The typical survey questions used to measure egotropic, retrospective/prospective evaluations are as follow: retrospective question - "Looking back over the past year, would you say the personal financial situation has gotten worse, better, or stayed the same?"; and prospective question – "Looking ahead to the next year, do you think the personal financial situation will be worse, better, or stay the same?".

Sanders (2000), summarizing many of the findings on economic voting in the UK, pointed at significant, predictable effects of personal expectations. The research on economic voting in the 2001 election showed the pocketbook variables, both retrospective and prospective were significant (Clarke et al., 2004). The most controversial empirical evidence for pocketbook voting has been found in Denmark. Nannestad and Paldam (1995) examined multiple surveys from 1990-1993 with 13 economic evaluation questions and vote intention questions. They discovered strong egotropic effects superior to sociotropic effects. They have confirmed their results using pooled, cross-sectional time series (Nannestad and Paldam, 1997). However, other researchers have been strongly against the existence of pocketbook voting in Denmark (Hibbs,1993).

In the literature there are some guides which factors and circumstances should be included in the research to discover egotropic effects. Lewis-Back and Stegmaier (2000, p. 212) suggest that "...economic distribution may be an emerging relevant dimension. That is, what are electoral effects of rising income inequality and insecurity?" Group membership and regional differences can also condition the economic vote. Heterogeneity in economic voting may affect the relative importance of pocketbook versus sociotropic effects.

3. CHARACTERISTICS OF MAIN PARTIES IN THE 2015 PARLIAMENTARY ELECTION IN POLAND

Five parties came into the Polish Parliament after the 2015 election. PIS, a winner, promised more money for people, directly by a money transfer to big families and indirectly by extension of free-tax sum, an increase in wages, cheap flats and the party declared to shorten retirement age that a previous coalition of PO and PSL had extended. In ideological terms, PIS is a conservative, national-oriented party. An electoral slogan sounded: "A good change".

PO, the incumbent party and a dominate partner in the previous coalition, emphasized macroeconomic stability, infrastructure development and an increase in an average wage. PO is a liberal and European-oriented party. In fact, there was no strong electoral slogan of this party. Leaders of the party have been involved in political scandals. A new party, established few months before the election, called “Modern.pl”, is also liberal and European-oriented. Its leaders were not involved in any political scandals. They were new people on a political scene. Modern.pl was an alternative for PO partisans in the 2015 election.

4. THE RESEARCH DESIGN

The paper is aimed at testing the existence of pocketbook effects in the 2015 parliamentary election in Poland. *The main hypothesis states that differences in household economic security and heterogeneity in economic voting contribute to explaining the relevance of egotropic effects across groups of voters.*

There are three research objectives: 1) to estimate a model of economic security; 2) to determine a fraction of economically insecure households, it means households with economic security lower than 60 % of median level, and depth of economic insecurity in each group of voters as well as a fraction of well-secure households, it means households with economic security higher than 140 % of median level, and depth of economic well-security in each group of voters ; 3) to compare the differences in a fraction of economically insecure/well-secure households across groups to differences in outcomes from the 2015 parliamentary election across groups of voters.

If the results show large differences in both economic security and electoral outcomes, it will be possible to draw conclusion that evaluation of household well-being influenced voting. The limitation is, the results will not allow to assert how egotropic effects were important in comparison to other factors. Any voting function is estimated. An advantage of the findings is they will point at groups of voters for whom egotropic effects matter.

Implementation of the research requires, at first, to build a model of economic security. A family can be regarded economically secured when it is able to satisfy its needs at the satisfactory level and has assets or means letting it to survive unfavorable circumstances. Economic security depends on resourcefulness which is defined as a set of family member capabilities to make economic decisions in the fields of labor, saving, investing, borrowing and insuring. Ensuring family economic security requires the capability of finding good job and building-up resources which protect the family against inverse events. Both economic security and resourcefulness are unobserved, or latent, variables. In the paper the measurement of them is based on the results from an estimation of structural equation model (SEM). Resourcefulness is resulted from individual traits but it is also shaped by socio-economic development. If socio-economic development matters, there are differences in resourcefulness as well as economic security across cohorts. In the paper cohorts are distinguished by common educational and professional experiences, controlling for economy conditions. The economic context covers: the beginning of transition in Poland (1990), Poland’s accession to the EU (2004) and the beginning of financial crisis (2008). Respondents investigated in the questionnaire survey have been educated during different stages of transition in Poland and they have differed in their job experiences.

5. COHORT-SEQUENTIAL DESIGN WITH INDEPENDENT SAMPLES

The research uses cohort-sequential design with independent samples which can reduce the single cross section studies limitation (Schaie, 1994, p.51). The research covers three samples of respondents which represent three cohorts. Cohort 1: “Children of transition” – respondents

are characterized as follows: all levels of education attained in a market economy, possibilities to study in the EU, difficult entry to the labor market after the financial crisis, professional training in an advanced market economy (“an advanced market economy” in comparison to the first stage of transition, not in comparison to the old members of the EU). Cohort 2: “Youth of transition” – respondents are characterized as follows: secondary and tertiary levels of education in a market economy, easy entry to the labor market just after Poland’s transition to the EU (dynamic growth during 2005-2007), extended professional experiences and more or less stable professional carrier during the financial crisis. Cohort 3: “Mobile-working-age-adults of transition” – respondents are characterized as follows: childhood in the communism time, all educational levels in the communism times, professional experiences achieved in the communism times, training at the first stage of transition, stable professional position during the financial crisis.

6. DATA

The questionnaire survey is a source of data for observed variables in SEMs. The survey was carried out by the professional polling agency in Poland in June 2013. The respondents were asked to express their opinions directly in the course of face-to-face interviews. The polling agency carrying out the survey has chosen respondents at random. The selection of the respondents had been representative due to a voivodship (an administrative unit), a place of residence, age, gender and educational level attained. Limitation of the research is a difference in time. The data on economic security were collected in 2013, while the parliamentary election was in 2015. It is possible to assume that economic security of households would not change too much to undermine robustness of the findings. The measure of economic security is not based only on the typical survey questions used to measure egotropic, retrospective/prospective evaluations: “Looking back over the past year, would you say the personal financial situation has gotten worse, better, or stayed the same?”; or “Looking ahead to the next year, do you think the personal financial situation will be worse, better, or stay the same?” In the paper the measure of household economic security is based on responses to 47 items referring to: 1) different kinds of behavior which influence saving, running up debts, purchasing insurance, investing in children, supporting old parents; 2) assets: cash available for unexpected spending, savings, valuable belongings, houses/flats; 3) job stability and current income from work; 4) health; 5) educational and professional aspirations, and 6) socio-economic status of respondent’s parents. It seems to be justified to presume that almost all of these issues were rather stable over two years (it means between 2013 and 2015). In general, responses would tend to give more or less the same picture of economic security.

The whole sample covers 800 respondents in age between 25 to 64. This sample is divided into three cohorts. The cohort 1: “Children of transition” covers 215 respondents; the cohort 2: “Youth of transition” – 197 respondents; the cohort 3: “Mobile-working-age-adults of transition” – 388 respondents.

7. EXPLORATORY ANALYSIS

The research uses an exploratory analysis based on structural equation modeling (SEM) implemented by IBM SPSS Amos. Maximum likelihood is a method for estimating structural equation models. A structural equation model (SEM) is build separately for each cohort and estimated by the data for this cohort. Each SEM is constructed to specify hypothetical relationships among variables: 1) how the latent (or unobserved) variables can be related to each other and 2) how the observed variables can depend on the latent. The structural model (the relationships between the latents) for each cohort covers the same six latent variables named as follows: 1) Socio-economic status of respondent’s parents, 2) Aspirations of a

respondent, 3) Economic resourcefulness of a respondent 4) Propensity to save, 5) Propensity to run-up-debts, 6) Economic security of a respondent's household.

Measures of the observed variables in the SEMs are based on responses to the items in the questionnaire survey (a list of items in the survey is available on the request). The majority questions refer to individual attainment/opinion/behavior of a respondent. Smaller part of questions concerns a financial situation of a respondent's household, like income per person, a level of savings/ total indebtedness, managing of household's income. Regarding such questions it is assumed that responses given by a respondent are representative for her/his household as a whole (only one member of a household was asked). The measures of observed variables are scaled: 1 – it means a high level of a variable; 0 – it means a low level of a variable.

Few observed variables are measured in other way, for example, "Income per person in a household" is measured in Polish currency

All regression coefficients in each SEM estimated for the cohort are significant at the 0.05 level (a majority of them are significant at the 0.01 level). All covariances between the errors included in the model are significant at the 0.05 level. The values of the fit measures in Table 1 indicate a good fit of all three models.

Table 1: Summary of the fit measures (IBM SPSS Amos)

Model for the cohort	P	CMIN/DF	CFI	RMSEA	PCLOSE
Children of transition	0,918	0,905	1,000	0,000	1,000
Youth of transition	0,887	0,907	1,000	0,000	1,000
Mobile-working-age-adults of transition	0,841	0,931	1,000	0,000	1,000

8. THE COMPARISON IN THE DIFFERENCES IN ECONOMIC SECURITY AND THE 2015 ELECTORAL OUTCOMES

Before analyzing the findings, some technical explaining should be provided. The values of economic security estimated from the SEMs are normalized from 0 to 1 taking into account the whole sample of respondents (N=800). Median economic security for the whole sample is equal to 0.393551. An economic insecurity line is determined similar to the relative poverty line suggested by Eurostat. Therefore, an economically insecure household means a household with economic security below 60% of median economic security (below 0.236131). Additionally, an economically well-secure household is defined as a household with economic security above 140% of median economic security (above 0.550971). Depth of insecurity/well-security is calculated like a poverty depth. It means as a mean gap between the insecurity line (60% of median economic security) and economic security of a households. Similarly, depth of well-security is a mean gap between economic security of a household and well-security line (140% of median economic security). Table 5 covers the findings on economically insecure and well-secure households by cohort, place of residence, educational level and group of five voivodships representing the West and the East of Poland. If any fraction of households is very, very small (less than 0,00%), 0% is shown in Table 5.

If egotropic effects mattered in the 2015 parliamentary election, two detailed hypothesis should hold. Firstly, *economically insecure households belong to a group of voters who punish the incumbent (PO) by casting their vote for the challenger (PIS)*. Secondly, *economically well-secure households belong to a group of voters who reward the incumbent with their vote*. Results from testing these two detailed hypotheses should give evidence for the main hypothesis: *Differences in household economic security and heterogeneity in economic voting*

contribute to explaining the relevance of egotropic effects across groups of voters. Verification of the hypotheses is based on comparison in a fraction of insecure/well-secure households to the electoral outcomes. It is supposed that egotropic effects can be revealed just regarding these extreme groups of households. The first look at the findings (Table 2) shows that verification will not be univocal. Considering the whole sample of respondents, a fraction of well-secure households is higher than insecure ones (20% versus 12%) nevertheless the incumbent was not rewarded.

The most interesting findings refer to the cohort 1 (people in age of 24-34) and the cohort 2 (people in age of 35-44), see Table 3. Insecure households belong mainly to the cohort 1, while well-secure households are almost not present in this cohort. An opposite picture is shown for the cohort 2. A fraction of well-secure households is highest just in this cohort. Therefore, the first detailed hypothesis is tested regarding the cohort 1 (8% of insecure households and considerable depth of insecurity, 5%), while the second detailed hypothesis is verified in reference to the cohort 2 (17% of well-secure households and also considerable depth of well-security, 6%).

A considerable number of insecure households among the young voters can explain why this group punished the incumbent (PO) and voted for the challenger (PIS), see Table 5, especially that PIS declared the generous social program oriented to the young. A majority of insecure households in the cohort 1 has attained a secondary level of education which does not create many opportunities to find well-paid jobs for new comers. Voters with this educational level chose more often the challenger (PIS), see Table 7. Moreover, more young insecure households live in the eastern Poland, visibly less developed than the western part. Summering, the findings suggest that young voters took into account their evaluation of household economic security when they punished the incumbent (PO) and voted for the challenger (PIS). The findings suggest that the first detailed hypothesis holds regarding young households who were economically insecure.

Considering the cohort 2, voters in age of 35-44, a fraction of well-secure households is visibly higher than insecure ones. The quite good financial situation of many households in age of 35-44 results from both the age and cohort differences in comparison to the younger (people of 25-34). The middle-age generation is relatively well educated and it entered to a labor market during economic prosperity, and it could make professional career as well as gather financial assets when the Polish economy experienced dynamic growth. Finally, this cohort had the opportunities and enough time to become well-off. Therefore, this generation should vote for the incumbent (PO). Indeed, visibly more voters in age of 30-39 and 40-49 voted for PO and Modern.pl (a new party similar to PO), however, not a considerable majority of them, see Table 4. It seems that personal or family good financial situation did not have a dominate impact on their electoral decision. Many of well-secure households in age of 35-44 live in small towns and villages (11% of total number of households, Table 5) and in the eastern part of Poland (6%, Table 5) where people are conservative and prefer an ideological narration offered by PIS (see electoral outcomes by place of residence, Table 6). The findings suggest that egotropic effects did not determine the voting of well-secure households. The second detailed hypothesis cannot be verified positively.

Table 2: Insecure and well-secure households, a whole sample of respondents (own calculation based on the SEMs)

INSECURE HOUSEHOLDS		WELL-SECURE HOUSEHOLDS	
Fraction of insecure households in a total number of households (%)	Depth of insecurity in the whole sample of households %	Fraction of well-secure households in a total number of households (%)	Depth of well-security in the whole sample of households (%)
12.00%	3,19%	19.63%	6.49%

Table 3: Insecure and well-secure households by cohorts (own calculation based on the SEMs)

ECONOMICALLY INSECURE HOUSEHOLDS					
Cohort 1: “Children of transition” 25-34 in 2013		Cohort 2: “Youth of transition” 35-44 in 2013		Cohort 3: “Mobile-working-age-adults of transition” 45-64 in 2013	
Fraction of insecure households in a total number of households (%)	Depth of insecurity in cohort 1 (%)	Fraction of insecure households in a total number of households (%)	Depth of insecurity in cohort 2 (%)	Fraction of insecure households in a total number of households (%)	Depth of insecurity in cohort 3 (%)
7.88%	5.28%	0.50%	0.06%	3.63%	0.54%
WELL-SECURE HOUSEHOLDS					
Cohort 1: “Children of transition” 25-34 in 2013		Cohort 2: “Youth of transition” 35-44 in 2013		Cohort 3: “Mobile-working-age-adults of transition” 45-64 in 2013	
Fraction of well-secure households in a total number of households (%)	Depth of well-security in cohort 1 (%)	Fraction of well-secure households in a total number of households (%)	Depth of well-security in cohort 2 (%)	Fraction of well-secure households in a total number of households (%)	Depth of well-security in cohort 3 (%)
0.13%	0.02%	17.38%	6.37%	2.13%	0.11%

Table 4: Outcomes of 2015 parliamentary election, by age (Exit poll carried out by IBSOS)

Parties	Outcomes of 2015 parliamentary election, by age				
	18-29	30-39	40-49	50-59	60 and more
Law and Justice (PIS)	26.6%	30.6%	38.7%	47.1%	48.7%
Civic Platform (PO)	14.4%	23.8%	25.8%	23.0%	28.1%
Modern.pl	7.8%	10.8%	8.2%	6.0%	3.8%

Table 5: Insecure and well-secure households, by cohort, place of residence, educational level and the East and the West of Poland (own calculation based on the SEMs)

	Cohort 1: “Children of transition” 25-34 in 2013		Cohort2: “Youth of transition” 35-44 in 2013		Cohort 3: “Mobile-working-age-adults of transition” 45-64 in 2013	
	Fraction of insecure households in a total number of households (%)	Depth of insecurity in cohort 1 (%)	Fraction of insecure households in a total number of households (%)	Depth of insecurity in cohort 2 (%)	Fraction of insecure households in a total number of households (%)	Depth of insecurity in cohort 3 (%)
Characteristics	ECONOMICALLY INSECURE HOUSEHOLDS					
Place of residence						
Large towns	2.25%	0.48%	0%	0%	0%	0%
Medium towns	1.63%	0.67%	0%	0%	0.01%	0.14%
Small towns	2.13%	0.71%	0.25%	0.03%	0.06%	0.86%
Villages	1.88%	0.73%	0.25%	0.03%	2.00%	1.68%
Educational level						
Primary	2.25%	0.48%	0.25%	0.03%	1.13%	0.13%
Basic vocational	1.88%	0.69%	0.25%	0.03%	1.88%	0.33%
Secondary	4.13%	1.24%	0%	0%	0.5%	0.08%
Tertiary	0.75%	0.01%	0%	0%	0%	0%
Group of voivodships						
Eastern Poland (PIS)	3.00%	0.81%	0.13%	2.72%	1.00%	0.04%
Western Poland (PO)	1.63%	0.56%	0.13%	2.99%	0.88%	0.14%
	WELL-SECURE HOUSEHOLDS					
	Fraction of well-secure households in a total number of households	Depth of well-security in cohort 1	Fraction of well-secure households in a total number of households	Depth of well-security in cohort 2	Fraction of well-secure households in a total number of households	Depth of well-security in cohort 3
Large towns	0%	0%	3.88%	1.37%	0.75%	0.65%
Medium towns	0%	0%	3.63%	0.97%	0.25%	0.14%
Small towns	0.13%	0.02%	5.63%	2.35%	0.50%	0.41%
Villages	0%	0%	5.25%	1.68%	0.63%	0.53%
Educational level						
Primary	0%	0%	0.13%	0.02%	0%	0%
Basic vocational	0%	0%	2.88%	0.70%	0.25%	0%
Secondary	0%	0%	8.13%	2.79%	1.00%	0.03%
Tertiary	0.13%	0.02%	6.25%	2.87%	0.13%	0.06%
Group of voivodships						
Eastern Poland (PIS)	0%	0%	5.75%	2.50%	0.50%	0.05%
Western Poland (PO)	0%	0%	3.25%	1.41%	0.88%	0.04%

Large towns – more than 200 thousands; Medium towns 50-200 thousands; Small towns – less than 50 thousands

Eastern Poland - the group of voivodships with the highest electoral outcome of PIS: Podkarpackie (53.1%), Lubelskie (49.9%), Malopolskie (49.1%), Podlaskie (47.4%), Swietokrzyskie (42.9%). Western Poland - the group of voivodships with the highest electoral outcome of PO: Pomorskie (33.7%), Zachodnio-pomorskie (30.0%), Lubuskie (27.5%), Kujawsko-pomorskie (27.2%), Dolnoslaskie (27.0%).

Table 6: Outcomes of 2015 parliamentary election, by a place of residence (Exit poll carried out by IBSOS)

Parties	Outcomes of 2015 parliamentary election, by a place of residence				
	Villages	Towns (habitants in thousands)			
		up to 50	51-200	201-500	more than 500
Law and Justice (PIS)	46.8%	37.4%	36.2%	32.00%	31.3%
Civic Platform (PO)	17.3%	25.3%	25.2%	30.00%	28.6%
Modern.pl	4.4%	6.5%	7.3%	9.0%	13.2%

Table 7: Outcomes of 2015 parliamentary election, by educational level (Exit poll carried out by IBSOS)

Two main parties	Outcomes of 2015 parliamentary election, by educational level			
	primary	basic vocational	Secondary	tertiary
Law and Justice (PIS)	55.9	53.0	39.2	30.4
Civic Platform (PO)	15.4	19.3	23.0	26.7
Modern.pl	1.9%	2.2%	5.1%	12.0%

9. CONCLUSION

The research was aimed at testing the relevance of egotropic effects in the 2015 parliamentary election in Poland. The findings suggest some asymmetry. It seems that economically insecure households tended to evaluate their financial situation when they voted and as a consequence, they punished the incumbent, preferring the challenger. While the majority of well-secure households was not motivated by their good financial situation to reward the incumbent. The results show that differences in household economic security and heterogeneity in economic voting contribute to explaining the relevance of egotropic effects across groups of voters.

ACKNOWLEDGEMENT: The paper is based on the findings from the research project financed by the National Centre for Science (DEC-2011/01/B/HS4/03239)

LITERATURE:

1. Alesina A, Londregan J, Rosenthal H. (1993). A model of the political economy of the
2. United States. *American Political Science Review* (p.87-12). 33
3. Clarke, H., Sanders, D., Stewart, M. C. and Whiteley, P. (2004) . *Political Choice in Britain*. Oxford: Oxford University Press.
4. Fiorina M. (1978). Economic retrospective voting in American national elections: a microanalysis. *American Journal of Political Science*. (p.22-426). 43
5. Fiorina, M. (1981). *Retrospective Voting in American National Elections*. New Haven. Yale: University Press.
6. Hibbs D.A. (1993). *Solidarity or Egoism?* Aarhus, Denmark: Aarhus Univ. Press
7. Key V. O. (1964). *Politics, Parties, and Pressure Groups*. New York: Crowell. 5th ed.
8. Key, V. O. (1966). *The Responsible Electorate*. New York: Vintage

9. Lewis-Beck, M. S. and Stegmaier, M. (2000). Economic determinants of electoral outcomes. *Annual Review of Political Science*, (p.183-219). 3
10. Nannestad P, Paldam M. (1994). The VP function: a survey of the literature on vote and popularity functions after 25 years. *Public Choice* (p.213–45). 79
12. Nannestad P, Paldam M. (1995). It's the government's fault! A cross-section study of economic voting in Denmark, 1990/93. *Eur. J. Polit. Res.* (p.28:33). 62
13. Nannestad P, Paldam M. (1997). From the pocketbook of the welfare man: a pooled crosssection study of economic voting in Denmark, 1986–1992. *Br. J. Polit. Sci.* (p. 27:119). 137
14. Sanders, D. (2000). The real economy and the perceived economy in popularity functions: how much do the voters need to know?: A study of British data, 1974-97. *Electoral Studies*, (p.275-94). 19
15. Schaie, K. W. (1994), "Developmental designs revisited". In S. H. Cohen and H. W. Reese (eds), *Life-span developmental psychology: Theoretical issues revisited*, Hillsdale, (p45-64). N.J.: Erlbaum.

CONSUMER PERCEPTION OF VIRAL MARKETING – EXAMPLE OF CROATIAN MARKET

Brigita Krizanec

Student

bkrizane@foi.hr

Damir Dobrinic

Faculty of Organization and Informatics, Varazdin, Croatia

ddobrinic@foi.hr

ABSTRACT

Internet marketing has a broad range of activities eligible for promotion and one of them is viral marketing. This form of promotion appears under different names so you can talk about: viral marketing, Word of Mouth Marketing, Buzz Marketing or just Buzz. It is a type of marketing that aims to create ads that will quickly spread through the Internet and thereby gain significant popularity. It is important to note that viral marketing can be realized in any format, on any media or on any Web site.

To make viral marketing successful, it is necessary to devise a quality content and the same content focus to a particular demographic group for which the content is created. If we want to achieve the interest of consumers or potential user of a product or service for content that is created, content must intrigue them in a way that recognizes the passion of the one that created the content. The key to a good viral marketing is a good story that requires innovation, creativity and quality of what is offered.

The subject and aim of the paper is to explore the perception of the concept of viral marketing by the Croatian consumers on the one hand and the use of such forms of promotion by the Croatian companies on the other.

We believe that the results of the present study will contribute to the understanding of viral promotion concept and its acceptance and further development.

Keywords: *Internet marketing, viral marketing, promotion, consumers.*

1. INTRODUCTION

The term viral marketing was created in December 1996 by professor of Harvard Business School, Jeffrey F. Rayport, in the article for FastCompany. Jeffrey F. Rayport held that if an ad on the Internet reaches prone to user, it becomes "infected" and therefore still "infects" other users and potential users. Specifically, it is about how Rayport said that if such a user sends an e-mail to more than one address, infection progressively begins to spread. (Haramija, 2007: 884).

A pioneer of viral marketing was Hotmail (webmail service), which success is based precisely on the viral marketing. In fact, every time a user with a Hotmail address sent someone a message, the service would be at the bottom of that message automatically added text content: "Get your private, free email at <http://hotmail.com>". (EBizMags, 2008).

Viral marketing is one type of internet marketing, and involves voluntary transmission of advertising messages by the users themselves. In order to further spread viral content, or to become a viral campaign successful, it must achieve a very positive effect. It is very important that the campaign challenges the consumer emotions because such campaigns spread further like a virus, all consumers want to see it, and, according to their opinion, to pay it forward. (Stanojevic, 2011: 174).

The article will fetch the feasibility and methodology that was used to find out the perception of customers and companies about viral marketing, it will be explain usefulness and

effectiveness of viral marketing, viral marketing in the Republic of Croatia, as well as the perception of viral marketing in the Republic of Croatia by customers and enterprises and the Croatian economy. At the end of this article authors will bring a conclusion.

2. FEASIBILITY AND METHODOLOGY OF RESEARCH

The article aims to explore the perception of viral marketing in Croatia by consumers and businesses. The survey was conducted through two online surveys. Research subjects in the first survey were consumers or customers, while in the second survey were companies. The survey of consumers was conducted through social network Facebook, while a survey of companies was conducted by sending an e-mail to the addresses of those responsible.

The survey included 95 individual subjects through Facebook network and 14 companies. The relatively small sample of the main limiting factor of this research can serve as a basis for further research on the subject.

3. USEFULNESS AND EFFECTIVENESS OF VIRAL MARKETING

Viral marketing can be realized, or realized in any format, on any media and on any Web site, but you need to know when this kind of marketing is good solution, and when not. The viral marketing is an excellent solution in situations where there is the presence of a recognizable brand on the market, when the company wants to place a given product for a longer period without having any additional changes in the near future and is generally suitable for long-term projects. On the other hand, viral marketing is not a good solution in situations when you are organizing a one-day sales because it could be too slow, and therefore wrong marketing decision. (DEJANSEO, X).

To create a successful viral campaign, you need a quality viral content. Each viral content should have a "bait" of any kind to consumers interested in it and which will caused certain reactions in them. Viral content can be a photo, video, web page, or a song, but to make that content really went viral, it must have good quality and a very good production. For each viral content is required a passion of person who creates the content because if the creator of the content while creating the same content do not feel any emotions, consumers will not feel them too. (DEJANSEO, X).

A viral content and viral campaigns must be directed to a specific demographic group, namely, the same has to be built around specific products or services that are available in the market. Also, in the viral marketing it is essential constant awareness creation, extending like a virus, the presence of products and / or services. In fact, the aim of viral campaign is to do the advertising market for the company, but to achieve this, it is required a well-designed approach and the help of experienced professionals for viral marketing. (DEJANSEO, X).

Škare says that according to the study of Jupiter Research's, common objective of viral campaigns is to raise awareness of the brand (71%), sales promotion via the Internet (50%) and sales promotion through classic marketing channels (44%). (Fijolić, 2008).

The biggest advantage of viral marketing is the spread of viral messages, or viral content, orally, in particular the recommendation of friends or acquaintances. In fact, if friends recommend something to each other, it is very likely that they will register message and brand and ultimately, perhaps, buy the product being advertised. (Business Diary, 2013). Also, the big advantage of viral campaigns are that it does not require large financial costs and which can be expanded rapidly, which in turn contributes greatly to the effectiveness of viral marketing. On the other hand, as a lack of viral marketing, we can mention the loss of control over viral campaign, and over its course, and sent message can take on negative connotations, and call into question the purpose of their own viral campaigns. (Virtual Factory, 2015).

4. VIRAL MARKETING IN REPUBLIC OF CROATIA

Viral marketing in the Republic of Croatia occurs in the mid-nineties, but about first successful example can be spoken since 2009. In fact, teleoperator network Tomato, before television advertising, has tested on YouTube four spot and monitor what will be the reaction of the viewer. It was a campaign "More is too much" which became extremely successful, and in support of this is the fact that even today, consumers remember Darinka and Ante. (Virtual Factory, 2015).

In Croatia the era of viral marketing is just starting, and the Croatian market tend to isolate agencies that specialize exclusively for viral marketing, due to the fact that the market is not big enough for that kind of specialization. As for the use of viral marketing in the Republic of Croatia, it is very rare, but every marketing agency can create a good viral campaign if rely on the creative department, media relations, if agency research the market and monitors trends. (Fijolić, 2008).

Igor Škunc, director of HTTPool, internet marketing agency, says that interest in viral marketing in Croatia awakens, precisely because it is an interesting distribution channel, which in turn may find fertile ground among the new generation. (Fijolić, 2008).

A good example of a successful viral marketing in Croatia is video of Ivan Saric "Hire me Jon Stewart," in which the famous stand-up comedian and presenter through humorous videos requested job at Stewart and thus tried to achieve his dreams. In fact, his "online resume" rapidly spread across the Internet. (BBC, 2013).

In support of the development of viral marketing in the Republic of Croatia is the fact that the HTZ (Croatian National Tourist Board) for 2013 planned viral campaign on the social networks of the tourist season that year. The plan was to engage the side bloggers who will be performing in Croatia in the pre-season and gained experience to their audience. To be hosted by bloggers, Croatian National Tourist Board in the budget provided 1.5 million kunas, and the viral campaign on social networks has invested about 4.5 million. (DugiRat, 2012). However, as stated in their report on the work, the means for viral marketing campaign planned for that year, converted for the activities envisaged revision of annual work programs. (HTZ, 2013: 260).

5. PERCEPTION OF VIRAL MARKETING BY CROATIAN CONSUMERS

In viral marketing customers or consumers are key to buy the product that is promoted by the viral campaign because it also means that the viral campaign succeeded and that desired effects and objectives are achieved. Also, apart from the customers, there are also key persons who sent viral message onwards to their friends and loved ones, if they are the same like it, but who are also potential customers or initiators of buying other users.

People who spread viral message still called "kihači", and these are people who will go first to spread the news about the products. People who are considered as the best "geek" are enthusiasts, who are fascinated by new products and for this reason they want to share acquired knowledge with others. Likewise, as the best "geek" are considered and people with the same interest as well as users with a certain product and / or services intended, in addition to the pro-active in interactions with their counterparts. (Stanojevic, 2011: 174).

In order to better understand the perception of viral marketing in the Republic of Croatia by the customers themselves, or consumers, in the continuation of the article is due to present their opinions collected through a questionnaire.

The questionnaire was conducted via the social network Facebook for the reason that there are gathering users or consumers of different generations, and collected the results can get different opinions and views on the subject matter of this article.

Conducted survey consisted of 22 questions, for whose fulfillment had to be about 10 minutes, and the same is completed with 96 respondents. It is important to note that no question in the survey was not mandatory.

As far as the demographic characteristics of the 95 respondents who answered the question about the same, 22 of them are men and 73 are women. Furthermore, when it comes to age, the two of them have less than 18 years, from 18 to 24 years has 74 participants, ten respondents have from 25 to 40 years, eight respondents have of 41-60 years, while, more than 60 years there is only one respondent.

When it comes to the status of respondents, out of 95 who responded to this question, two are students, 74 of them are college students, 14 were employed, and five are unemployed. Also, 92 of the respondents are active consumers of goods or services, while three of them are not active consumers of goods or services.

Consumer habits are different, so out of 95 respondents who answered this question, 55 of them used food items, 29 of them used non-food products, 12 respondents most used services, while 34 respondents used all states equally.

Respondents were further asked in the survey on their preferences according to conventional or modern technologies, to which the answer gave 93 patients, of whom 79 more preference modern technology, while only 14 believes that conventional methods for better advertising.

When it comes to the knowledge of internet marketing, out of 90 who answered this question, 77 were familiar with Internet marketing, while 13 of the same does not know.

As for viral marketing and the customer's perception of the same, which is the topic of this article, from 76 respondents who answered the question on knowledge of viral marketing, 51 of them are familiar with the viral marketing, while 25 of them are not familiar with it.

Respondents were asked their opinion about viral marketing, to which was answered by 52 respondents. 32 respondents said that they liked a variety of viral messages that company or an advertising agency on behalf of the company creates for customers and consumers, while twenty of respondents do not like this kind of viral messages.

Very important is the fact that, in the opinion of respondents, better go viral messages that are directed to the original and / or unexpected story (41 respondents) and the product companies (10 respondents). On this issue, therefore, answered 51 subjects.

Furthermore, respondents were asked their opinion on the impact of viral campaigns to them as consumers. The 26 respondents believe that viral campaigns have a positive effect on them as consumers, 25 are considered to have a positive effect on them as consumers, while one respondent have no opinion.

Many respondents cited numerous examples well worked viral campaign, showing their familiarity and ability to recognize viral messages or viral campaigns. Some of the examples cited by the Tele 2, where sheep Gregor sings in the church, which caused many reactions of viewers and advertising for beer Ožujsko (Bednja, Čabar).

Also, the survey became the object of respondents on viral campaigns as a way of encouraging the purchase of products, to which answered 51 respondents. In fact, four of the respondents said that viral campaign in no way encouraged them to purchase products, 24 of respondents said that they neither stimulate viral campaigns, nor encouraged to purchase products, 11 of respondents said that viral campaigns generally do not encourage the purchase of products, while 12 respondents consider that viral campaigns generally encouraged them to buy the product.

Of the respondents was trying to find out whether, if they were able, will still send viral messages. On this question have answered 51 subjects. 34 respondents said that they will send viral message to their friends and / or acquaintances, while 16 respondents would not report it. Also, one of the participants had no thought about the matter.

In the questionnaire, from the respondents wanted to find out what must have a successful viral campaign. 42 respondents believe that successful viral campaign needs to have a good "bait", six respondents believes that successful viral campaign must have intended that the viral content

later transferred to an aggressive manner, or a manner that will in humans immediately cause reactions, while 21 respondents believe that successful viral campaign must have quality.

One of the important issues that arose respondents were if they love in the future, if they have still not, meet with viral marketing. The answer gave 91 subjects. In fact, 69 of the respondents prefer to learn about viral marketing, eighteen of them would not like to meet with viral marketing, while four respondents did not express an opinion.

From the above it can be concluded that viral marketing has the potential on the Croatian market, but also, there is still much room for progress and development. Customers and consumers are mostly unfamiliar with viral marketing and to most of them, and those who are not, it would still be the same love to meet in the future. Also, respondents' opinions about the impact of viral messages on them as consumers are pretty much divided, but it is justified opinion. Also, the majority of respondents believe that good viral campaign or viral message (content) must have a good "bait" and the quality to become successful, and therefore interesting to them as consumers. Respondents of the survey were willing to send forward viral messages to their friends and / or acquaintances if they enjoy the same, which is a good indicator of the success of viral marketing itself on the Croatian market.

In conclusion, it can be said that the consumer's perception of viral marketing on the Croatian market is generally positive, but the same could be raised to a higher level. Also, the results of this survey can greatly contribute to the further development of viral marketing on the Croatian market, as well as help companies that opt to use viral marketing in a way that the same pay attention to the opinions of customers, as well as to their wishes and needs.

6. PERCEPTION OF VIRAL MARKETING BY CROATIAN BUSINESSES

In order to better understand the application of viral marketing, as well as the understanding of the same in terms of Croatian companies, and Croatian economy, authors have carried out the questionnaire among companies. Specifically, the survey included 14 companies, to which was set 26 questions, and to fulfill the same they needed about 10 minutes. The survey is conducted online, via e-mail, to personalize examination.

The continuous of this article will highlight some of the most important results obtained from the implementation of the survey in order to obtain a better insight into the thinking of companies about viral marketing,

Of the 14 companies that participated in the survey, three are large, five are medium-sized, and 6 are small businesses. The survey involved a row following companies: Zagreb Brewery, Unity dd, Katarina line doo, Pula Herculanea, Dubrovnik Water Ltd., Health Care Institution Hippocrates, Bead Iton, Mobilisis Ltd., SLink, Biovit, Mobis, Adecco Ltd. For temporary employment and Yasenka Ltd. Companies that participated in the survey deal with different sectors from different branches of the economy, which is a good indicator for the survey, as authors want to know different opinions and views of businesses about viral marketing.

As for the use of Internet marketing, from 13 companies that responded to this question, nine of them use some form of Internet marketing, while four companies do not use any form of this kind of marketing.

When it comes to the topic of this article, or on viral marketing and the perception by the customer and the company, the question of whether companies use the viral marketing in their business, answer has given by 10 companies, of which four companies use viral marketing, four don't use viral marketing, and the two companies are considering this possibility.

Companies were also asked their opinion about viral marketing as a way of solutions to their business, on which was answered five companies, out of which all five considered to be the viral marketing an excellent solution for their business. The assumption is that all four companies that are alleged to use viral marketing in their business feel that it is the perfect solution for their business, while one of two companies that are considering the possibility of

introducing viral marketing in the business, also believes that viral marketing was excellent solution for their business.

Furthermore, authors wanted to find out from the companies in which situations they are using viral marketing, to which the answer is given by 5 companies. Three companies use viral marketing for short-term projects, which is not desirable in theory, the two companies replied that they use viral marketing to the marketing of products, and three responded that they use the same in situations where there is the presence of a recognizable brand.

One of the very important question was about creating viral content, specifically what is most important to companies in the creation of the same, and to this question six companies have responded. The three companies believe that in creating viral content, most important is to having a "bait" of any kind, the two companies are considered quality as the most important, while one company considers the most important intention of the content aggressively later transferred in a way that humans immediately cause reactions .

When it comes to elements of viral marketing, on this question answered six companies. 2 companies are considered as the most important element of the transmission of a message, which does not require too much effort, to others, one company considered as the most important element of viral marketing offering products or services, one company believes that most important element is use of common motivations and behaviors, one thinks that this exploitation existing communications network, while one considers that this is something else, but it is not specified which.

Companies in Croatia believe that the biggest advantage of viral marketing is voluntarily spread the message by friends and / or acquaintances (4 companies), one company believes that the biggest advantage of the financial cost, until one considers that this is an intimate and personalized messages that result in greater efficiency. On the other hand, as the biggest drawback, three companies state that it is designation viral campaigns as unwanted by consumers, two companies as the biggest disadvantage of viral marketing considered the danger of a certain loss of control over the campaign, and one company believes that it is damaged image of the company in case of unintended reaction of the market. When asked about the advantages and disadvantages of viral marketing responded 6 companies.

As for the mode of implementation of viral marketing, 4 out of 5 companies that responded to this question viral marketing conducted themselves, while one company has not declared about how they conduct viral marketing.

Companies were also asked about which channels are considered the most important for the spread of viral message, which was answered by 7 companies. 6 companies believe that social networks are the best channel for the spread of viral messages, while one company believes that the best way of spreading viral messages to the target group is through oral tradition channel-"word of mouth".

Also, companies are asked and what they think about which viral messages do better with their customers. Three companies believe that their consumers respond better to messages directed to the original and / or unexpected story, while the two companies believe that with their consumers best passing messages directed to the product itself.

When asked whether the company, as such, benefit from viral marketing, from five companies that responded to this question, 3 are considered to benefit from the same, while the two companies are considered to have little use of viral marketing.

Very important question for companies, which directly touches on the theme of this article, was whether they find it is viral marketing in Croatia is still a phenomenon, and whether consumers continue to represent viral marketing as something abstract, but the same was answered by six companies. The three companies believe that the viral marketing in Croatia is still a phenomenon, while three companies do not agree with that, or do not believe that is the case.

Also, most of the companies that responded to the question about satisfaction with the use of viral marketing are satisfied or mostly satisfied with the same, and none led to dissatisfied using viral marketing in their business. Accordingly, the company considered that their campaigns were successful, largely successful, or neither successful nor unsuccessful, which is a good indicator because neither company did not specify how their viral campaigns were unsuccessful.

Companies are asked whether to recommend other companies to use viral marketing in their business. 6 of 7 companies that responded to this question, gave an affirmative answer, while one company didn't have an answer.

Modern technologies are considered to be better and more successful way of advertising than conventional methods, which is considered as many as 9 out of 10 companies that responded to this question, while one company considers that are still better conventional methods.

In conclusion, it can be said that those companies that use viral marketing are satisfied or mostly satisfied with the results of the same, and the benefits they receive by implementing viral campaigns. Also, companies should not use viral marketing for short-term projects, such as, for example, a one-day sale because it will not bring positive results. Also, it is very important to pay attention to the importance of planning viral campaigns by the companies themselves, how they could be more successful and more natural, and therefore would have a greater effect on the market, as well as a greater willingness of buyers to such viral content is sent on.

7. CONCLUSION

Viral marketing is one of the types of Internet marketing, and involves spreading advertising messages by consumers to their friends and / or acquaintances. When creating viral campaigns, it is essential for viral messages that may be developed very good viral content. Also, it is necessary to know in what situations the viral marketing can be used, and in which not. In fact, it is not advisable to use for short-term projects, while, for example, for products that are intended to keep a long time in sales greatly recommended.

In Croatia viral marketing is not as developed as much, for example, outside its borders. In fact, in Croatia the same began to develop the nineties, however, the first true viral campaign was in 2009, and was initiated by teleoperator network Tomato. Also, in the Republic of Croatia is harder to find agencies that specialize exclusively for viral marketing, which is understandable given the fact that he is still developing and that is not so much present on the Croatian market, as it is for example in America.

In order to obtain a better insight into the customer's perception of viral marketing on the Croatian market on the one hand, and the opinion of the company on the same on the other hand, conducted a survey of consumers and businesses with the intent to collect certain results. Based on the data collected, and the results, it can be concluded that the majority of respondents are familiar with the viral marketing and its features, which is not surprising given the fact that most respondents just younger people. Furthermore, the majority of respondents believe that the better-off viral messages that are directed to the original and / or unexpected story, which is understandable because the buyers or consumers prefer those viral messages that in themselves have certain emotions. Respondents believe that viral campaigns have a positive effect on them as consumers, but almost half of them, too, believes just the opposite. The majority of respondents agreed with that and that viral campaign to be successful, it must have a good "bait", whether it is about photography, text, video, or something similar. In support of this article is the fact that the majority, if not, love to meet with the features of viral marketing in the future, which is a good indicator, because respondents as consumers are willing to know more about the topic of this article.

On the other hand, of the companies that participated in the survey, less than half of them used viral marketing, while a few are considering the possibility of introducing viral marketing in

your business. A good indicator is exactly what companies are thinking about implementation of the same in business, and that those companies that already use viral marketing in your business are the same happy and feel that their viral campaigns were successful and largely successful. Furthermore, half of the companies believe that the viral marketing in Croatia is still a phenomenon, and that continues to consumers represents something abstract, which is not a good indicator because there is a possibility that the very reason companies do not opt for this form of advertising, no matter what is something cheaper than other forms of advertising.

In conclusion, we can say that viral marketing in Croatia has the potential for development, as well as the possibility to become one of the best methods of advertising, however it is necessary the Croatian market, as enterprises and consumers familiar with the definition and characteristics of the same as far as possible, with the fact that the same is under-researched in the Croatian market.

LITERATURE:

1. DEJANSEO, URL: <http://dejanseo.hr/viralni-marketing/>, učitano: 21.06.2016.
2. Dugirat, URL: <http://www.dugirat.com/opcina/tzo/16300-viralna-kampanja-pisanje-stranah-blogera-o-hrvatskoj-platit-emo-15-mil-kuna.html> , učitano: 22.06.2016.
3. eBizMags, URL: <http://www.ebizmags.com/kako-napraviti-pozitivan-viralni-marketing/> , učitano: 21.06.2016.
4. Fijolić M. (2008), *Virusni marketing: Marketinška „zaraza“ koja se širi internetom*, URL: <http://lider.media/arhiva/37101/> , učitano: 22.06.2016.
5. Haramija P. (2007) *Marketing usmenom predajom: fenomen i mogućnosti*, URL: http://hrcak.srce.hr/index.php?show=clanak&id_clanak_jezik=35463 , učitano: 21.06.2016.
6. Hrvatska turistička zajednica, Izvješće o ostvarenju Programa rada Hrvatske turističke zajednice s izvješćem o financijskom poslovanju za 2013. godinu, URL: <http://business.croatia.hr/Documents/3642/Izvjesce-o-radu-2013-.pdf> , učitano: 22.06.2016.
7. Index, URL: <http://www.index.hr/black/clanak/ivanu-saricu-nakon-hire-me-jon-stewart-javio-se-producent-s-nbcja/670382.aspx> , učitano: 22.06.2016.
8. Link na anketu za poduzeća:
https://docs.google.com/forms/d/1wXEzstJhnyI64Vq7ZJTlmpoNoMtD1rnOHwvXn_mpqZk/edit
9. Link na anketu za potrošače:
https://docs.google.com/forms/d/10Pjig_2r_pt05Hrfc0_2kUZaORJg_ILyViYg9jDbN-g/edit
10. Poslovni dnevnik, URL: <http://www.poslovni.hr/marketing-i-mediji/viralni-marketing-ideje-tako-dobre-da-ih-ljudi-dije-240768> , učitano: 21.06.2016.
11. Stanojević M. (2011) *Marketing na društvenim mrežama*, URL: http://hrcak.srce.hr/index.php?show=clanak&id_clanak_jezik=115717, učitano: 21.06.2016.
12. Virtualna tvornica, URL: <http://www.virtualna-tvornica.com/viralni-marketing/> , učitano: 21.06.2016.

RELAXED BUSINESS REGULATIONS AS A PUSH FACTOR FOR THE ENTREPRENEURIAL ACTIVITY IN THE EUROPEAN UNION?

Valentina Vuckovic

*Faculty of Economics and Business, University of Zagreb, Croatia
vvuckovic@efzg.hr*

Martina Basarac Sertic

*Croatian Academy of Sciences and Arts
Economic Research Division, Croatia
mbasarac@hazu.hr*

Ruzica Simic Banovic

*Faculty of Law, University of Zagreb, Croatia
ruzica.simic@pravo.hr*

ABSTRACT

Since 2008 European Union countries have been enduring the effects of the most severe economic crisis experienced in 50 years. Consequently, since enterprises represent a principal component in creating a job-rich recovery, the European Commission, within the Europe 2020 Strategy and Entrepreneurship 2020 action plan, stressed the importance of entrepreneurial spirit in Europe. In that context, private sector development is recognized as a crucial determinant for long-term economic success. On the other side, countries' regulatory and administrative frameworks often hinder entrepreneurial initiatives. The main goal of this paper is to empirically analyse whether relaxing the constraints imposed by regulations increases the entrepreneurial activity in European Union countries. The special emphasis will be put on the effects of change in regulations on both opportunity-based and necessity-based entrepreneurship, using the GEM (Global Entrepreneurship Monitor) data. In this line of research, following the analysis of van Stel et al. (2007) and Stenholm, Acs and Wuebeker (2013), the paper will encompass the quality of entrepreneurship activity in countries, not only their number. In performing the analysis, a system GMM approach will be used for the 2001-2015 period. As an indicator of business regulation, we will use the Index of Business Freedom which is part of the Heritage Foundation Index of Economic Freedom that measures barriers faced by business sector from starting to closing the business, whereas the data for the quality of entrepreneurship will be obtained from the GEM database.

Keywords: *Entrepreneurship, European Union, Global Entrepreneurship Monitor, System GMM.*

1. INTRODUCTION

This paper is focused on the analysis of business regulations as one of the elements of broad concept of business environment. Precisely, business environment is a multi-dimensional concept for which there is no single definition, and there is a variety of terms used in the literature, such as the investment climate, entrepreneurial climate, the business environment, regulatory business environment etc., all of which are often used as synonyms. In its broadest terms, the business environment includes a large number of factors such as norms, customs, laws, regulations, policies, international trade agreements and public infrastructure.

Moreover, there are two basic approaches commonly used to explain the concept of a favourable business environment from the perspective of different assumptions about key elements of the business environment, the role of government and a design of appropriate policies (UNIDO, 2008, p. 5-6). The focus in this paper is on the neoclassical approach, which

further distinguishes narrower concept of regulatory business environment and broader concept of investment climate. More precisely, regulatory business environment that is analysed in this paper, encompasses regulations which affect business through costs of their compliance. These costs include direct costs such as the cost of obtaining permits and indirect costs resulting from very often unnecessary transactions (e.g. time spent to get a license and costs arising from the regulations that complicate the contract enforcement and the processes of hiring or firing workers). On the other hand, the concept of the investment climate, with all the elements of the regulatory business environment also includes the quality of infrastructure, health system, education policies, the rule of law, political stability and security, functional financial markets, trade liberalization and international rules and standards. As already mentioned, research in this paper will focus on the regulatory and administrative aspects of the business environment.

The paper is structured as follows. After the introductory section, Section 2 brings the overview of existing empirical research on the effects of business environment quality on private sector development. In Section 3 of the paper we analyse whether relaxing the constraints imposed by regulations increases the entrepreneurial activity in European Union countries. Besides the econometric analysis, this section also encompasses the descriptive analysis of the rate and type of entrepreneurial activity in selected countries, as well as the quality of their regulatory environment. Finally, Section 4 concludes and provides recommendations for future research in this area, taking into consideration all of the methodological limitations.

2. BUSINESS ENVIRONMENT QUALITY AND PRIVATE SECTOR DEVELOPMENT – OVERVIEW OF THE EXISTING RESEARCH

Despite the fact that the connection between the regulation and economic outcomes is intensively investigated in the last twenty years, there are relatively few studies that offer definite insights on the impact of the change in business regulations on economic performance, which is partly due to different methodologies used by various authors and data unavailability (e.g. see Eifert, 2009; Kirkpatrick, Parker and Zhang, 2006; Djankov, McLiesh and Ramalho, 2006; Haidar, 2012; Allard, Martinez and Williams, 2012).

From the perspective of the private sector, business environment includes a set of conditions that affect the behaviour of entrepreneurs (Kirkpatrick and Piesse, 2001). Therefore, in order to encourage private sector development and entrepreneurship (especially small and medium ones (SMEs)), many countries have (along with the macroeconomic stabilization policies; price liberalization and privatization) implemented business environment reforms. In following lines, we focus specifically on the impact of change in regulations on the private sector development. The aim of this section is to provide an overview of the literature on the impact of the business environment reforms on the development of the private sector and entrepreneurship in developed and developing countries.

Desai, Gompes and Lerner (2003) investigated the impact of the institutional environment on the nature of entrepreneurial activity in Europe. In doing so, they focused on the political, legal and regulatory factors, suggesting that greater fairness and greater protection of property rights increase entry rates, reduce exit rates, and lower average firm size. However, the results are less significant for the developed countries of Western Europe which points to the existence of unobserved factors (such as tax rates, regulations of the labour market and innovation) that affect the dynamics of companies in these countries.

Using the sample of companies from Eastern and Western Europe, Klapper, Laeven and Rajan (2004), explore different channels through which the business environment affects the establishment of new enterprises. Their results show that regulation adversely affects the entry of enterprises, especially in industries that naturally should have high entry. Additionally, value added per employee in industries with naturally high levels of entry grows more slowly in countries with stronger regulatory burden. The authors also point out that regulations which

enhance the enforcement of intellectual property rights or those that lead to a better developed financial sector do lead to greater entry in industries that do more R&D or industries that need more external finance. Thus, the authors do not provide the final answer on the issue whether the regulation is harmful or good. The issue regarding the optimal level of government intervention in regulating the business environment remains open.

Klapper and Love (2011), on a panel data of 91 countries, explored the impact of the ease of registering a business and the magnitude of registration reforms on the number of registered new companies. The results show that the costs, days and procedures required to start the business affect the number of newly registered companies. Furthermore, the study shows that small reforms (less than 40% reduction in procedures or 50-60% reduction in the costs and days) have no significant impact on the company registration. Also, the authors find significant synergy effects of reforms in two or more indicators of the business environment. In other words, reforms in several dimensions at the same time (e.g. in the cost and number of procedures) have a greater impact on company registration than sequential reforms. Finally, the results show that in countries with relatively weak initial business environment, larger reforms are needed in order to have an effect on the number of registered companies.

Kaplan, Piedra and Seira (2011) evaluated the effects of the reform on the registration procedures on formal firm registration in Mexico. The results show that reducing the costs of obtaining an operation license can lead to increased formal firm creation. The authors also find that the effects were only temporary and hardly will decrease informality or spur large growth. The authors point out that there are other barriers to "formalization" of business (e.g. taxes and access to credit), which is why programs that attack single aspects of the problem will have small effects on informality and firm creation, and therefore on growth.

Further, van Stel et al (2007) conducted an analysis on a sample of 39 countries, and show that in those countries that are more burdened by regulations on the entry of enterprises, there an increase in business activity after reducing such barriers is not expected. According to them, reducing barriers to entry does not solve the structural problems of the majority of informal enterprises. The authors find substantial differences between the determinants of opportunity entrepreneurship and those of necessity entrepreneurship. Whilst opportunity entrepreneurship is influenced by higher education, necessity entrepreneurship is not. Also, for those who become entrepreneurs out of necessity it is not likely that their companies become more dynamic after lowering the cost of registration. The authors conclude that if obstacles to the new firm creation have a modest role in explaining the differences in the rate of establishment of new enterprises, strategies to increase competitiveness based on the removal of only the above described barriers to entry should be revised.

Okey (2011) analyses the impact of positive changes in the business environment on private sector development and economic outcomes (such as private investment, foreign direct investment, domestic loans to the private sector and the GDP growth rate) in African countries. As indicators of business environment author used data of the Doing Business report series, Index of Economic Freedom and Corruption Perception Index. Obtained results, based on the panel analysis for the period from 2003 to 2008, indicate statistically significant impact of business environment reforms on selected indicators, implying that reforms represent an important factor for increasing employment and economic growth as well as for attracting investment.

Perotti and Volpin (2006), based on spatial analysis, show that increased investor protection positively influences the entry of the companies and the total number of procedures in sectors that depend on external sources of financing. However, while increased investor protection favoured consumers and poorer entrepreneurs, the authors point out that the same is not true for wealthy entrepreneurs who are more inclined to lower the level of investor protection. The authors suggest that improving formal investor protection laws while ignoring its enforcement

may not improve access to finance, as reforms may be captured by the current economic elite. In addition, based on the results, the authors conclude that countries with larger accountability of political institutions are characterized by higher level of investor protection as well as lower costs for starting businesses.

Stenholm, Acs and Wuebeker (2013) explored how differences in the institutional framework influence the rate and type of entrepreneurial activity in countries. The authors developed specific measure of environment that includes regulatory, normative and cognitive dimensions of entrepreneurial activity, adding the conducive measure of the country's capability to support high-impact entrepreneurship. The results indicate that the regulatory institutional environment has a statistically significant effect on the rate, but not on the type of entrepreneurial activity. In other words, according to the authors, favourable regulatory environment is a key factor for starting any kind of business activity. In contrast, in order to encourage the development of innovative entrepreneurship that has the greatest impact on development, it is necessary to focus on dimensions that affect the quality of entrepreneurial activity.

3. RELATION BETWEEN RELAXING BUSINESS REGULATIONS AND ENTREPRENEURIAL ACTIVITY

3.1. Descriptive analysis of business environment and entrepreneurial activity in European Union countries

The recovery and further development of the European economy will be based on private sector development, as demonstrated by the key strategic documents of the EU. However, this requires an environment that will encourage the development of SMEs, not limit it. It is therefore necessary to carry out business regulation reforms, especially in those countries with lower quality of entrepreneurial activity.

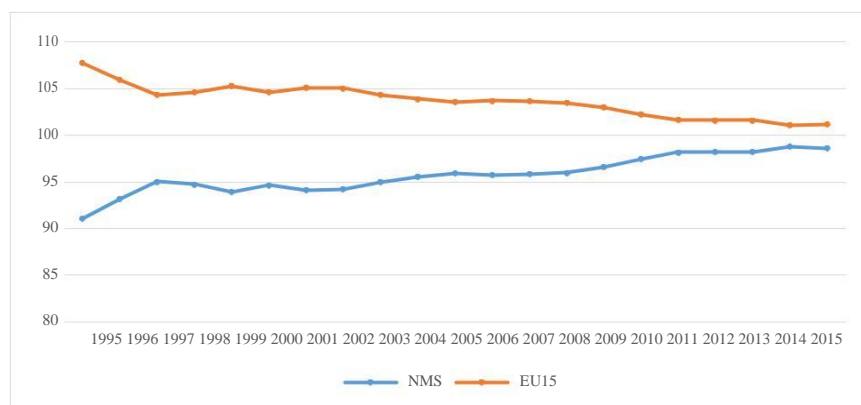
The first issues that arise within the analysis of business environment among countries is related to the measurement. Precisely, various organizations developed a number of indicators in order to measure the quality of the business environment, with each of them having some advantages and shortcomings since being mainly composite indicators. Indicators that are mostly used in the literature are the following: *Doing Business* (World Bank); *Investment Climate index* (World Bank); *Investment Reform Index* and the *SME Policy Index* (OECD); *Economic Freedom of the World* (Fraser Institute) and the *Index of Economic Freedom* (Heritage Foundation).

In this paper, as a measure of the quality of business environment we use the indicator of Heritage Foundation, i.e. *Index of Economic Freedom*, and its sub-component *Index of Business Freedom* in particular. On the other side, for measuring the quality and type of entrepreneurial activity the paper focuses on Global Entrepreneurship Monitor (GEM) data.

3.1.1 Measuring quality of business environment in the EU

Figure 1 shows data on the *Index of Economic Freedom* that measures the quality of business environment from the aspect of economic freedom (aggregate data) in the EU countries. Although this index represents broader concept than business environment, it offers an interesting insight into the perspectives of business environment in observed countries. For a more detailed analysis we chose the Heritage Foundation database (relative to e.g. *Economic Freedom of the World*) because the Fraser Institute database is dominated by outcome variables, while the variables included in the Heritage Foundation database are primarily related to the policies over which the governments have control (Heckelman, 2000).

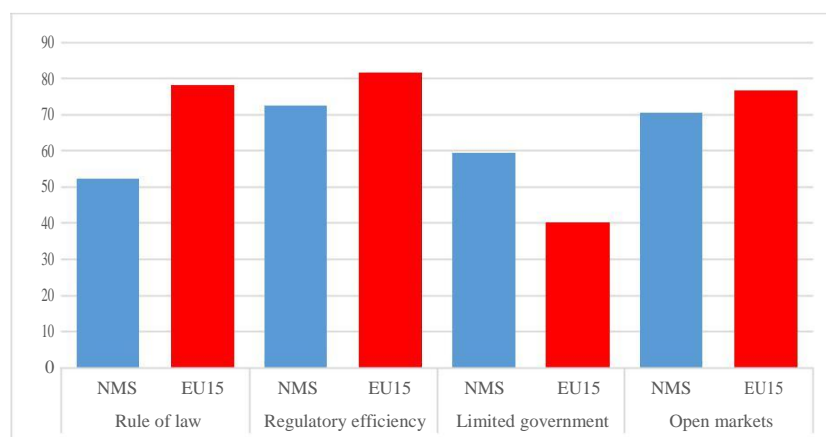
Figure 1: Index of Economic Freedom as a measure of business environment quality, EU28=100 (Authors calculations based on Heritage Foundation)



Based on the presented data, we can conclude that the quality of the business environment in the new EU member states (NMS)¹ was growing, especially after joining the EU (2004 and 2007), implying that the new member states increased the scope and pace of implementation of the business environment reforms after the EU accession. However, Figure also shows that, despite these trends, there is still a gap in the quality of the business environment between the EU15 and NMS13.

Since previous Figure shows the aggregate data, we cannot observe from which specific freedoms such situation arises between countries. Therefore, the following figure (Figure 2) shows the trends in the individual sub-indices contained in the Index of Economic Freedom related to the four categories of economic freedom: *rule of law* (average of the index of property rights protection and freedom from corruption), *limited government* (the average of index of fiscal freedom and government spending), *regulatory efficiency* (average of the index of business freedom and monetary freedom) and *open markets* (average of the index of trade freedom, investment freedom and financial freedom). In terms of the displayed sub-indices, we can conclude that the NMS are lagging behind the EU28 average in all categories. Specifically, the biggest gap is observed in the sub-index of *regulatory efficiency* and *rule of law*, the two elements that are mostly recognized as a constraining factor for increasing the entrepreneurial activity.

Figure 2: Trends in sub-indices contained in the Index of Economic Freedom (1995-2015 average) (Authors calculations based on Heritage Foundation)

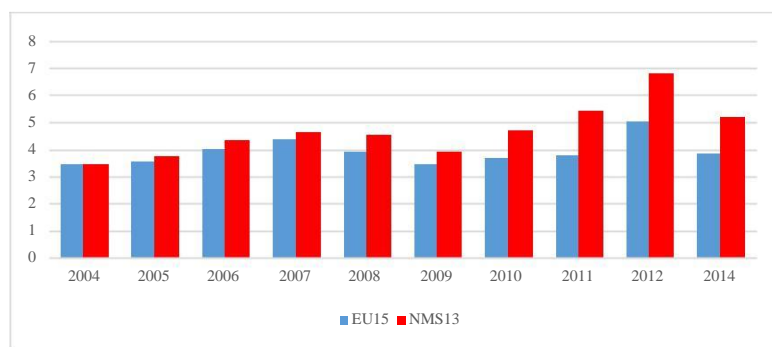


¹NMS – 13 countries that joined EU 2004, 2007 and 2013.

3.1.2 Measuring entrepreneurial activity in the EU

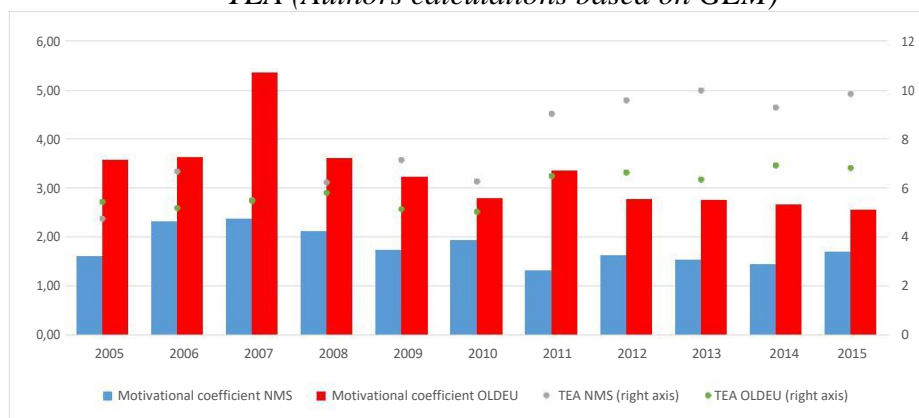
In addition, when comparing the EU15 and NMS groups of countries, and analysing data on new business entry density, defined as the number of newly registered corporations per 1,000 working-age people (those ages 15–64) (World Bank, last available year 2014), we can intuitively conclude that barriers which are placed upon the development of the private sector represent a significant limiting factor for entrepreneurship initiatives (Figure 3).

Figure 3. Entry density rate, % (Authors calculations based on World Development Indicators database, World Bank)



Furthermore, it is interesting to analyse the quality of the entrepreneurship according to the methodology of Global Entrepreneurship Monitor (GEM). Based on these data we can calculate a motivational factor, as a ratio between opportunity-based (improvement-driven opportunity) and necessity-based (necessity-driven) entrepreneurial activity. This is an important indicator of entrepreneurial capacity of a particular country because “the higher the motivational factor, the higher the likelihood that the business venture will be successful” (CEPOR, 2012: 11). In doing so, opportunity-based entrepreneurship is expressed as a percentage of those involved in TEA who (i) claim to be driven by opportunity as opposed to finding no other option for work; and (ii) who indicate the main driver for being involved in this opportunity is being independent or increasing their income, rather than just maintaining their income. On the other hand, necessity-based entrepreneurship is defined as a percentage of those involved in TEA who are involved in entrepreneurship because they had no other option for work. Finally, TEA (the total early-stage entrepreneurial activity) is expressed as a percentage of 18-64 population who are either a nascent entrepreneur or owner-manager of a new business.

Figure 4. Entrepreneurial activity (GEM methodology) – motivational coefficient and TEA (Authors calculations based on GEM)



We can see from the Figure that, in both the old and new EU member states, there is a higher proportion of opportunity-based entrepreneurship than necessity-based entrepreneurship (motivational factors in average amount to 3.3 and 1.8 respectively). In addition, we can also

see that, also in the NMS and old EU countries, the motivational factor decreased after the onset of the global economic crisis in 2008 implying that the number of necessity entrepreneurs increased due to adverse effects of the crisis. In the following section we explore whether change in business regulations (measured as change in *Index of Business Freedom*) had effect on number (measured by TEA data) and the type of entrepreneurial activity (measured by motivational factor).

3.2. Econometric analysis

3.2.1 Data and the sources

The econometric analysis included 23 European Union countries (Austria, Belgium, Croatia, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and United Kingdom). Further, we estimate two equations over the sample period 2001–2015, including the period of economic downturn, which was marked by unemployment rates at a historically high level (European Commission, 2015). Following previous discussion, we empirically assess whether relaxing the constraints imposed by regulations increases the entrepreneurial activity in European Union countries. The first depended variable is the total early-stage entrepreneurial activity (TEA). The values were taken from the Global Entrepreneurship Monitor (GEM) research database. In the next step, as discussed earlier, as a measure of the quality of business environment we use the *Index of Business Freedom* from the Heritage Foundation web site. Hence, the impact on TEA is expected to be positive. Furthermore, in the equations we also evaluate the importance of unemployment rate, expressed as a percentage of active population. The source of the data was Eurostat. Here we expect a negative sign. We also check the significance of corruption measured by Corruption Index (captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests) and rule of law (captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence), as additional factors that beside regulations influence the quality of entrepreneurial activity. The values were taken from the Worldwide Governance Indicators (WGI) research dataset. Further, central to our analysis, the second depended variable is the ratio between opportunity-based and necessity-based entrepreneurship, which was estimated in the second equation. All the variables are on a yearly basis. The lagged value (one-period lag) of the dependent variable will be used as an instrumental variable.

3.2.2 Model selection

For the purposes of this paper, the linear dynamic panel data models are examined. Further, since there are no data for all countries and years of interest, an unbalanced panel model will be used to estimate the models. The following specification was employed:

$$y_{it} = \beta_0 + \eta y_{it-1} + \sum_{k=1}^K \beta_k x_{kit} + u_{it},$$

where y_{it} is the dependent variable (entrepreneurial activity / ratio between opportunity-based and necessity-based entrepreneurship), y_{it-1} is the lagged endogenous variable (lagged one period of time); $k=1,2,3,\dots,K$ is the number of different independent variables of interest, $i=1,2,3,\dots,N$ is the number of different individuals or panels in the sample observed (23 EU

countries) at $t=1,2,3,\dots, T$ time points. Further, x_{kit} is any of the explanatory or exogenous

variables whose lags are also included in the model (index of business freedom, unemployment, control of corruption and rule of law), and finally, u_{it} is the error term in the model. Hence, we employ the Arellano–Bover/Blundell–Bond system estimator (Arellano and Bover, 1995; Blundell and Bond, 1998) augments Arellano–Bond (Arellano and Bond, 1991) by making an additional assumption that first differences of instrument variables are uncorrelated with the fixed effects, which allows the introduction of more instruments and can dramatically improve efficiency (Roodman, 2009). It is known as system GMM, because it establishes a system of two equations, the original and the transformed one. In our analysis, we employ the two-step estimator that was computed using STATA.

3.2.3 Empirical results

To investigate the impact of change in business regulations on the entrepreneurial activity, the set of regression analysis that use panel estimation models and that were discussed in the previous section were taken under sample of 23 European Union member states.

As can be seen in outputs (1) and (2) in Table 1, model diagnostics provides support to the analysed dynamic models. First, the GMM estimator is consistent according to the test for second order serial correlation, where the regression outputs show no autocorrelation between the residuals. Second, the specification Sargan test of overidentifying restrictions imply that the null hypothesis of instrument validity cannot be rejected (i.e. there are no correlation between the instrument and the error terms). The lagged dependent variable presents a positive sign, showing that entrepreneurial activity / motivational factor have a significant impact on long-term effects.

Third, the results of the corresponding Wald test suggest the significance of all explanatory variables. Table 1 also contains the results of the impact assessment of the selected variables on the entrepreneurial activity in European Union countries. More precisely, the model includes a persistence element (the lagged dependent variable), the index of business freedom, rule of law, control of corruption and the unemployment rate. The data in column 1 indicate a significant impact of business freedom, rule of law and control of corruption on the increase of the dependend variable (entrepreneurial activity). Specifically, the index of business freedom suggest that its increase will have a stimulating effect on the entrepreneurial activity in 23 EU member states. The effect is significant at the 5% statistical level, and economically meaningful. The empirical model also reveals that lower control of corruption and higher rule of law have statistically significant impact on entrepreneurial activity.

On the other hand, in order to investigate the reason behind the entrepreneurial activity, we estimate another model with the motivational factor as the dependend variable (column 2). It is interesting to notice, that in comparison with the model 1, higher control of corruption and lower rate of unemployment have statistically significant impact on motivational factor. The results clearly suggest the important difference when analysing specific type of entrepreneurial activity measured by motivational factor calculated as the ratio between opportunity- and necessity-based entrepreneurship. Moreover, the results indicate that crisis (measured in the model by unemployment rate) leads to a decrease of motivational factor (i.e. increase (decrease) in necessity (opportunity)-based entrepreneurship).

Table 1 The Results of the Dynamic Linear Panel Model – Dependent variables: Total early-stage Entrepreneurial Activity (TEA) (1); motivational factor (2) (Authors calculations)

	(1)	(2)
Lagged dependent variable	0.360*** (0.000)	0.423*** (0.006)
Index of business freedom	0.034* (0.080)	-0.006 (0.958)
Rule of law	2.370*** (0.000)	-3.319 (0.131)
Control of corruption	-3.874*** (0.000)	3.271* (0.061)
Unemployment	-0.037 (0.280)	-0.102* (0.056)
Constant term	3.604*** (0.010)	3.795 (0.633)
Sargan test	0.8558	0.4172
Arellano-Bond test for AR(2)	0.7686	0.4112
Number of observations	210	155
Number of groups	23	23
Wald test	2371.58 (0.0000)	42.06 (0.0000)

Note: ***, **, * indicate statistical significance at 1%, 5% i 10%; p-values in parenthesis.

4. CONCLUDING REMARKS

In order to encourage private sector development and entrepreneurship (especially small and medium ones (SMEs)), business environment reforms are much needed. In this paper, we focus specifically on the impact of change in business regulations on the entrepreneurial activity, measured by its number (TEA) and type (opportunity vs necessity based entrepreneurship). For this purpose, using the system GMM methodology, on the dataset of 23 European Union member states over 2001-2015 period, we obtain that main variable of interest - Index of Business Freedom – has a positive and statistically significant impact on the total early-stage entrepreneurial activity (TEA) expressed as a percentage of 18-64 population who are either a nascent entrepreneur or owner-manager of a new business. In addition, interesting result in this model is that higher (lower) corruption is connected with increased (lower) TEA, which points out to some previous findings that corruption facilitates new firm creation (so called greasing effect of corruption) (see e.g. Dreher and Gassebner, 2013).

On the other side, when analysing specific type of entrepreneurial activity measured by motivational factor calculated as the ratio between opportunity- and necessity-based entrepreneurship, the variable Index of Business Freedom is no longer statistically significant, implying that relaxing business regulations (such as costs of registering a company) are not crucial factor for increasing the number of opportunity- based entrepreneurs. On the other side, crucial factor in this model is control of corruption, where increase in the *Control of Corruption* index (lower corruption) results in larger motivational factor which implies an increase (decrease) in opportunity (necessity)-based entrepreneurship. Also, the results show that crisis (measured in the model by unemployment rate) leads to a decrease of motivational factor (i.e. increase (decrease) in necessity (opportunity)-based entrepreneurship).

We can conclude that the results presented in this paper are in line with the previous research. Specifically, as in Stenholm, Acs and Wuebeker (2013), the obtained results demonstrated that, while enabling business environment (measured through business regulations) is a necessary condition to start any type of business activity (increased TEA), in order to encourage businesses that would result in the largest effects on the development, it is necessary to focus on those elements of business environment that would increase the proportion of opportunity-based entrepreneurs, such as policies aimed at reducing corruption. Therefore, governments at all levels should play an important role in creating favourable environment for the development of the business sector.

LITERATURE:

1. Allard, G., Martinez, C. A., and Williams, C. (2012). *Political instability, pro-business market reforms and their impacts on national systems of innovation*. Research Policy 41, pp. 638–651.
2. Arellano, M., and Bond, S. (1991). Some tests of specification for panel data: Monte Carlo evidence and an application to employment equations, *Review of Economic Studies*, 58, pp. 277–297.
3. Arellano, M., and Bover, O. (1995). Another look at the instrumental variable estimation of error-components models, *Journal of Econometrics*, 68, pp. 29–51.
4. Blundell, R., and Bond, S. (1998). Initial conditions and moment restrictions in dynamic panel data models, *Journal of Econometrics*, 87, pp. 115–143
5. Desai, M., Gompers, P. and Lerner, J. (2003). *Institutions, Capital Constraints and Entrepreneurial Firm Dynamics: Evidence from Europe*. NBER Working Paper 10165.
6. Djankov, S., McLiesh, C. and Ramalho, R. (2006). Regulation and growth, *Economic Letters*, 92 (3), pp. 395–401.
7. Eifert, B. (2009). *Do Regulatory Reforms Stimulate Investment and Growth? Evidence from the Doing Business Data, 2003-2007*. Working Paper No. 159. Center for Global Development.
8. European Commission (2015) Annual Growth Survey 2016, Strengthening the recovery and fostering convergence, Brussels, 26.11.2015, COM(2015) 690 final.
9. Eurostat, <http://ec.europa.eu/eurostat>
10. GEM Global Entrepreneurship Monitor, <http://www.gemconsortium.org/>
11. Haidar, J. I. (2012). The impact of business regulatory reforms on economic growth, *Journal of The Japanese and International Economies*.
12. Heckelman, J. C. (2000). Economic freedom and economic growth: a short-run causal investigation, *Journal of Applied Economics*, Vol. III, No. 1, pp. 71-91.
13. Index of Economic Freedom, <http://www.heritage.org/index/>
14. Kaplan, D., Piedra, E. and Siera, E. (2011). Entry Regulation and Business Start Ups: Evidence from Mexico, *Journal of Public Economics*, 95(11-12): pp. 1501-15.
15. Kirkpatrick, C. and Piesse, J. (2001). *Regulation for Enterprise Development and Regulatory Impact Assessment*. Enterprise Development Impact Assessment Information Service (EDIAS).
16. Kirkpatrick, C., Parker, D. and Zhang, Y. F. (2006). *Foreign Direct Investment in Infrastructure in Developing Countries: Does Regulation make a Difference?*. Transnational Corporations, 15 (1).
17. Klapper, L. and Love, I. (2011). *The Impact of Business Environment Reforms on new Firm Registration*, available under:
http://siteresources.worldbank.org/INTFR/Resources/Klapper_Love_Feb14_12.pdf.
18. Klapper, L., Laeven, L. and Rajan, R. (2004). *Business Environment and Firm Entry: Evidence from International Data*. CEPR Discussion Papers 4366.
19. Okey, M.K.N. (2011). *Institutional Reforms, Private Sector, and Economic growth in Africa*. Working paper No.2011/40. UNU World Institute for Development Economics Research.
20. Perotti, E. and Volpin, P. (2006). *Investor Protection and Entry*. Tinbergen Institute Discussion Paper TI 2007-006/2, available under: <http://papers.tinbergen.nl/07006.pdf>

21. Roodman, D. (2009). How to do xtabond2: An introduction to difference and system GMM in Stata, *The Stata Journal*, 9, Number 1, pp. 86–136.
22. Stenholm, P., Acs, Z. J. and Wuebker, R. (2013). Exploring country-level institutional arrangements on the rate and type of entrepreneurial activity. *Journal of Business Venturing*, 28, pp. 176-193.
23. The World Bank, <http://www.worldbank.org/>
24. Worldwide Governance Indicators (WGI),
<http://info.worldbank.org/governance/wgi/index.aspx#home>
25. UNIDO (2008). *Creating an Enabling Environment for Private Sector Development in sub-Saharan Africa*.
26. Van Stel, A., Storey, D. and Thurik, R. (2007). *The Effect of Business Regulations on Nascent and Young Business Entrepreneurship*. *Small Business Economics*, 28, pp. 171 – 186.

E-COMMERCE DELIVERIES 2.0: TOWARDS A SUSTAINABLE E-COMMERCE

Verheyen Wouter

Erasmus University Rotterdam, The Netherlands

Odisee UC Brussels, Belgium

verheyen@law.eur.nl

ABSTRACT

Over the last decade e-commerce has reached the age of maturity. However, there are still some growing pains remaining. An important one is the delivery method of parcels, both the strength of e-commerce as the Achilles heel. First of all, the costs of delivery are substantial. If the cargo interest decides to use his right of withdrawal, such costs remain with the webshop. Moreover, parcels get lost or damaged during delivery, while the risk remains with the webshop and the recourse possibilities against the carrier are often very limited. Finally, e-commerce still can't provide the same consumer experience as physical sales, as consumers can't "test" their orders. Even though this is possible at home, the consumer has to pay the costs of reshipment and might see the time investment of reshipment as an obstacle. Webshops meet these concerns by providing for free reshipment, but this further increases the costs. In this paper, two alternatives to deal with these obstacles are introduced. The first one is cooperative e-commerce, whereby different specialized webshops act as mutual delivery points, where parcels of the other webshops can be picked up, tested and left behind in case of a change of preferences. This creates a proximity without having to engage in expensive delivery at home. In the second model this role is performed by individual loyal consumers, who will play a role as ambassadors and accept delivery at home for consumers choosing this delivery point. Albeit such delivery methods seem to be valid complementary alternatives, there are different legal obstacles to such alternative delivery methods. In this paper, after investigating the current obstacles, we investigate the liability impact of both alternatives..

Keywords: *e-commerce, damage during delivery, crowd logistics, cooperative logistics.*

1. INTRODUCTION

In the Green Paper An integrated parcel delivery market for the growth of e-commerce in the EU, (EU Commission, 2012, 22) one of the central threats of a sustainable e-commerce is identified: *"Parcel operators are concerned by potential increases in costs which might have to be reflected in higher prices to customers. At the same time, consumers are getting used to "free shipping" offers, as a result of which they might underestimate the true operational and societal costs linked to delivery operations."* While large e-retailers have a bargaining position towards the parcel delivery companies, SME's lack such bargaining position. If they want to compete with the large e-retailers *"free shipping-policy"*, SME's will have to internalise shipping costs in their retail price.

This can however endanger either profitability or competitive price setting. This is even more the case because the consumer is entitled to a 14 days right of withdrawal, with the webshop remaining liable for costs of the initial carriage. In addition, the seller bears the risk for damage during the transport (article 20 Consumer Rights Directive¹). Even though the e-retailer could in such situation seek compensation from the carrier, especially in the case of high value

¹

Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council, L 304/64, 22 November 2011.

consumer goods, carriage law is very carrier-friendly, creating a recourse gap for the e-retailer. Moreover in case of e-commerce it will often prove to be difficult to establish that damage came into existence during the carrier's period of responsibility. The current liability rules, albeit consumer-friendly, seem therefore to endanger sustainability of SME e-retailers. In logistics, just like in other fields, new cooperative models are being developed. Applying such models to e-delivery could provide for a more sustainable distribution model for e-commerce businesses. In this paper we focus on two such cooperative models: horizontal cooperation between webshops (see for an overview of studies on horizontal cooperation in logistics: L.E. Amer and L.E. Eltawil, 2015, 1-10) and crowd logistics (for an overview of different types of crowd logistics, see: A. Mladenow, C. Bauer and C. Strauss, 2016, Vol. 12 Issue: 3). In case of horizontal cooperation, webshops cooperate as mutual delivery points for each other, while in case of crowd logistics, individual consumers can act as delivery point for a specific webshop. Both these models allow to create thicker cargo bundles and in case of webshops dedicated to a specific type of products (for example a specific sport), consumers acting as crowd logistics distribution points could really act as ambassadors for the e-retailer and with this enhance loyalty as a value added service in addition to the logistic services they provide.

Horizontal cooperation thus can have several advantages for SME's. However, there are also different legal questions that arise from such alternative delivery models. In this article the focus lies with the impact of cooperative delivery on the aforementioned costs and liability exposure. Therefore after in the first chapter introducing both types of horizontal cooperation, in the second chapter we will analyse whether horizontal cooperation could effectively eliminate the consumer's right of withdrawal. In the third chapter we investigate at what time the risk passes to the consumer and whether the (passing of the) risk could be manipulated through horizontal cooperation. A final question is what liability rules apply in case damage is caused to the goods after delivery to the delivery point (the third webshop or the consumer delivery point) but before handing them over to the consumer. As in general no mandatory rules govern this period of storage, recommendations are being made for contractual stipulations.

2. COOPERATIVE DELIVERY POINTS?

The two delivery models that are being investigated have in common that a third party acts as a delivery point for the parcels sold by the e-retailer. The delivery point doesn't act here as an agent for the carrier, as in case of traditional delivery points (for example UPS access points) but instead for the e-retailer. Delivery by the carrier thus happens at the time when he delivers the parcel to the delivery point. The delivery point will thus accept delivery of the goods for the e-retailer, inspect their apparent order and condition and notify the carrier of any damage (see further under 3.2.2), store them and deliver them to the consumer when he picks the goods up. In addition the delivery point should dispatch the inspection of the goods by the consumer and if the contract between the consumer and the e-retailer is only concluded at the time of picking up of the parcel (see further under 3.2.2), the delivery point should conclude such contract on behalf of the e-retailer.

The difference between both types of delivery points lies in the capacity of the delivery point. In case of horizontal cooperation between co-e-retailers, e-retailers cooperate as mutual delivery points for each other, while in case of crowd logistics, individual consumers can act as delivery point for a specific webshop. Especially the latter model raises additional legal questions, falling outside the scope of this article, such as labour law questions (is there a risk for the delivery point to be qualified as an employee, (see for example Commercial Court Brussels 25 September 2015, [http://www.legalworld.be/legalworld/uploadedFiles/Rechtspraak/De_Juristenkrant/Kh.%20Brussel%2025%20september%202015%20\(UberPop\).pdf?LangType=2067](http://www.legalworld.be/legalworld/uploadedFiles/Rechtspraak/De_Juristenkrant/Kh.%20Brussel%2025%20september%202015%20(UberPop).pdf?LangType=2067) on the qualification

of an Uber-driver as employee)) and even questions of spatial planning (can an individual exercise activities as a delivery point in a residential area and, if so, is there a limit to the extent of such activities.). For the three issues dealt with in this article the difference between the two types of delivery point is however largely irrelevant (to the exception of a desirable liability standard, discussed in chapter 5). Therefore further in this article both types of delivery points will be referred to as "delivery points".

3. IMPACT HORIZONTAL COOPERATION ON RIGHT OF WITHDRAWAL

3.1. Right of withdrawal?

The exercise of the right of withdrawal constitutes a major cost for e-retailers. Consumers possess of a period of 14 calendar days (For the fact that it concerns calendar days, see: recital 41 Consumer Rights Directive. See also: Guidance document consumers Rights Directive, 37) to withdraw from an online sales contract, without giving any reason, and without incurring any costs (Article 9.1 Consumers Rights Directive). The e-retailer will in such case have to refund the price, including the shipping costs, within a few working days (Guidance document Consumers Rights Directive, 46). The e-retailer will thus ultimately bear these shipping costs himself in case of changed consumer preferences. The costs connected to the exercise of the right of withdrawal can however go beyond these shipping costs. As the consumer is entitled to test the product in order to establish the nature, characteristics and functioning of the goods (Art. 14(2) Consumer rights Directive.), there can be damage to the package or even a (limited) loss of value to the goods, without the e-retailer being allowed to refuse to refund (part of) the sales price.

The question arises now whether delivery through horizontal cooperation could eliminate the consumer's right of withdrawal or whether it could alternatively eliminate (part of) the costs connected to the exercise of this right.

3.3. Can horizontal cooperation eliminate right of withdrawal?

3.2.1 Right of withdrawal not impacted by delivery method

In recital 37 of the Consumer Rights Directive, the rationale behind the right of withdrawal is being explained. Here it reads that *"Since in the case of distance sales, the consumer is not able to see the goods before concluding the contract, he should have a right of withdrawal. For the same reason, the consumer should be allowed to test and inspect the goods he has bought to the extent necessary to establish the nature, characteristics and the functioning of the goods."*

Consequently such right is independant of the question whether the parcel will be delivered to the consumer or whether he should alternatively pick it up somewhere. It follows from this that the e-retailer can't exclude the right of withdrawal by performing delivery through horizontal cooperation.

3.2.2 horizontal cooperation as a limit to the right of withdrawal

Even though as a rule the delivery method can't impact the existance of the right of withdrawal, there are two ways in which the e-retailer can use this delivery method to exclude, or at least limit the negative consequences connected with the exercise of the withdrawal right.

The first option is to conceptualise the online order as a reservation to hold the goods during a certain time at a specific place. As the sale will only be concluded at the time of picking up of the goods, after the consumer had the opportunity to inspect them, no distance sale contract would be concluded and therefore the e-retailer could validly exclude the right of withdrawal. There are however two constraints to this method. The first one is that such method might increase the number of no shows, consumers making an order without picking it up at all.

However, this risk should at the same time be nuanced. First of all, also in case of traditional e-sales, the withdrawal rate is high. As delivery costs would be much lower, a higher number of no shows would not necessarily be detrimental to the e-retailer. Second, making orders still involves transaction costs for the consumer. This would be a limit to large scale fun shopping, without effective picking up. Finally e-retailers could provide in their terms and conditions that after a specific number of reservations, followed by a no-show, the consumer will be refused access to this option.

The second alternative is to conclude the contract in the same way as in case of traditional e-sales, but to oblige the consumer to inspect and test the goods at the delivery point. According to the Directive, the right to use the goods before a withdrawal of the sale shouldn't go beyond what is necessary to establish the nature, characteristics and functioning of the goods (Art. 14(2)

Consumer rights Directive). Recital 47 further specifies the limits to this use: *“the consumer should only handle and inspect them in the same manner as he would be allowed to do in a shop.”* The guidance document provides further guidance as to how this standard is to be interpreted. *“Before purchasing audio/video and recording equipment, the consumer would normally be able to test the image or sound quality; Trying on a garment in a shop would not involve the removal of the manufacturer's tags; The consumer would not normally be able to practically test household appliances, such as kitchen appliances, the actual use of which unavoidably leaves traces; The consumer would not be able to configure software on a computer; hence reasonable costs for any resetting of such equipment would also constitute diminished value”* (Guidance document Consumers Rights Directive, 47). Therefore, such use could also be performed in the delivery point, provided that the same facilities are available as in a traditional shop (for example wardrobes in case of the purchase of clothes). Still the possibility to sanction a later withdrawal is limited as the e-retailer can't refuse the consumer's withdrawal or sanction withdrawal by means of for example a belated refund.

Even if a more extensive use of the product is established, this doesn't deprive the buyer from the right to withdraw. In such case, the buyer will however be liable for the additional decrease of value that was caused by this use (such value decrease could also follow from damage to the package). It is unlikely that a standard clause according to which a fixed deduction of compensation would be applied if the consumer withdraws after testing the goods in the delivery point would stand in court. The burden of proof that the product was used beyond what was necessary and that this effectively resulted in a depreciation of the value lies with the seller (See in this respect also: ECJ C-489/07 *Pia Messner v Firma Stefan Krüger*, ECR 2009 I-07315). In order to improve his evidentiary position, the e-retailer should anyway ask the consumer to sign a statement upon delivery according to which goods were properly tested before the consumer left the delivery point.

Also a belated refund in case of withdrawal after the picking up of the parcel is not possible. After the goods are sent back, according to the Regulation the e-retailer has to refund the consumer with undue delay. Even though no specific deadline is put forward in the Regulation, the guidance document stipulates that this should be done within a few working days (Guidance document Consumers Rights Directive, 46). Therefore the only diversification that is permissible here, is that the e-retailer could immediately refund in case of an immediate withdrawal, while he would wait some days in case of a later withdrawal. This however doesn't seem to constitute a strong incentive for the consumer to exercise the withdrawal right immediately.

The greatest permissible sanctioning mechanism lies in the attribution of the costs of returning the goods. According to article 14 of the Directive, the consumer shall bear the costs of returning the good. Therefore the e-retailer could provide for a free returning policy in case the parcel is left behind at the delivery point, while in case of a later withdrawal, the consumer

should bear the costs of returning. In order to lay such costs with the consumer, the e-retailer should notify the consumer hereof.

In summary, if e-retailers are willing to change their contracting method and delay the time of the actual conclusion of the contract, they could exclude the withdrawal right. This would however in many cases also postpone payment of the goods. If however they want to maintain their traditional contracting method, then still cooperative logistics could allow to limit the exercise of the withdrawal right after the time of picking them up at the delivery point.

4. IMPACT HORIZONTAL COOPERATION ON (PASSING OF) RISK

4.1. (Passing of) risk in case of traditional e-sales²

According to article 20 of the consumer rights directive, the risk for loss, damage or delay during shipment only passes to the consumer when the consumer or a third party indicated by the consumer, has acquired the physical possession of the goods. Existing practises such as “delivery on driveway” or “delivery next door” don’t constitute a physical delivery in the sense of article 20, except if the neighbour was indicated by the consumer himself as a person entitled to take delivery (art 20 Consumer Rights Directive). Consequently, if the goods are delivered on the driveway and they get damaged or lost, the seller still bears the risk. The same is true if the goods get damaged during their stay at a non-designated neighbour. While such practises aim at reducing the costs connected to multiple delivery attempts, they also contain a risk for the e-retailer. During such period there is obviously an increased exposure to theft, but also to damage due to exposure to the natural elements.

If the goods effectively get damaged or lost during this time, the e-retailer could in theory hold the carrier liable. The liability of the carrier is governed by the CMR Convention in case of international transport by road.³ The same regime is implemented, either directly or in a modified form in several countries` national law (for example in Belgium, the Convention is implemented (Art. 51 Wegvervoerwet⁴), but also in the Netherlands, the changes are rather limited (art. 8:1090-8:1138 BW. See about the changes: *Memorie van Toelichting bij het ontwerp voor een nieuw Burgerlijk Wetboek, Toelichting zesde gedeelte (Boek 8 - Verkeersmiddelen en vervoer), Kamerstukken II, 1979-80, 15 966, nr. 3-4, p. 5* and also in Germany there are strong similarities (§ 407 e.v. HGB; see H. MERKT, 2012, nr. 3)). CMR requires a consent between carrier and consignee in order for there to be a valid delivery (HR The Netherlands 20 April 1979, ECLI:NL:HR:1979:AC6562, *Ribro/Smits*, <http://deeplinking.kluwer.nl/?param=0019BC48&cpid=WKNL-LTR-Nav2>, NJ 1980, 518; Cass. France 20 May 1986, *ETL* 1986, 340; HR The Netherlands 17 February 2012, *Tele Tegelen BV/ Stainalloy Nederland B.V.*, deeplink.rechtspraak.nl/uitspraak?id=ECLI:NL:HR:2012:BT8464, NJ 2012/289). Therefore “delivery” on driveway or to the neighbours will as a rule not discharge the carrier from liability, keeping him liable for damage (Kh. Thume, 2007, p. 377), still there is a great risk for the e-retailer. First of all, if delivery is impossible (Kh. Thume, 2007, p. 328), the carrier can validly deliver to the neighbours and only a fault-based liability will apply to the carrier in such

² This issue is discussed more in depth in some of my earlier studies, such as W. Verheyen, 2015 (1), p. 1-16 and W. Verheyen, 2015 (2), p. 185-223.

³ Convention on the Contract for the International Carriage of Goods by Road (CMR), Geneva, 19 May 1956.

⁴ Wet betreffende het goederenvervoer over de weg en houdende uitvoering van de Verordening (EG) nr. 1071/2009 van het Europees Parlement en de Raad van 21 oktober 2009 tot vaststelling van gemeenschappelijke regels betreffende de voorwaarden waaraan moet zijn voldaan om het beroep van wegvervoerondernemer uit te oefenen en tot intrekking van richtlijn 96/26/EG van de Raad en houdende uitvoering van de Verordening (EG) nr. 1072/2009 van het Europees Parlement en de Raad van 21 oktober 2009 tot vaststelling van gemeenschappelijke regels voor toegang tot de markt voor internationaal goederenvervoer over de weg, B.S. 18 februari 2014, 13108.

case. Secondly, in other cases this liability will in general be limited. This liability is in case of road transport limited to 8,33 SDR/kg, an amount that is highly insufficient for many high value consumer goods (See on this question in depth my earlier studies: W. Verheyen, 2013, p. 3-12; W. Verheyen, 2015 (2), p. 208-210; see further CA Antwerp 31 October 2011, 2010/AR/875, N. V. DPD Belgium/ P. J. Timmermans, *ETL* 2013, 82 (in this case a luxury watch was lost during carriage and compensation under CMR would have amounted to 0,0026% of the value of the watch)). These limits can only be set aside in case of wilful misconduct or a fault equivalent to wilful misconduct. It is debated whether a delivery on the driveway (Kh. Thume, 2007, p. 341; I. Koller, 2013, 1029) constitutes a wilful misconduct, allowing to break through the limits (this falls outside the scope of this article. See on this question in depth my earlier study: W. Verheyen, 2015 (2), p. 211-212) Secondly, in case of delivery with a neighbour, parcel delivery companies' standard terms contain clauses broadening the concept of consignee to neighbours of the designated consignee (see for example Art.10.1 UPS terms and conditions of carriage, www.ups.com/media/en/gb/terms_carriage_eur.pdf). With this, it could be argued that every neighbour is a valid consignee and that therefore the carrier can validly deliver the goods to such neighbour and end his period of responsibility. A counter argument against this is that, especially in case of a broad circle of consignees, such clauses erodes the essential obligation of the carrier to deliver the goods to the consignee and with this, constitutes a prohibited exoneration clause, as it is contrary to article 41 CMR (see M.A. CLARKE, 2014, p. 289-290; see with regards to the Warschau Convention: Cass. France 17 February 2009, D. 2009, 1308 (note P. DELBECQUE); Ph. DELBECQUE, 2009, p. 1309).

A different problem for the e-retailer lies in the fact that it will be very difficult, if not impossible to establish that damage was caused during transport. As a rule, in case of apparent damage immediate notice of any loss or defects should be given to the carrier in order for him to be presumed liable. In case of hidden damage the notification time amounts to 7 days (article 30 CMR; M.A. CLARKE, 2014, p. 86; I. Koller, 2013, p. 1156-1159; J. PUTZEYS, 1981, p. 184-192). For the consumer there is however no incentive to give such immediate notice. This follows from the fact that according to Art. 2.1 *jo.* 5.1 of the Consumer Sales Directive,⁵ if the damage takes place within the first six months, the damage is presumed to have existed at the time of the delivery (Art. 5.3 Consumer Sales Directive), placing the burden of proof upon the seller. Thus the consumer can claim for reparation, replacement or restitution from the e-retailer (Art. 3(2) Consumer Sales Directive), even if he waits some time before notifying this retailer. The retailer will then have to establish that damage was not existing at the time of delivery in order to escape liability or alternatively he will have to establish that the parcel was damaged at the time of delivery. Proof in both directions will be virtually impossible.

4.2. Can horizontal cooperation reduce risk in case of damage before delivery?

In case of horizontal cooperation, the risk will as a rule again only pass upon the moment that the consumer takes physical delivery of the goods. Delivery to the delivery point will not qualify as such delivery. Albeit this is not explicitly stated in the Consumer Rights Directive, this follows implicitly from article 20 *in fine* according to which, "*the risk shall pass to the consumer upon delivery to the carrier if the carrier was commissioned by the consumer to carry the goods and that choice was not offered by the trader.*" Thus, also if a list of delivery points is being provided by the e-retailer, the risk shall not pass. The situation is different in cases of bottom up crowd logistics, where the consumer chooses a crowd logistics provider not listed by the e-retailer.

Albeit cooperative delivery will thus not advance the time of the passing of the risk, still it offers a solution for the two aforementioned problem: it eliminates high risk/ low carrier liability

⁵ Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees.

practises such as delivery on driveway or to the neighbours and it improves the evidentiary position of the e-retailer. Obviously, if delivery is being made to a delivery point the potential risk of delivery on the driveway or to the neighbours is avoided. Also the evidentiary position of the e-retailer towards the carrier can however strongly improve in case of delivery to the delivery point. In such case, it will be in the interest of the delivery point to examine whether the goods are being delivered by the carrier in good order and condition. If not, the delivery point is at risk of incurring liability itself. In order to limit the costs connected to such inspection by the delivery point, it is recommended to set the picking up period for the consumer at maximum 7 days. This is advisable because the notification period amounts in case of hidden damage to 7 days (article 30.2 CMR). Thus if the picking up deadline is set at 7 days, and inspection will be performed by the consumer at the picking up point (see previous title), then the e-retailer can still give a timely notification of the damage to the carrier.

Cooperative delivery can thus eliminate the high risk delivery periods and in addition it can strongly improve the evidentiary position of the e-retailer towards the carrier in case of damage during delivery.

5. LIABILITY RULES APPLICABLE TO COOPERATIVE DELIVERY POINT

While carrier liability is governed by mandatory Conventions and national law, often modelled after these Conventions and equally mandatory, the liability of the delivery points is not governed by mandatory rules. As mentioned above, the contract between the e-retailer and the delivery point, can either be considered as a storage contract or as an agency contract. Both have in common that in general no uniform or mandatory rules exist for these contracts. Even though the liability standard is not uniform, many national regimes apply for both contracts a fault based liability. That is obviously disadvantageous for the e-retailer compared to the presumed liability of the carrier and similar to the liability standard applicable to the carrier in case of delivery to neighbours. Such fault based liability could take away the incentive for the delivery point to properly inspect the goods after delivery and would still confront the e-retailer with the same evidentiary problem. That is that he would need to deliver evidence in both directions.

Disadvantageous for the delivery point is the fact that liability is here as a rule unlimited. Such unlimited liability can entail a risk in case of high value parcels, such as consumer electronics. This is even more so in the second type of horizontal delivery services: crowd logistics. It seems undesirable that a consumer, maybe even an ambassador, would incur a liability of thousands of euros in exchange for a compensation of a few euros or even a voucher for next purchases. Also co-e-retailers could however be reluctant to cooperate with e-retailers selling high valued goods.

Confronted with these shortcomings, it could be advisable to contractually provide for presumed but limited liability. One possibility is to contractually incorporate the CMR liability regime, in order to make the entire delivery process subject to the same liability rules. An alternative is however to apply per collo limits instead of per kilo limits. Such limits exist in some national law parcel delivery conditions (see for example the SVA Conditions (SVA, 2011, www.sva.nl), which apply a limit of 454 euro per parcel). Such limits provide for a more effective compensation, and with this also for a better sanctioning mechanism for bad care for the goods by the delivery point. In case of storage of an Iwatch, compensation according to the CMR-limits would for example be limited to +/- 2 euro, what would not even provide the delivery point with an incentive to inspect the apparent state of the parcel upon delivery by the parcel delivery company. Irrespective of the limit that is chosen, still the question remains whether from a commercial point of view it is wishful to claim such compensation from the crowd logistics provider-ambassador. An alternative could here lie in a deduction of the credit available to this crowd logistics provider.

5. CONCLUSION

Cooperative delivery cannot only constitute thicker cargo bundles and with this reduce the costs connected to e-commerce delivery. In addition, it can also reduce several other costs that endanger the sustainability of SME e-commerce. First of all the costs connected to the exercise by the consumer of his right of withdrawal can be reduced, by channelling the exercise of such right to the moment of the picking up of the parcel. If e-retailers are willing to change the order system and postpone the moment of the conclusion of the sales contract until the moment the goods are picked up at the delivery point, the e-retailer could even eliminate such right of withdrawal. Secondly, the e-retailer can eliminate some special risks connected to parcel delivery. By providing in the carriage contract that delivery is to be made to a delivery point, the possibility of delivery on driveway or to the neighbours is excluded. Finally, cooperative delivery increases the possibility to receive a compensation from the carrier in case of damage during delivery, as the evidentiary position of the e-retailer improves. A threat to the success of cooperative logistics is the legal framework governing the liability for damage during the time that goods are at the delivery point. While the often fault based liability is disadvantageous to the e-retailer, the unlimited liability might take away the willingness for cooperative logistic providers and co-e-retailers to accept high value cargoes. Therefore, the incorporation of standard clauses, providing for a presumed but limited liability seems advisable. Such standard terms could be a catalyst to the development of cooperative delivery as a model for sustainable e-commerce.

LITERATURE:

I. Legislation

1. Convention on the Contract for the International Carriage of Goods by Road (CMR), Geneva, 19 May 1956.
2. Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees.
3. Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council, L 304/64, 22 November 2011.
4. Wet betreffende het goederenvervoer over de weg en houdende uitvoering van de Verordening (EG) nr. 1071/2009 van het Europees Parlement en de Raad van 21 oktober 2009 tot vaststelling van gemeenschappelijke regels betreffende de voorwaarden waaraan moet zijn voldaan om het beroep van wegvervoerondernemer uit te oefenen en tot intrekking van richtlijn 96/26/EG van de Raad en houdende uitvoering van de Verordening (EG) nr. 1072/2009 van het Europees Parlement en de Raad van 21 oktober 2009 tot vaststelling van gemeenschappelijke regels voor toegang tot de markt voor internationaal goederenvervoer over de weg, B.S. 18 februari 2014, 13108.

II. EU publications

1. EU Commission, Green Paper An integrated parcel delivery market for the growth of e-commerce in the EU, Brussels, 29.11.2012, COM(2012) 698 final
2. European Commission DG Justice, *DG Justice Guidance document concerning Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive 1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council*, June 2014.

3. European Commission, 2014, *Key Facts on the new EU Consumer Rights Directive*, retrieved 5 August 2016 from http://ec.europa.eu/justice/consumer-marketing/files/crd_arc2014_factsheet-consumer_general_en.pdf.

III. Case law

1. HR The Netherlands 20 April 1979, ECLI:NL:HR:1979:AC6562, Ribro/Smits, retrieved 5 August 2016 from <http://deeplinking.kluwer.nl/?param=0019BC48&cpid=WKNL-LTR-Nav2>, NJ 1980, 518
2. Cass. France 20 May 1986, ETL 1986, 340
3. ECJ C-489/07 Pia Messner v Firma Stefan Krüger, ECR 2009 I-07315
4. Cass. France 17 February 2009, D. 2009, 1308 (note P. DELBECQUE)
5. CA Antwerp 31 October 2011, 2010/AR/875, N. V. DPD Belgium/ P. J. Timmermans, ETL 2013, 82
6. HR The Netherlands 17 February 2012, Tele Tegelen BV/ Stainalloy Nederland B.V., retrieved 5 August 2016 from deeplink.rechtspraak.nl/uitspraak?id=ECLI:NL:HR:2012:BT8464, NJ 2012/289
7. Commercial Court Brussels 25 September 2015, retrieved 5 August 2016 from [http://www.legalworld.be/legalworld/uploadedFiles/Rechtspraak/De_Juristenkrant/Kh.%20Brussel%2025%20september%202015%20\(UberPop\).pdf?LangType=2067](http://www.legalworld.be/legalworld/uploadedFiles/Rechtspraak/De_Juristenkrant/Kh.%20Brussel%2025%20september%202015%20(UberPop).pdf?LangType=2067)

IV. other sources

1. Amer, L.E. and Eltawil, L.E.; Analysis of quantitative models of horizontal collaboration in supply chain network design: Towards “green collaborative” strategies. *2015 International Conference on Industrial Engineering and Operations Management (IEOM)*
2. Clarke, M.A. (2014); International carriage of goods by road: CMR, (6), Londen: LLP.
3. Delbecque, Ph. (2009). Transport aerien, le transporteur peut-il encore compter sur ses conditions générales?, *Revue Dalloz*. Paris:Dalloz
4. Koller, I. (2013); Transportrecht Kommentar (6), München: Beck
5. H. Merkt (2012), “HGB § 407 Frachtvertrag”, in: K. Hopt, H. Merkt, M. Roth en A. Baumbach (eds.), *Handelsgesetzbuch*. München: Beck
6. Mladenow, A. Bauer, C. and Strauss, C. (2016) ‘Crowd Logistics’: The Contribution of Social Crowds in Logistics Activities. *International Journal of Web Information Systems*
7. Putzeys, J. (1981); *Le contrat de transport routier de marchandises*, Brussel: Bruylant
8. SVA (2011), *Algemene Voorwaarden voor Koeriersdiensten*, retrieved 5 August 2016 from www.sva.nl
9. Thume, Kh (2007); Kommentar zur CMR. (2). Frankfurt am Main, Recht der Internationalen Wirtschaft
10. UPS terms and conditions of carriage, retrieved 5 August 2016 from www.ups.com/media/en/gb/terms_carriage_eur.pdf
11. Verheyen, W. (2013). The DPD-case: a case for a parcel-specific liability regime?, Jan Loyens (ed.) *Antwerp: ETL*
12. Verheyen, W. (2015). Starting B2c E-commerce in Europe: legal risks and challenges. *Biz and Bytes* Verheyen, W. (2015) “Stuck between consumer protection and carrier’s limited liability: the recourse gap in case of e-commerce”, Pravni Fakultet y Zagrebu, *Zagreb:Zbornik*

CONCESSION PRACTICES OF PUBLIC ENTERPRISES IN KOSOVO

Milaim Berisha

Tax Administration of Kosovo

Part-time Lecturer College of International Management „Globus”

milaim.berisha@gmail.com

ABSTRACT

Public Enterprises in the Republic of Kosovo for the purpose for which they were formed, at certain periods have faced different problems in terms of business, investments, management, etc. as well as the primary purpose for which were established- for service to the citizens (public wide). In order to serve to the broad public (citizens) in much qualitative manner, it was necessary that some enterprises start doing significant investments (in industry, infrastructure etc.). Considerable capital is required in order that such investments to be carried out by those public enterprises. After noting the deficiency in capital, experience, and technology, governments decided that a part of public enterprises is given to Public Private Partnership. In this way it becomes possible that the ownership of a public enterprise becomes mixed (depending on the percentage of shares). Mixed enterprises, which are entities owned jointly by public and private sector tend to be spread throughout the Western world, and is increasingly proved that they are successful in their activity.

Keywords: *public enterprises, public-private partnerships.*

1. CONCESSION PRACTICES OF PUBLIC ENTERPRISES IN KOSOVO (case analysis of Pristina Airport)

Mixed enterprises, which are entities owned jointly by public and private sector tend to be spread throughout the western world. The value of this phenomenon has not been studied enough in economic life. In order to discuss about the concession of Public Enterprises it is appropriate that first to clarify what are public enterprises. Enterprises can be interpreted simply as a legal entities which aim to carry out certain activities and to achieve the profit. This is a simple interpretation of the meaning of enterprises. But the main purpose for which the public enterprises were established (state-owned) was not only the profit achieved but also the services to the public (the general public).

Number of enterprises owned by the state or as they were previously referred to as the public enterprises (PE), was increased significantly during early 30's of the last century, but especially after the Second World War as in developed countries, also in countries on development. The aim was manifold, such as:

- a) Overcoming problems stemming from deficits and shortages in the capital market.
- b) Promoting economic growth.
- c) Reduction of unemployment and
- d) Provision of control over the overall management of the economy at the national level

After noting that the capital and technology in strategic areas private sector did not enter or lacked the capital needed to invest (such as heavy industry or infrastructure) most governments

were hoping that by means of public enterprises (PE) to increase the formation of capital, to produce the necessary goods at low cost, increase the number of jobs and contribute significantly to the development of the country¹. This trend continued until the early 80s of the last century. But a number of negative phenomena, as the increase of corruption, inefficiency in management, staff overflow in enterprises, inflation and increase of budget deficit, made that the 80s were exposed to the massive failures of governments and limiting the role of previously defined for public enterprises as key stakeholders in economic development².

Despite all of these and the reduction made to the number and to the weight of the Public Enterprises through the privatization process, still Public Enterprises continue to have a significant presence in many countries, by being the biggest providers of a range of social services and generating a significant number of jobs³.

Noting that public enterprises are facing difficulties of the aforementioned nature there was a need for a "new public management" or "new concept of governance". These ideas articulate the belief that public organizations or systems that underlie according to public systems lack the capacity to face challenges and to exploit the opportunities offered on XXI century. So re-conception or notion of "New Public Management" is considered as a new treatment of an old case: how to improve performance and accountability of governance⁴?

The best way to mitigate the potential difficulties associated with the privatization of PEs is the preparation of an adequate legal framework and commitment of governmental institutions for its implementation. Naturally, for the implementation of any large scale project, full accountability and transparency are essential prerequisites for achieving any success⁵.

The Republic of Kosovo has had some experience with privatization, especially in connection with the privatization of socially owned enterprises (SOEs). Without going into too much detail, the privatization of SOEs was managed by UNMIK (who prepared the necessary legal framework) and was implemented by the Kosovo Trust Agency (KTA) and later by Kosovo Privatisation Agency (KPA)⁶. There are two ways to transform a PE into a privately owned. The first: one PE can go through the traditional process of privatization, or rather say that by selling the shares of PE to a private entity. However, on the other hand, an PE can pass into private ownership through a public-private partnership (PPP) and/or with the concession to build, use and/or utilize public property infrastructure, and to provide public services⁷.

Public-private partnership is another way to have a privatized public enterprises for a certain period of time which means by giving them in concession. Procedures and other issues of public-private partnership are regulated by the Law on Public-Private Partnership ("PPP Law"). The purpose of the PPP Law is to set the legal framework for the award of public-private partnerships and concessions to build, use and/or exploit publicly owned infrastructure and to

¹ Corporate governance lectures chapter.9 page 260-265 February 2008

² Public sector efficiency A.Afonso Translated by V.Tanzi January 2008

³ The size and performance of public sector activities in Europe April 2002 H.Heinz,R.Philip

⁴ Public Administration, An Action Orientation, Robert B. Denhardt, Janet V. Denhardt, UFO Press, 2010, Tirane

⁵ Riinvest, Dilemmas and Backwards in a fast track -Privatization of POEs in Kosovo,Prishtine, October 2009.

⁶ Riinvest, Dilemmas and Backwards in a fast track -Privatization of POEs in Kosovo,Prishtine, October 2009

⁷ Riinvest, Dilemmas and Backwards in a fast track -Privatization of POEs in Kosovo,Prishtine, October 2009

provide public services. In particular, the Law on PPP "regulates the rights to utilize and/or exploit publicly owned infrastructure and/or provide public services in all economic and social sectors.

As provided by Article 2, the PPP law applies to a wide range of areas including, but not limited to, transport, energy, heat, water, telecommunications, education, health, and many other fields⁸.

The process for implementation of a PPP or granting a POE for concession to a private party is strictly defined that it should be under the authority of the government. According to Article 6.1 of the Law on PPP, PPP and concessions "will be given by a public authority which, according to the law, is directly responsible for the economic activity, which is subject to agreement." However, with the prior approval from the Government to public-private partnerships, inter-ministerial Steering Committee on public private Partnership (PPP-MSK) has the authority "to act as a Contracting Authority and grant concession and other rights to build PPP, use and/or exploit a public infrastructure facilities"⁹.

2. THE PURPOSE OF GRANTING FOR CONCESSION (PPP) PRISTINA AIRPORT

Government with the purpose of meeting the economic and operating potentials, and based on recommendations from the feasibility studies of investment levels, has decided to issue for concession the Prishtina International Airport, as it represents much higher economic benefit to Kosovo and in this way it will provide modern infrastructure and high quality services. In the last meeting of the Inter-Ministerial Steering Committee are reviewed and approved the request for proposals together with the Draft Agreement, which were sent to three pre-qualified companies on 29.12.2009. Bidders that are qualified and who are invited to participate in a competitive tender for the right to enter into Public – Private Partnership for the operation and expansion of Pristina International Airport, are¹⁰:

- 1) Fraport IC ICTAS Havalimani Isletme A.S
- 2) Bouygues Batiment International, Egis Project, Segap, Eurokoha
- 3) Limak/Aeroport de Lyon Consortium

The next step of this process is to organize a conference for investors, which was scheduled to be held in the last week of January 2010, where they will invite 3 qualified companies in order to clarify and discuss the questions they may have regarding to request for proposals. According to the schedule defined by the ISC, the final deadline for submission of bids was the last week of the month of March 2010, and award would be published the latest in early April.

3. TRANSACTION STRUCTURE

Public Private Partnership in PIA is expected to be a 20-year agreement form of Design - Construction - Finance - Operate - Transfer, and will include construction of a new terminal, three times larger than the existing one, 25,000 square meters. The new terminal will be monumental symbol of the future of Kosovo and will make proud citizens of Kosovo. Other

⁸ Law Nr 04/L-045 for Public Private Partnership but also cited at Riinvest....

⁹ Law Nr 04/L-045 for Public Private Partnership but also cited at Riinvest

¹⁰ www.pppkosova.org

required investments include the construction of a new tower of air traffic and the associated equipment, new aircraft parking apron that would provide another additional 9 positions, water treatment plant, etc. The Private Partner will be offering to each worker of PIA an employment contract for at least another three next more years, with wages and benefits that they currently have¹¹.

On 1 June 2010, the Kosovo Government announce as the winner consortium of the Turkish company "Limak" and French company "Aéroport de Lyon". Turkish conglomerate "LIMAK" that owns 90% shares of the winning consortium of the ANP, which was known for involvement in construction, energy and cement. Meanwhile the remaining 10%, was in possession of the French company "Aéroport de Lyon" that brought with them the experience - proportionate to ownership - in the field of airport¹².

4. IMPLEMENTATION OF CONTRACT

In the PPP agreement, implementation of the contract and investment supervision is foreseen by two mechanisms:

- Article 10.13 of the contract provides the establishment of the Project Management Unit (PMU) as an established unit by the provider; through which the recruitment of the professional staff that will supervise the implementation of the contract and will continuously inspect the concessionaire's operations is foreseen.
- The "independent engineer" will be responsible for inspecting, monitoring and evaluating the investment costs in the investments undertaken by the private partner.

Both mechanisms are important especially because of the investment levels which are foreseen to be done during the 20 years of concession- with particular emphasis in the first years of functioning, the concessionaire- as well as to supervise the eventual operations which affect the strategic interests and orientations of Kosovo¹³.

USW has not been established and it has never functioned as envisaged in the contract. Instead, contract supervision and implementation was carried out by the existing officials of the PPP Unit. In the race for "independent engineer" for the period April 2011 - January 2014, have competed four international companies, among which "Scott Wilson", "Ae-Com", "Hill International" and "Ine-co". The contract winner was selected the Spanish company "INECO"¹⁴.

Related to the scope of the contract implementation, according to the audit that was made by the Office of the Auditor General 2014 Contract/Agreement PPP PIA AJ it was concluded that: The new terminal started operation on time, in accordance with the PPP agreement and has been certified by the Civil Authority Aviation of Kosovo. Some shortcomings are presented in the report, which if not eliminated can bring serious problems in the implementation of PPP in

¹¹ www.pppkosova.org

¹² Riinvest Institute, Prishtina Airport Concession, Prishtine, 2015.

¹³ Riinvest Institute, Prishtina Airport Concession, Prishtine, 2015

¹⁴ Riinvest Institute, Prishtina Airport Concession, Prishtine, 2015

the next Agreement. For these issues were given 8 key recommendations to Committee for PPP¹⁵.

However PPPC with the new composition (established in 2015) and Central PPP Department have made some actions towards addressing the issues arising from the report in 2014.

From 8 (eight) main recommendations, four (4) recommendations have been addressed, three (3) were partially addressed and 1 (one) recommendation is not addressed¹⁶.

Recommendations addressed:

- 1) First recommendation for directives, regulations and minutes of meeting was addressed. PPPC produced and signed new rules of procedure.
- 2) Second recommendation. The PPC Committee has decided to establish the Permanent Project Management Unit (PPMU) consisting of five officials, civil servants.
- 3) Third recommendation. This recommendation has been addressed through the Decision on the establishment of the Permanent Unit for PPP. The decision sets forth for the Unit to report to CA/Committee for the PPP on quarterly basis. This rule may be incorporated in the PPP regulations/directives.
- 4) Fifth recommendation. Since the terminal facilities were not equipped with construction license in timely manner, MESP has taken actions in 2014 to legalise terminal/PIA-AJ facility, and it is treated as a pilot project for legalisation of unauthorized constructions.

Recommendations partially addressed

- 1) Fourth recommendation. All official documents and agreements are available in the official languages of the country. This recommendation is in process of being addressed. This recommendation has not been implemented in terms of PPP Agreement for PIA-AJ, because the basic PPP Agreement for PIA-AJ foresees that communications should take place in English. In this way, correspondence, annexes and issues related to the PPP Agreement for PIA-AJ are carried out in English. Contracts/agreements for new projects which are under implementation through PPP form are drafted in the official languages of the country.
- 2) Seventh recommendation. New Terminal should be accepted in accordance with the PPP Agreement with the expected level of safety and capacities. This recommendation is not yet fully implemented. Addressing of the recommendation it became even more unclear after the request from the chairperson of the former PPPC that signed the works acceptance certificates not become effective until the legal requirements are met and

¹⁵ Office Of The Auditor General, Nr doc.23.6.11-2013/14-08, implementation of recommendations on public-private partnership agreement for PIA Adem Jashari", Prishtine, March/2016.

¹⁶ Office of the Auditor General, Nr doc.23.6.11-2013/14-08, implementation of recommendations on public-private partnership agreement for PIA Adem Jashari", Prishtine, March/2016.

completion of outstanding works. Outstanding works related to item 4, Annex 13 of the PPP Agreement, which include: works in the Runway End Safety Areas (RESA), shoulders for aircraft accommodation, platform-icing and improvised fire-fighters training area.

- 3) Eight recommendation - . Supervision of outstanding works. This relates to the previous recommendation (number 7), PPC actions have resulted in signing an annex agreement for outstanding works. Although this Annex agreement did not clarify how the works will be carried out, who will supervise them and there is no schedule for carrying out the outstanding works.

Recommendations not addressed

- 1) Sixth recommendation. Immediate actions should be undertaken regarding the property dispute with KFOR and clarify the dispute and close the unresolved issues on expropriation of private properties in order to have construction of entrance road of PIA-AJ finished. The government failed to fully fulfill its commitment regarding the property given for use to PP to construct the new terminal. Still no action for understanding or agreement on the presence of KFOR in PIA AJ property is in place. Works planned in that area have not yet been completed.

5. CONCLUSION

From the current practice of concessions of public enterprises (the case of the airport) it can be concluded that the Government of the Republic of Kosovo has to show a good example of project management for the Public Private Partnership. This is due to the fact because in Kosovo there are still public enterprises (PTK) which must be given in concession and in this case (the case of the airport) should serve as an example that the government not only supports giving the PPP PE but at the same time respects the agreements precisely. In this way, it can also encourage foreign investors to invest in this form (PPP) and in other cases such as PTK, Brezovica etc.

LITERATURE:

1. Corporate governance lectures, February 2008
2. Public sector efficiency A.Afonso translated by V.Tanzi January 2008
3. The size and performance of public sector activities in Europe April 2002 H.Heinz,R.Philip
4. Public Administration, An Action Orientation, Robert B. Denhardt, Janet V. Denhardt, UFO Press, 2010, Tirana
5. Riinvest, Dilemmas and Backwards in a fast track -Privatization of POEs in Kosovo, Prishtine, October 2009.

6. Law Nr o4/L-045 for Public Private Partnership
7. www.pppkosova.org
8. Riinvest Institute, Prishtina Airport Concession, Prishtine 2015.
9. Office Of The Auditor General, Nr doc.23.6.11-2013/14-08, implementation of recommendations on public-private partnership agreement for PIA Adem Jashari”, Prishtine, March/2016
10. Task Force for European Integration, Discussion Paper on social and public enterprises in the Republic of Kosovo, Pristina, October 2012.
11. PPP Public Procurement number PPP-09-001-611 for Operation and Expansion of Pristina International Airport, Prishtine, August 2010.

SMEs IN EU AND EMPLOYMENT – IS THERE A CONNECTION?

Jelena Vidovic

*University Department of Professional Studies, Croatia
jvidovic@oss.unist.hr*

Jasenska Bubic

*University Department of Professional Studies, Croatia
jbubic@oss.unist.hr*

ABSTRACT

Small and medium enterprises (SMEs) are often perceived as an important segment of every modern economy. Through economic literature, SMEs are often seen as drivers of economic growth, new employment and it is presumed that they foster innovation. Preferential taxation of micro and small enterprises is considered as a normal feature of taxation in a number of tax systems. This paper argues the policy of preferential taxation of micro, small and medium enterprises in the context of their contribution to reduction of unemployment. We observe relationship between unemployment and four variables; value added, employment and number of enterprises in 25 EU member states and Croatia in period from 2010 to 2013. Each variable is defined as a percentage corresponding to the each of four SME categories; micro, small, medium and large enterprises. Major drawback of data is presence of missing data. Results indicate that only large and medium enterprises significantly influence on unemployment reduction. In the same time increase of value added of large and medium enterprises results in increase of unemployment. On the other hand increase of employment in micro enterprises is connected to rise of unemployment. Also, increase of value added in micro enterprises results in reduction of unemployment.

Keywords: value added, SMEs, unemployment, European Union.

1. INTRODUCTION

When total number of SMEs is observed in EU member states it can be seen that they are the dominant category of enterprises in 2012. If we observe structure of total number of enterprises, micro-enterprises are the largest group of enterprises and make on average about 92.07% of the total number of enterprises, small make about 6.64% of the total number of enterprises, medium 1.16% and large only 0.23% on average. Although numerous, through economic literature it is not proven that SMEs contribute to economic growth or contribute to a rise of employment rate. In this paper, different questions will be addressed; share of employment in SMEs in contrast to total number of employed; relation between value added of SME sector and unemployment rate.

The paper is organized as follows; in the second part of the paper overview of current literature regarding connection between SME sector economic growth and employment is presented. In the third part of the paper sample of EU states, variables and applied panel model are defined. In the fourth part of the paper results of the panel data analysis are given and explained. In the fifth, final part of the paper main conclusions were drawn.

2. LITERATURE REVIEW

Through inspection of relevant literature it can be seen that different authors tried to describe connection between SME sector, employment and economic growth. None of these studies gave straightforward evidence that SMEs contribute to economic growth and rise of employment. Parker argues that general measures to support SMEs including tax cuts and labor market

deregulation may have the consequence of promoting those SMEs which do not undertake research and development and which engage in insecure and low wage employment. Author concluded that there is only a very small number of SMEs that make a significant contribution to net job creation and innovation and utilize progressive work practices. (Parker, 1999; p. 87) Rodica explored the role of micro, small and medium size enterprises in the growth of per capita gross domestic product at European Union level between 2005 and 2010. Using a panel of data from 25 Member States the results show a positive connection between the prevalence of SME in terms of created value added and GDP per capita growth. The analysis results show that, although micro enterprises dominate the private sector of all EU Member States, in terms of unit number, they do not contribute to GDP per capita growth. At the level of small and medium firms there is sustained evidence of a positive, causal relationship between their prevalence and economic growth (Rodica, 2012; p.149).

Varum and Rocha studied effects of firm size on employment growth during economic slowdowns using a rich microeconomic database for the 1988–2007 period in Portuguese manufacturing industry. The results show that economic downturns affect firm growth negatively. This negative effect is found to be higher for larger firms, both during and immediately following crisis periods. Small and medium-sized enterprises (SMEs) emerge as potential stabilizers in downturn periods. However, larger firms seem to be able to quickly recover from downturn periods.

Beck et al used database on SME size for over 70 developing and developed countries. In sum, although a prosperous SME sector is a characteristic of flourishing economies, this paper's cross country regressions do not support the contention that SMEs foster economic success. Thus, while a large SME sector is a characteristic of successful economies, the data do not confidently support the conclusions that SMEs exert a causal impact on growth. Furthermore, authors find no evidence that SMEs alleviate poverty or decrease income inequality (Beck, 2005; p. 25).

Vidović and Bubić observed the number of micro, small, medium and large enterprises in 2012 for 27 EU member states. The results show that there is no significant difference in the structure of enterprises by size in states with higher tax burden compared to the states with lower tax burden on the EU level. The results show that the share of micro, small and medium enterprises in the total number of companies is not statistically significantly different in countries with higher tax burden compared to countries with a lower tax burden. Micro-enterprises are the largest group of companies independent of the tax burden level and make on average about 92.07% of the total number of enterprises, small make up about 6.64% of the total number of enterprises, medium 1.16% and large only 0.23% on average (Vidović and Bubić, 2016; p. 172).

3. DATA AND METHODOLOGY

To examine whether employment in SMEs, their value added and number of SMEs contribute to unemployment reduction we used unbalanced panel data set. The data used in the analysis were drawn from Eurostat database for the period from 2010 to 2013. Due to lack of data availability, Cyprus and Denmark have been excluded from the analysis. As from 2013 Croatia is a new EU member state and in observed period data for Croatia were available, in the final sample Croatia was added. The final sample consists of 26 EU Member States, or to be precise 25 EU member states in period from 2010 to 2013 and Croatia which is a EU member state from 2013. Missing data are particular problem in data, for example: Germany (data not available for 2010, 2011 and 2013), Italy (data not available for 2010 and 2011), Ireland (data not available for 2013, for other years partly), and France (data not available for 2010 and 2011), Greece (data not available for 2010, 2011 and 2013). The presence of missing data affects the quality of conducted analysis.

In this paper we observe unemployment rate in EU member states in relation to four independent variables: 1. Gross domestic product growth (GDPG), 2. share of employment in SMEs (EMSME) and large firms, 3. share of value added produced by SMEs (VASME) and large firms and 4. share of SMEs (NUMSME) and large firms in total number of companies. The dependent and explanatory variables used in the model are:

A. Dependent variable

UNEP - Unemployment rate represents unemployed persons as a percentage of the labour force. The labour force is the total number of people employed and unemployed. Unemployed persons comprise persons aged 15 to 74. The indicator is based on the EU Labour Force Survey.

B. Independent variables

GDPG – Gross domestic product (GDP) is a measure of the economic activity, defined as the value of all goods and services produced less the value of any goods or services used in their creation. The calculation of the annual growth rate of GDP volume is intended to allow comparisons of the dynamics of economic development both over time and between economies of different sizes.

SME - SMEs are defined by the European Commission as having less than 250 persons employed. They should also have an annual turnover of up to EUR 50 million, or a balance sheet total of no more than EUR 43 million (Commission Recommendation of 6 May 2003). However, the main classes used for presenting the results are:

- micro enterprises: with less than 10 persons employed (MICRO);
- small enterprises: with 10-49 persons employed (SMALL);
- medium-sized enterprises: with 50-249 persons employed (MED);
- large enterprises with 250 or more persons employed (LARGE);

According to that share of persons employed in each category of SMEs (EMSME) is denoted as: EM-MICRO, EM-SMALL, EM-MED and EM-LARGE for large firms.

VASMES (VA-MICRO, VA-SMALL, VA-MED, VA-LARGE) Value added represents the difference between the value of what is produced and intermediate consumption entering the production, less subsidies on production and costs, taxes and levies. Data used in this study represent the share of total value added which belongs to each SME category. These indicators represent the share of gross value added created by micro, small and medium sized enterprises in total gross value added at country level in each year of the analyzed period.

NUMSMES (NUM-MICRO, NUM-SMALL, NUM-MED, NUM-LARGE) Number of micro, small, medium and large enterprises is defined as a percentage of each category in total number of enterprises in each member state.

We use panel data model where 25 EU member states along with Croatia were observed in four year period from 2010 to 2013. Included member states are: Austria, Belgium, Bulgaria, Croatia, Czech Republic, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and United Kingdom.

In the following analysis we observe following unbalanced panel data model:

$$UNEP_{it} = \alpha + GDPG_{it} + EMSME_{it} + VASME_{it} + NUMSME_{it} + u_{it} \quad (1)$$

Where $i = 1, 2, \dots, N$ represents observed member states and $t = 1, 2, \dots, T$ time periods. The common constant method also called pooled OLS method of estimation presents results under principal assumption that there are no differences among the data matrices of the cross-sectional dimension (N). In other words the model estimates a common constant α for all cross-sections (common constant for countries). However, this case is quite restrictive and cases of more interest involve the inclusion of fixed and random effects in the method of estimation. (Asteriou, 2007; p. 345). As we in our sample have different countries we expect differences in their behavior:

$$UNEP_{it} = a_i + GDPG_{it} + EMSME_{it} + VASME_{it} + NUMSME_{it} + u_{it} \quad (2)$$

where a_i can differ for each country in the sample. When N is large and T is small, the estimates obtained by the two methods can differ significantly (Park, 2011; p. 3). In order to compare fixed and random effects model we apply Hausman test. The null hypothesis underlying the Hausman test is that the fixed effect and random effect estimators do not differ substantially. The test statistic developed by Hausman has an asymptotic χ^2 distribution. If the null hypothesis is rejected, the conclusion is that random effect is not appropriate and that we may be better off using fixed effect model. (Gujarati, 2004; p. 651).

4. THE RESULTS

In the following section results of performed panel data analysis are presented. In order to compare fixed and random effects model we apply Hausman test and according to results fixed of random effects model was applied.

Table1: Descriptive statistics on share of employment in SMEs, GDP growth, share of value added of every single SME category in total value added and share of SMEs in total number of enterprises (author's calculation)

	N	Minimum	Maximum	Mean	Std. Deviation
EM-MICRO	87	17,16	58,61	30,7263	7,52627
EM-SMALL	79	13,04	26,62	20,9023	3,17299
EM-MED	80	10,87	25,31	19,1181	3,63750
EM-LARGE	78	13,47	47,21	29,4979	6,43995
VA-MICRO	87	11,59	35,93	20,9513	4,70186
VA- SMALL	80	13,16	24,35	19,0041	2,92589
VA-MED	76	14,88	30,00	21,2289	4,06290
VA-LARGE	75	23,96	50,48	38,1867	7,12376
NUM-MICRO	92	82,31	96,75	92,2453	3,13379
NUM-SMALL	88	2,70	14,70	6,4216	2,58783
NUM-MED	88	0,35	2,53	1,1523	0,48839
NUM-LARGE	82	0,08	0,50	0,2276	0,10841
UNEP	104	4,60	27,50	10,6817	4,89313
GDPG	104	-7,10	9,60	0,9760	2,52957

According to the results of descriptive statistics from Table 1, in micro enterprises around 31% of all employed is employed, micro enterprises produce around 21% of total value added and

92% of the total number of enterprises are micro enterprises. Around 6% of all enterprises are small enterprises, they produce around 19% of total value added and employ around 21% of total number of employed. Medium enterprises are smallest category of SMEs – around 1% of total number of companies but still produce 21% of value added (more than micro and small enterprises) and employ around 19% of total employed (same as small enterprises). Only 0,23% of all companies are large firms, they produce greatest percentage of value added (38%) and employ almost the same percentage of employees (29%) as micro enterprises (31%).

Table2: Results of panel data random effects model – independent variables are related to MICRO enterprises (author's calculation)

Correlated Random Effects - Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	
Cross-section random	6.169.284	4	0.1869	
Dependent Variable: UNEP				
Method: Panel EGLS (Cross-section random effects)				
Sample: 2010 2013				
Periods included: 4				
Cross-sections included: 26				
Total panel (unbalanced) observations: 86				
Swamy and Arora estimator of component variances				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.933.938	2.499.068	1.574.162	0.1193
GDPG	-0.038896	0.107057	-0.363321	0.7173
EM-MICRO	0.594518	0.133098	4.466.773	0.0000
VA-MICRO	-0.380217	0.139828	-2.719.168	0.0080
NUM-MICRO	-0.422105	0.301306	-1.400.917	0.1651
	Effects Specification			
			S.D.	Rho
Cross-section random			3.761.307	0.8736
Idiosyncratic random			1.431.041	0.1264
	Weighted Statistics			
R-squared	0.238355	Mean dependent var		2.160.899
Adjusted R-squared	0.200743	S.D. dependent var		1.684.969
S.E. of regression	1.443.408	Sum squared resid		1.687.576
F-statistic	6.337.189	Durbin-Watson stat		0.737653
Prob(F-statistic)	0.000173			
	Unweighted Statistics			
R-squared	0.350361	Mean dependent var		1.065.465
Sum squared resid	1.215.976	Durbin-Watson stat		0.102374

This random effects model is significant at the 0,5 significance level (F=6,337189). R-squared of 0,238355 says that GDP growth rate, percentage of employed in micro enterprises, value added in micro enterprises and share of micro enterprises in total number of enterprises explains only 24% of changes in unemployment rate. Share of value added of micro enterprises and

share of employed in micro enterprises are statistically significant variables in the model. For one unit increase in employment rate in micro enterprises unemployment rate will rise for 0,59 units holding all the other variables constant. Increase in share of value added of micro enterprises for 1 unit reduces unemployment rate for 1 unit holding all the other variables constant.

Table3: Results of panel data fixed effects model – independent variables are related to SMALL enterprises (author's calculation)

Correlated Random Effects - Hausman Test				
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	
Cross-section random	13.309.644	4	0.0099	
Dependent Variable: UNEP				
Method: Panel Least Squares				
Sample: 2010 2013				
Periods included: 4				
Cross-sections included: 25				
Total panel (unbalanced) observations: 78				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	2.230.221	7.154.698	3.117.142	0.0031
GDPG	-0.044229	0.116992	-0.378048	0.7070
EM-SMALL	-0.877396	0.547064	-1.603.826	0.1152
VA-SMALL	-0.222862	0.360597	-0.618035	0.5394
NUM-SMALL	1.724.492	0.914472	1.885.779	0.0653
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.948847	Mean dependent var	1.065.256	
Adjusted R-squared	0.919617	S.D. dependent var	4.826.569	
S.E. of regression	1.368.427	Akaike info criterion	3.743.902	
Sum squared resid	9.175.700	Schwarz criterion	4.620.114	
Log likelihood	-1.170.122	Hannan-Quinn criter.	4.094.666	
F-statistic	3.246.107	Durbin-Watson stat	1.205.114	
Prob(F-statistic)	0.000000			

Applied fixed effects model fits the data well at the 0,5 significance level ($F=3,246107$). R-squared of 0.948847 says that GDP growth rate, percentage of employed in small enterprises, value added in small enterprises and share of small enterprises in total number of enterprises explains the 95% of unemployment rate. None of the observed variables related to the small enterprises is statistically significant.

Table4: Results of panel data fixed effects model – independent variables are related to MEDIUM enterprises (author's calculation)

Correlated Random Effects - Hausman Test				
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	
Cross-section random	10.384.939	4	0.0344	
Dependent Variable: UNEP				
Method: Panel Least Squares				
Sample: 2010 2013				
Periods included: 4				
Cross-sections included: 25				
Total panel (unbalanced) observations: 76				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.076.815	1.129.739	0.537895	0.5932
GDPG	-0.052100	0.132618	-0.392853	0.6962
EM-MED	-1.568.649	0.775978	-2.021.511	0.0489
VA-MED	0.934937	0.404823	2.309.493	0.0254
NUM-MED	1.287.200	4.879.067	2.638.210	0.0113
Effects Specification				
Cross-section fixed (dummy variables)				
R-squared	0.943705	Mean dependent var	1.058.553	
Adjusted R-squared	0.910167	S.D. dependent var	4.805.100	
S.E. of regression	1.440.188	Akaike info criterion	3.849.997	
Sum squared resid	9.748.467	Schwarz criterion	4.739.356	
Log likelihood	-1.172.999	Hannan-Quinn criter.	4.205.428	
F-statistic	2.813.882	Durbin-Watson stat	1.399.076	
Prob(F-statistic)	0.000000			

This fixed effects model fits the data well at the 0,5 significance level ($F=2,813882$). R-squared of 0.943705 says that GDP growth rate, percentage of employment in medium enterprises, value added in medium enterprises and share of medium enterprises in total number of enterprises explains the 94% of changes in unemployment rate. Share of value added of medium enterprises, share of employed in medium enterprises and share of medium enterprises in total number of enterprises are statistically significant variables in the model. For one unit increase in employment rate in medium enterprises unemployment rate will decline for 1,7 units holding all the other variables constant. Increase in share of value added in medium enterprises for 1 unit results in increase of unemployment rate for 0,93 units holding all the other variables constant. If share of medium enterprises rises for 1 unit unemployment rate will rise for 1,3 units holding all the other variables constant.

Table5: Results of panel data random effects model – independent variables are related to LARGE enterprises (author's calculation)

Correlated Random Effects - Hausman Test				
Test Summary		Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random		4.295.838	4	0.3674
Dependent Variable: UNEP				
Method: Panel EGLS (Cross-section random effects)				
Sample: 2010 2013				
Periods included: 4				
Cross-sections included: 25				
Total panel (unbalanced) observations: 75				
Swamy and Arora estimator of component variances				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.619.743	4.016.946	4.032.274	0.0001
GDPG	-0.098920	0.125315	-0.789365	0.4326
EM-LARGE	-0.504026	0.182786	-2.757.466	0.0074
VA-LARGE	0.281258	0.132533	2.122.169	0.0374
NUM-LARGE	-7.136.831	8.922.895	-0.799834	0.4265
Effects Specification				
			S.D.	Rho
Cross-section random			4.144.514	0.8750
Idiosyncratic random			1.566.778	0.1250
Weighted Statistics				
R-squared	0.182115	Mean dependent var		2.200.475
Adjusted R-squared	0.135378	S.D. dependent var		1.732.006
S.E. of regression	1.535.648	Sum squared resid		1.650.750
F-statistic	3.896.644	Durbin-Watson stat		0.745361
Prob(F-statistic)	0.006485			
Unweighted Statistics				
R-squared	0.290883	Mean dependent var		1.056.000
Sum squared resid	1.232.219	Durbin-Watson stat		0.102079

Observed random effects model is significant at the 0,5 significance level ($F=3,896644$). R-squared of 0.182115 says that GDP growth rate, percentage of employed in small enterprises, value added in small enterprises and share of small enterprises in total number of enterprises explains the 18% of unemployment rate. Share of value added of large enterprises, share of employed in large enterprises are statistically significant variables in the model. For one unit increase in employment in large enterprises unemployment will decline for 0,5 units holding all the other variables constant. Increase in value added of large enterprises for 1 unit results in increase of unemployment 0,28 units holding all the other variables constant.

5. CONSLUSION

When observing simple descriptive statistics on share of value added, number of companies and employment in each SME category it can be seen that micro enterprises employ 30,73% of all employees, and large companies 29,50% of all employees. Almost the same percentage of workers produce 20,95% of value added which belongs to micro enterprises and 38,18% of total value added which belongs to large companies. Almost double! On average 92,25% of all enterprises are micro enterprises while there is only 0,23% of large companies. According to these results one should conclude that micro enterprises are work intensive and create small value added, what makes theoretical view that SMEs are drivers of innovation very questionable. On the other hand large enterprises with the same work force create double value added what could lead to the conclusions that they foster technology development and innovation.

Results of applied panel model lead to the same conclusions. When observing 26 EU member states in period from 2010 to 2013 results show that increase in employment of micro enterprises leads to rise of unemployment. Rise of value added of micro enterprises leads to reduction of unemployment. Possible explanation can be found in Parker who concluded that that there is only a very small number of SMEs that make a significant contribution to net job creation and innovation and utilize progressive work practices. (Parker, 1999; p. 87)

Both medium and large firms through increase in value added influence on increase of unemployment. It is obvious that their value added is not result of workforce but we presume it is realized through technology and innovations. Increase of share of employed in medium and large enterprises results in reduction of unemployment, and this impact is larger for medium SMEs. Number of medium enterprises is also connected to the rise of unemployment. Rise in number of medium companies results in unemployment growth what again can be connected to their large value added which probably does not come from prevalence of work. In conclusion, although together micro and small enterprises make 98,66% of all companies their contribution to reduction of unemployment cannot be confirmed.

LITERATURE:

1. Asteriou, D., & Hall, S. (2007). *Applied Econometrics: a modern approach, revised edition*. China: Palgrave Macmillan.
2. Beck, T., Demirguc-Kunt, A., & Levine, R. (2005). *SMEs, growth, and poverty: cross-country evidence*. Journal of economic growth, 10(3), 199-229.
3. GDP, Eurostat. (2016). Retrieved 03.08.2016. from <http://ec.europa.eu/eurostat/tgm/web/table/description.jsp>
4. Gujarati, D. N. (2004). *Economics Basic Econometrics*.
5. Parker, R. (1999). *From national champions to small and medium sized enterprises: changing policy emphasis in France, Germany and Sweden*. Journal of Public Policy, 19(01), 63-89.
6. Silivestru, D. (2012). *European SMEs and Economic Growth: A Firm Size Class Analysis*. Annals of the Alexandru Ioan Cuza University-Economics, 59(2), 143-151.
7. *Structural Business Statistics, Small and medium-sized enterprises (SMEs)*, Eurostat. (2016). Retrieved 06.04.2016. from <http://ec.europa.eu/eurostat/web/structural-business-statistics/structural-business-statistics/sme>
8. *Unemployment rate*, Eurostat. (2016). Retrieved 03.08.2016. from <http://ec.europa.eu/eurostat/tgm/web/table/description.jsp>

9. *Value added of the non-financial business economy by size class of employment*, Eurostat. (2016). Retrieved 03.07.2016. from http://ec.europa.eu/eurostat/search?p_auth=eSkz1sqo&p_p_id=estatsearchportlet_WAR_estatsearchportlet&p_p_lifecycle=1&p_p_state=maximized&p_p_mode=view&_estatsearchportlet_WAR_estatsearchportlet_action=search&text=value+added+at+factor+cos
10. Varum, C. A., & Rocha, V. C. (2013). *Employment and SMEs during crises*. Small Business Economics, 40(1), 9-25.
11. Vidović, J., Bubić, J. (2016). *Struktura poduzeća po veličini u EU i porezno opterećenje*. Accounting and management - A&M Računovodstvo i Menadžment – RIM 17th International Scientific and Professional Conference Proceedings from the International Scientific and Professional Conference: 163 - 174

REINVESTED PROFITS AS THE ENGINE OF GROWTH OF COMPANIES ON THE STOCK EXCHANGE IN CROATIA

Vlasta Roska

University North, Koprivnica, Croatia

University Center Varaždin

vlasta@vlastaroska.hr

ABSTRACT

Tax reform in tax on profit is happened very often in Croatia. Croatian's government wants to increase a investment with a different type of tax relief. Companies can decrease of tax base in the amount of reinvested profit from 2012. In 2015, companies can reinvested profit only for the amount of investment in long term material and non-material assets. Companies increase the registered capital and have a better cash flow without the payment of taxes. Corporations who are not engaged in banking and financial not banking sector can apply for this tax benefit. Investment in long term material and non-material assets, renewed old assets, raises the productivity of companies and improvement of the business. From 2015 is also added one of very important conditions like as the preservation of number of employee at least two years after the year of the investment. Otherwise, the companies have to pay the amount of the less paid profit tax. The aim of this paper is to confirm whether adding conditions for reinvested profit in amount of investment on long term material and non-material assets and keeping the number of employees decreased overall using tax relief of reinvested profit for companies at the Zagreb Stock Exchange in relation to the previous year. This research of reinvested profit in 2014 and 2015 shows that reinvested profit cannot be the engine of growth of companies on Zagreb Stock Exchange.

Keywords: *investment in long term material and non-material assets, reinvested of profit, tax base, tax relief.*

1. INTRODUCTION

Tax incentives are being introduced in the tax system of each country to develop the economy and attract new investment. In the Republic of Croatia, introduced tax reliefs for reinvested profit from 2012. This tax relief is intended for capital companies with the obligation to increase of the equity. Companies, for using the tax relief of reinvested profit, need to finished the fiscal year with profit and must satisfy all the other legal conditions.

Government very often, during the application of certain tax relief, changes the terms of the tax relief with the aim of better tax incentives effects. Thus, at the end of 2014 was a change of legislation of reinvested profit with introduced additional elements such as, required investment in long term material and non-material assets and the preservation of the number of employees. The aim of this paper is to confirm whether adding conditions for reinvested profit in amount of investment in the long term material and non-material assets and keeping the number of employees decreased overall using tax relief of reinvested profit for companies at the Zagreb Stock Exchange in relation to the previous year, when this additional condition did not exist.

The paper consists of seven parts, including introduction, conclusion and bibliography. In the second part describe the theoretical assumptions of reinvested profit in Croatia. In the third part analyzes the previous research. In the fourth part define objectives and hypotheses. The fifth part analyzes the results of research.

2. LEGAL FRAMEWORK OF REINVESTED PROFIT IN CROATIA

The tax relief for reinvested profit is defined in the Law and the Regulations on Corporate Profit Tax (2011 to 2014), as a decrease in the tax base. Tax reliefs for reinvested profit was introduced in 2012 year. The main objective of tax relief for reinvested profit is to strengthen the economy in world crisis and the struggle to attract investments. Government, for this reason was introduced additional criteria for reinvestment profit in 2015 year.

Taxpayer, who established a corporation with a registered capital have a right to deduct profit tax on the basis of reinvested profits. Reduction of the tax base for the reinvested profit, can achieve taxpayers who have a profit before increases and decreases tax base in tax year (Article 5, paragraph 1 Law on Corporate Profit Tax), if their meet the following criteria:

1. the profit or part of the profit of current tax period is used to increase capital, and
2. in the court registry, in accordance with special regulations, registered an increase of the capital in the amount of reinvested profits, and
3. no profit is earned in the banking and financial non-banking sector
4. the amount of reinvested profit is equal the amount of investment in long term material and non-material assets in order to preserve existing jobs and all costs of invested assets is entirely identified as tax deductible (additional criteria from 2015)
5. the taxpayer is required to keep the number of workers at the beginning of the tax period when he reinvested profit, at least two years after the expiry of that period (additional criteria from 2015).

Long term material and non-material assets is determined according to accounting standards, registered in the business books and put into use. Long term material and non material assets must be purchased on market terms. All costs from these assets must be determined as tax deductible. A more detailed explanation of what can be use as long term assets for the purpose of reinvested profit are described in the opinions of the tax administration (October, 2015, January 2016). Taxpayers who use tax relief under the Law of encouraging investment and improving the investment climate (2012,2013) can not used tax relief for reinvested profit for the same assets.

The second condition is the maintenance of employment that the taxpayer had at the beginning of 2015 for the next two years, has led to many controversies with entrepreneurs. Tax office issued the opinion from October 2015, where the number of workers are described "only the number of workers with whom the employer has entered into a valid employment contract for an indefinite period", but in December 2015 the Rules of Corporate Profit Tax prescribed that is calculated the number of workers on permanent and temporary contract. In July 2016 Tax Office issued the new opinion for further clarification about the number of workers and temporary fluctuations during 2015.

Special regulations of reinvestment of profit get assume implementation of the Companies Act (2011 to 2013), in particular for the profit distribution and increasing of capital. The process of increasing the capital of companies, including from the company's profit, prescribed by the Companies Act. It is assumed that the capital increase is based upon the audited financial statements, not older than 8 months. Financial statements need get Unmodified opinion by the auditor to be able to execute increasing of capital.

Taxpayers, who reported reduction in the tax for reinvested profit, need provide a proof of increasing of share capital in the court register at the latest within six months of the expiry of the deadline for filing income tax returns. The taxpayer need to submit to Tax Administration

also a decision of the profit distribution, including reinvested profits, and overview of equity after the court registered of increasing the share capital. The tax relief of reinvested profit requires increase the share capital, on the ground that such a profit is not subject to taxation and needs to remain permanently available to the company for the purposes of investment and further development of company. The decision of profit distribution of joint-stock company should be in accordance with the Companies Act (Article 220) where it is prescribed by the order of use of the net profit of the business year. Net profit can be used in the order of: 1. covering the loss carried forward from previous years, 2. entry in the legal reserves, 3. entry in the reserve for own shares, if the company is acquired or intends to acquire, 4. entry in the statutory reserves, if the company has it, 5. the rest by the decision of shareholders for dividends, for retained profits or for reinvestment. When the company increases the share capital with reinvested profit, shareholders belong new shares in proportion of the existing share capital.

The Rules of Corporate Profit Tax (article 12a, paragraph 7) provides that the reduction in the tax on reinvested profit will not be recognized if the taxpayer subsequently reduce the share capital and / or the reduction of the share capital effected to increase other items of the capital and reserves, which in future tax periods allow payment to shareholders. The tax exemption would not recognize if taxpayer use the reinvested profit for tax evasion or avoidance of tax payment. In the case when it is established that the requirements for recognition of reinvested profits is not acceptable, taxpayer needs to correction income tax in accordance with the General Tax Law (2008 to 2015).

Taxpayers in the amount of reinvested profits do not pay corporate income tax at a rate of 20%. Owners of shares in the case of reinvested profit do not need to pay withholding tax (art. 31, paragraph 11 Law on Company Profit Tax) or tax on capital income on the amount of 12 % (art.30 paragraph 13 Law on Income Tax).

2.1. Practical example of reinvested profit

The example of the joint stock company “ A “ shows the difference in reinvested profit in 2014 and 2015 years and the impact of these additional requirements on businesses and the state budget. In the case, joint-stock company make a profit before impairment and increase the tax base of HRK 30,000,000.00. During the year the company had investments in long term material and non-material assets in the amount of HRK 10,000,000.00. The Company has made a decision on reinvested profit of HRK 28,500,000.00 in 2014 and in amount of HRK 10,000,000.00 in 2015. Other increases and decreases the tax base were not. The shareholders are natural persons from Zagreb, who instead of profit distribution decided to increase share capital.

Table 1. The example of differences in reinvested profit in 2014 and 2015 (Author)

No.	Description	Amount 2014.	Amount 2015.
1.	Accounting profit	30,000,000.00	30,000,000.00
2.	Reinvestment profit	28,500,000.00	10,000,000.00
3.	Tax base	1,500,000.00	20,000,000.00
4.	Tax rate	20.00 %	20.00 %
5.	Tax	250,000.00	4,000,000.00
6.	Net profit	29,750,000.00	26,000,000.00
7.	Tax benefit from reinvestment profit	5,700,000.00	2,000,000.00
8.	Tax benefit from dividends	4,035,600.00	1,416,000.00
19.	Total benefit	9,735,600.00	3,416,000.00

In 2014, because of reinvested profit the company received a tax saving in the amount of HRK 5,700,000.00. Owners increased the number of shares due to not paying taxes on capital to HRK 4,035,600.00. Owners cannot reduce increased share capital tax-free, but the current owners can sell shares to other owners and make a profit. In short, the use of tax facilities the state budget had got less money for HRK 9,735,600.00. In 2014, the company has not obligated to invest the full amount to long term assets, they can spend some money for working capital.

In 2015, with new conditions, the company can decide to reinvested profit only in the amount of investment in long term assets, in this case HRK 10,000,000.00. In 2015 the company received a tax savings only in the amount of HRK 2,000,000.00, and the owners increased the number of shares for HRK 1,416,000.00 HRK. In short, the state budget had got less money for HRK 3,416,000.00.

Due to the changed conditions of use tax facilities of reinvested profit the company has paid more tax in the amount of HRK 3,700,000.00 than in the same conditions last year. Also, the owners are therefore get less shares with the same market value of the shares as well as in 2014.

3. PREVIOUS RESEARCH

All counties in the word want to attract to foreign investment in their county. They can do this with a low tax rate or with a different forms of tax relief. Corporate income tax rate in Croatia is 20 percent and is much higher than those in countries in the region but has a lower tax rate than half of EU Member States. All counties, because the tax rate is not enough to attract foreign investment, including in their tax system a different kind of tax reliefs.

Tax reliefs against company profit tax can adopt different forms. Each form implies either a decrease in the tax rate or narrowing of the tax base. As can be seen in the literature, income tax incentives can be classified into three major categories: lowered income tax rates, the tax holiday, and investment allowances.

Some of related paper explore only for theoretical assumption in tax system in different county. Blažić (2006) provides a comprehensive analysis of tax incentives in the region, but also in EU countries.

So far, only theoretical research and critical analysis of reinvested profits as tax relief have done in Republic of Croatia (Kapetanović, 2015, Bubić, Gorjanac, 2015, Cipek, Herceg, 2012).

In Estonian system of corporate taxation became well known as “zero corporate profit on reinvested profit (Angelov, 2007). In 2001 the Central bank of Finland published a research on the dynamic effects of the introduction of a zero tax rate on the reinvested profit in Estonia. A subsequent study in 2005 confirms the positive effects from the introduction of zero corporate tax on reinvested profit – the 2000 tax law leads to higher investment, including foreign investment, in short, medium and long term. Overall, there is a significant growth of the foreign investment in Estonia in the years after the introduction of zero corporate tax on reinvested profit (Angelov, 2007, p.3).

The tax incentive applies for the profit reinvested in technological equipment manufactured and/or acquired as of 1 July 2014 and commissioned by 31 December 2016 inclusively. In order to benefit from this tax exemption, taxpayers have to keep the equipment in their patrimony for at least half of the useful life, but for no longer than five years other forms of tax relief, specially for foreign direct investment (PWC Romania, 2014).

4. THE GOALS, BASIS, AND HYPOTHESIS OF THE RESEARCH

The aim of this paper is to confirm whether adding conditions for reinvested profit in amount of investment on the long term material and non-material assets and keeping the number of employees decreased overall using tax relief of reinvested profit for companies at the Zagreb Stock Exchange in relation to the previous year, when this additional conditions did not exist.

The research described in this paper is based on information obtained from the financial statement for 2014 and 2015 of 138 enterprises on the Zagreb Stock Exchange. The research includes 118 (85.51%) nonfinancial companies in Republic of Croatia (excluding bank and insurance companies), which satisfied conditions of reinvested profit. Data are comparable because all the companies in the sample are join stock company and they prepare financial statements in accordance with IFRS (Accounting Act, 2015, art.17).

Because, the number of companies who reinvested profit was very small, but very important, to use some other statistical method, this paper uses analysis stemming from chi-square tests and correlation coefficients to examine interdependencies; response frequencies in terms of fundamental variables, the company activities and countries of company. Chi-square test considers the disposition of frequencies inside of sheet. The statistical study used the software package SPSS 21.

The working hypothesis is as follow:

H = Reinvested profits as tax relief does not become an engine of growth of listed companies

To test the working hypothesis, the following statistical hypothesis were used:

H₁ = *There is not a significant difference between the activity of the company and reinvested profit*

H₂ = *There is not a significant difference between country of the company and reinvested profit.*

5. RESULTS OF RESEARCH

In the sample of the company on the Zagreb Stock Exchange only 12 (10.20%) companies used tax facilities of reinvested profit in the total amount of HRK 1.372.512.483 in 2014 year. In 2015 year, when the government tightened conditions of reinvested profit with too new conditions, such as, investment in long term material and non-material assets and keep the number of employees' only 5 (4.20%) companies reinvested profit in the total amount of HRK 93.785.906. In 2015, companies reinvested profit only in the amount of 6.83% of reinvested profit in 2014. In 2015, only 0.96% of gross profit is reinvested and in 2014 it was 14.64%. Companies paid the less profit tax because of reinvested profit in amount of HRK 274,502,496.61 and in 2015 this amount was HRK 18,757,181.28. Capital in the balance sheet is increased for 0.20% in 2015, and for 3.13% in 2014. Only, less than 5% of employee will keep they jobs at least next two years. Other elements of descriptive statistic are shown in table 2.

Table 2 Descriptive Statistics od Reinvested Profit (Author)

DESCRIPTION	N	Minimum	Maximum	Sum	Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Statistic
REINVESTED PROFIT 2014	12	5.542.250	940.000.000	1.372.512.483	2.62003E8
REINVETED PROFIT 2015	5	8.228.580	37.824.339	93.785.906	1.30453E7

Table 3 indicates the corelation of companies activities and reinvested profit (RP). Distribution of companies by activity is made in accordance with the National Classification of Activities 2007. In the table 3 marks for activities mean: 1 – Manufacturing, 2 – Production, 3 – Construction, 4- Wholesale and retail, 5 - Transport of passengers and goods, 6 – Hotels, 7 – Telecommunications, 8 - Real estate and 9 - Management and other activities.

Results from Table3 lead to the conclusion that there is not a statistically significant difference between companies activities and reinvested profit in both examined years, ($p = .334$) in 2014 and ($p = .634$) in 2015 year. Of the total number of enterprise examinees 118 (100%), only 13 (10.20%) companies reinvested profit in 2014. Between the companies who reinvested profit in 2014, the 4 companies (3.4 %) was from hotels industry, 2 companies (1.7%) was from manufacturing, also 2 companies (1.7%) from transport of passenger and goods, the rest by 1 company was from production, wholesale and retail, telecommunications and real estate.

In 2015, situation with the new conditions have led to the fact that only 5 (4.2%) companies decided to reinvested profit. The most companies 3 (2,5%) was from hotel industry and the rest by 1 companies was from production and wholesale and retail.

From all of this, we can conclude that the first hypothesis is accepted.

Table following on the next page

Table 3 Chi – square Test between Companies Activities and Reinvested Profit (Author)

Activities	RP 2014	RP 2014	TOTAL	RP 2015	RP 2015	TOTAL
	NO	YES		NO	YES	
1 Count	30	2	32	32	0	32
% within RP	28,3%	16,7%	28,3%	28,3%	,0%	27,1%
% of Total	25,4%	1,7%	27,1%	27,1%	,0%	27,1%
2 Count	12	1	12	12	1	13
% within RP	11,3%	8,3%	10,6%	10,6%	20,0%	11,0%
% of Total	10,2%	,8%	10,2%	10,2%	,8%	11,0%
3 Count	7	0	7	7	0	7
% within RP	6,6%	,0%	6,2%	6,2%	,0%	5,9%
% of Total	5,9%	,0%	5,9%	5,9%	,0%	5,9%
4 Count	11	1	11	11	1	12
% within RP	10,4%	8,3%	9,7%	9,7%	20,0%	10,2%
% of Total	9,3%	,8%	9,3%	9,3%	,8%	10,2%
5 Count	8	2	10	10	0	10
% within RP	7,5%	16,7%	8,8%	8,8%	,0%	8,5%
% of Total	6,8%	1,7%	8,5%	8,5%	,0%	8,5%
6 Count	26	4	30	27	3	30
% within RP	24,5%	33,3%	23,9%	23,9%	60,0%	25,4%
% of Total	22,0%	3,4%	22,9%	22,9%	2,5%	25,4%
7 Count	1	1	2	2	0	2
% within RP	,9%	8,3%	1,8%	1,8%	,0%	1,7%
% of Total	,8%	,8%	1,7%	1,7%	,0%	1,7%
8 Count	2	1	3	3	0	3
% within RP	1,9%	8,3%	2,7%	2,7%	,0%	2,5%
% of Total	1,7%	,8%	2,5%	2,5%	,0%	2,5%
9 Count	9	0	9	9	0	9
% within RP	8,5%	,0%	8,0%	8,0%	,0%	7,6%
% of Total	7,6%	,0%	7,6%	7,6%	,0%	7,6%
Count	106	12	118	113	5	118
% within RP	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%
% of Total	89,8%	10,2%	100,0%	95,8%	4,2%	100,0%

	Value 14	Df 14	Asymp. Sig. (2-sided) 14	Value 15	Df 15	Asymp. Sig. (2-sided) 15
Pearson Chi-Square	9,103 ^a	8	,334	6,121 ^a	8	,634
N of Valid Cases	118			118		

a. 11 cells (61,1%) have expected count less than 5. The minimum expected count is ,20 in 2014. and ,08 in 2015.

Table 4 indicates the corelation of companies country and reinvested profit (RP). In the table 4 marks for country mean: 1 – Zagreb Country, 2 – Krapina-Zagorje Country, 3 – Sisak -Moslavina Country, 4 – Karlovac Country, 5 – Varaždin Country, 6 – Koprivnica – Križevci Country, 7 - Bjelovar– Bilogora Country, 8 -Primorje – Gorski kotar Country 9 – Lika – Senj Country, 10 — Virovitica -Podravina Country, 11 – Požega – Slavonia Country, 12 - Brod- Posavina Country, 13 – Zadar Country, 14 – Osijek – Baranja Country, 15 – Šibenik – Knin Country, 16 -Vukovar- Srijem Country, 17 – Split-Dalmatia Country, 18 – Istra Country, 19 – Dubrovnik – Neretva Country, 20 – Međimurje Country, 21 – The City of Zagreb. Results from Table 4 lead to the conclusion that there is not a statistically significant difference between company's country and reinvested profit in both examined years, (p= .396) in 2014 and (p= .650) in 2015 year. Of the total number of enterprise examinees 118 (100%), 34.5% is form the City of Zagreb, but only 3 (2.5%) companies reinvested profit in 2014. Between the companies who reinvested profit in 2014, by 2 companies (1.7%) are from Primorje-Gorski Kotar country and Zadar Country and by 1 company (0.8%) is from Koprivnica-Križevci Country, Osijek-Baranja Country, Istra Country, Dubrovnik-Neretva Country and Međimurje Country. In 2015,

reinvested profit are 2 (1.7%) companies from the City of Zagreb, but only 3 (2.5%) companies and by 1 company (0.8%) are from Zadar County, Osijek-Baranja County and Istra County. From all of this we can conclude that second hypothesis is accepted.

Table 4 Chi – square Test between Companies Country and Reinvested Profit (Autor)

COUNTRY	RP 2014	RP 2014	TOTAL	RP 2015	RP 2015	TOTAL
	NO	YES		NO	YES	
3 Count	2	0	2	2	0	2
% within RP	1,9%	,0%	1,8%	1,8%	,0%	1,7%
% of Total	1,7%	,0%	1,7%	1,7%	,0%	1,7%
5 Count	3	0	3	3	0	3
% within RP	2,8%	,0%	2,7%	2,7%	,0%	2,5%
% of Total	2,5%	,0%	2,5%	2,5%	,0%	2,5%
6 Count	1	1	2	2	0	2
% within RP	,9%	8,3%	1,8%	1,8%	,0%	1,7%
% of Total	,8%	,8%	1,7%	1,7%	,0%	1,7%
7 Count	1	0	1	1	0	1
% within RP	,9%	,0%	,9%	,9%	,0%	,8%
% of Total	,8%	,0%	,8%	,8%	,0%	,8%
8 Count	10	2	12	12	0	12
% within RP	9,4%	16,7%	10,6%	10,6%	,0%	10,2%
% of Total	8,5%	1,7%	10,2%	10,2%	,0%	10,2%
11 Count	2	0	2	2	0	2
% within RP	1,9%	,0%	1,8%	1,8%	,0%	1,7%
% of Total	1,7%	,0%	1,7%	1,7%	,0%	1,7%
12 Count	1	0	1	1	0	1
% within RP	,9%	,0%	,9%	1,8	,0%	,8%
% of Total	,8%	,0%	,8%	1,7	,0%	,8%
13 Count	3	2	4	4	1	5
% within RP	2,8%	16,7%	3,5%	3,5%	20,0%	4,2%
% of Total	2,5%	1,7%	3,4%	3,4%	,8%	4,2%
14 Count	2	1	2	2	1	3
% within RF	1,9%	8,3%	1,8%	1,8%	20,0%	2,5%
% of Total	1,7%	,8%	1,7%	1,7%	,8%	2,5%
15 Count	3	0	3	3	0	3
% within RP	2,8%	,0%	2,7%	2,7%	,0%	2,5%
% of Total	2,5%	,0%	2,5%	2,5%	,0%	2,5%
16 Count	3	0	3	3	0	3
% within RP	2,8%	,0%	2,7%	2,7%	,0%	2,5%
% of Total	2,5%	,0%	2,5%	2,5%	,0%	2,5%
17 Count	17	0	17	17	0	17
% within RP	16,0%	,0%	15,0%	15,0%	,0%	14,4%
% of Total	14,4%	,0%	14,4%	14,4%	,0%	14,4%
18 Count	11	1	11	11	1	12
% within RP	10,4%	8,3%	9,7%	9,7%	20,0%	10,2%
% of Total	9,3%	,8%	9,3%	9,3%	,8%	10,2%
19 Count	6	1	7	7	0	7
% within RP	5,7%	8,3%	6,2%	6,2%	,0%	5,9%
% of Total	5,1%	,8%	5,9%	5,9%	,0%	5,9%
20 Count	3	1	4	4	0	4
% within RP	2,8%	8,3%	3,5%	3,5%	,0%	3,4%
% of Total	2,5%	,8%	3,4%	3,4%	,0%	3,4%
21 Count	38	3	39	39	2	41
% within RP	35,8%	25,0%	34,5%	34,5%	40,0%	34,7%
% of Total	32,2%	2,5%	33,1%	33,1%	1,7%	34,7%
Count	106	12	118	113	5	118
% within RP	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%
% of Total	89,8%	10,2%	100,0%	95,8%	4,2%	100,0%
	Value 14	df	Asymp. Sig. (2-sided) 14	Value 15	df	Asymp. Sig. (2-sided) 15
Pearson Chi-Square	15,785 ^a	15	,396	12,380 ^a	15	,650
N of Valid Cases	118			118		

a. 27 cells (84,4%) have expected count less than 5. The minimum expected count is ,10 in 2014 and ,04 in 2015.

All result in this research is not encouraging, because from 118 companies of Zagreb Stock Exchange in 2015 only 4.2% of companies used the tax relief of reinvested profit. In 2014, it was only 10.2% of all companies. That percentage says that the reason of not using the reinvested profit like engine of growth listed companies is not only two new conditions. Only 15.58% profitable companies reinvested profit in 2014 and only 6.76% in 2015. That means that is not a problem only the profit, legal condition but also wish of shareholder for dividends.

We can conclude that the working hypothesis is confirmed that reinvested profit is not engine of growth for listed companies.

6. CONCLUSION

The main goal of tax relief of reinvested profit is to encourage investment and prevent the dismissal of workers and preserve companies capital. Following the prescribed conditions of reinvested profit can be seen as tax relief of reinvested profit adjusted to taxpayers who are already engaged in an activity, have employed workers on the first day of the tax period and they do not expect higher labor turnover during the tax period.

Advantages of reinvested profit:

- ✓ The company pays less profit tax for the amount of reinvested profit.
- ✓ Shareholders are exempt from paying taxes on capital income, or withholding tax for the amount of reinvested profit.
- ✓ Permanent increase of capital is welcome protection for creditors.
- ✓ Improved the cash flow of the company.
- ✓ The obligation of investment in long term material and non-material assets, should lead to improvements in the productivity and not only for the preservation of jobs, but also the possibilities for increasing number of employment.
- ✓ Preservation of company's capital is as its own source of funding.

Disadvantages of reinvested profit:

- ✓ There is no public information on the overall amount of reinvested profit in Republic of Croatia and its impact on the state budget.
- ✓ There is no public available information on the increase of investment, domestic or foreign and new jobs on the basis of reinvested profit.
- ✓ It is not limited the rate of depreciation of long term of material and non-material assets, because in accordance the Tax Law taxpayers can use double rates and through increased cost of depreciation achieve profit in the year after reinvested profit and distribute dividends to shareholders.
- ✓ It is not limited the period of use of long term assets.

The research present here is only one part of overall research of reinvested profit. Only 4.20% of companies reinvested profit of all companies on Zagreb Stock Exchange in 2015 compared with 10.20% in 2014. The new conditions will protect only less than 5% of working place from the listed companies. Tax administration need to explore the benefits for the companies and for state budget, also. The state budget, but also, all taxpayers lost about 450 millions HRK in 2014 and about 31 millions of profit tax, withholding tax or tax on capital income in 2015 years. For further research of tax administration is a very important topic, which kind of benefit this lost of state budget brings to companies and economic development. This research of using the reinvested profit in 2014 and 2015 shows that reinvested profit cannot be the engine of growth of companies on Zagreb Stock Exchange.

LITERATURE:

1. Accounting Act. (2013). Official Gazette, 54/13.
2. Angelov, G. (2007). Zero Tax on Reinvested Profit – the Example of Estonia. Bulgaria: Institute for Market Economics. retrieved. 28.07.2016. from http://www.irefeurope.org/en/sites/default/files/Estonia_G_Angelov.pdf
3. Blažić, H. (2006). Comparative tax systems, income and profit tax. Rijeka: Faculty of economy
4. Bubić, J. Gorjanc, V. (2014). Tax and Accounting Aspect of Reinvesting Profit in Croatia. Požega: 4th International Conference “ Vallis Aurea” Focus on: Regional & Innovation Development
5. Cipek, K. Herceg, M. (2012) Tax relief of reinvested profit. Retrieved 28.07.2016. from <http://www.ijf.hr/upload/files/file/PV/2012/12/cipek-herceg.pdf>
6. Company Act. (2015). Official Gazett. 111/93, 34/99, 121/99, 52/00, 118/03, 107/07, 146/08, 137/09, 125/11, 152/11, 111/12, 68/13, 110/15
7. General Tax Law. (2016) Official Gazette. 147/08, 18/11, 78/12, 136/12, 73/13, 26/15, 44/16
8. Kapetanović, J. (2015). The effects of income taxes on economic growth. Retrieved 30/07/2016. from <http://www.ijf.hr/upload/files/file/PV/2015/11/kapetanovic.pdf>
9. Law on Corporate Profit Tax.(2014) Official Gazette. 177/04, 90/05, 57/06, 146/08, 80/10, 22/12, 148/13, 143/14, 50/16
10. Law of encouraging investment and improving the investment climate. (2012) Official Gazette. 111/12, 28/13
11. Law on Income Tax. (2015). Official Gazette. 177/04, 73/08, 80/10, 114/11, 22/12, 144/12, Odluka USRH - 120/13,125/13, 148/13, Odluka USRH - 83/14, 143/14, 136/15
12. Ministry of finance. Tax office. (2016). Application of tax relief of reinvested profit. Zagreb: Ministry of finance. Number of classes:410-01/16-01/1548. Docket Number: 513-07-21-01/16-01. Retrieved 20.07.2016 from http://www.porezna-uprava.hr/HR_publikacije/Stranice/lista-misljenja.aspx
13. Ministry of finance. Tax office. (2016). Instructions on compiling and submitting tax returns income tax payers and accounting for income taxes by the annual accounts for 2015. Zagreb: Ministry of finance. Number of classes:410-01/16-01/81, Docket Number:513-07-21-01/16-1, Retrieved 20.07.2016 from http://www.porezna-uprava.hr/HR_publikacije/Stranice/lista-misljenja.aspx
14. Ministry of finance. Tax office. (2015). Applications tax relief for reinvested profit of 2015. Zagreb: Ministry of finance. Number of classes.:410-10/15-01/2750; Docket number:513-07-21-01/15-01. Retrieved 20.07.2016 from http://www.porezna-uprava.hr/HR_publikacije/Stranice/lista-misljenja.aspx
15. PWC Romania. (2014). Tax and Legal Alert. retrieved 15.07.2016 from http://www.pwc.ro/tax_and_legal_alert_no._12_pwc.pdf
16. Rules on Profit Tax (2015) Official Gazette. 95/05, 133/07, 156/08, 146/09, 123/10, 137/11, 61/12, 146/12, 160/13, 12/14, 157/14, 137/15

THE EUROPEAN UNION'S TRADE WITH AFRICA AND LATIN AMERICA

Wioletta Nowak

University of Wrocław, Poland
wioletta.nowak@uwr.edu.pl

ABSTRACT

The paper presents the scale of and trends in merchandise trade of the European Union with 54 African and 21 Latin American countries over the period from 2000 to 2014. Moreover, the EU-Africa trade and the EU-Latin America trade are compared with the trade in goods of the United States and China with those regions. The analysis is based on the data retrieved from the UN Comtrade Database. Africa is more significant trading partner for the European Union than Latin America. During analysed 15 years, the value of the EU's bilateral trade with Africa was 1.5 bigger than with Latin American countries. The average annual growth rate of trade with Africa was higher than with Latin America. However, the EU faster increased its trade with Latin American countries than with Africa after the outbreak of the global financial crisis.

Africa and Latin America were mainly the EU's import market but the EU had a surplus in trade with Latin American countries in the years 2013-2014. The European Union is a major trading partner for Africa. It increased its advantage over the US in trade with the African continent but it has been steadily losing its advantage over China. Since 2010, China has been more significant trading partner for Africa's 34 least developed countries than the EU. The European Union is still the second (after the US) important trading partner for Latin America.

However, China's trade with South America surpassed the EU's one in 2014. Besides, China has been more important trading partner for Central America than the EU since 2010.

Keywords: EBA, EPA, EU-LAC summits, least developed countries, trade in goods.

1. INTRODUCTION

In the years 2000-2008, the merchandise trade of the European Union with Africa was growing annually by more than 12% and the EU-Latin America trade grew by nearly 12%. The EU's advantage over the United States and China in trade with Africa was steadily increasing. The European Union also increased its advantage over China in trade with Latin America. Moreover, the differences in the value of the EU-Latin America and the US-Latin America bilateral trade in goods were decreasing at least during the first four years of the 21st century. After the outbreak of the global financial crisis, the significance of the EU as a major trading partner began to change. In order to restore its economy, the EU developed closer economic and trade relations with Asia and its role in the trade with Africa and particularly in trade with Latin America has been declining. The aim of the paper is to show the scale of and trends in merchandise trade of the European Union with 54 African and 21 Latin American countries in the years from 2000 to 2014. Moreover, the EU-Africa trade and the EU-Latin America trade are compared with the trade in goods of the United States and China with those regions. The analysis is based on data retrieved from UNCD. As the trade data for South Sudan are available from 2012, they were combined with the data for Sudan in the following study.

2. DEVELOPMENT OF THE EU-AFRICA AND THE EU-LATIN AMERICA TRADE RELATIONS IN THE 21ST CENTURY

In the twenty first century, the commercial relations between the European Union and Africa were defined by the Cotonou Agreement. It was signed on June 23, 2000 and replaced the Lomé

Conventions¹ which granted non-reciprocal trade preferences to Sub-Saharan African countries. The Cotonou Agreement assumes that trade between the EU and African countries will be based on the principles of free trade and neoliberal orthodoxy. Since 2008, the EU has been negotiating the Economic Partnership Agreements (EPAs)² with five groups of African countries: Central Africa, Eastern and Southern Africa, East African Community, Southern African Development Community (SADC), and West Africa. In 2009, Madagascar, Mauritius, Seychelles, and Zimbabwe signed interim EPA with the European Union. Five years later, the East African Community (Burundi, Kenya, Rwanda, Tanzania, and Uganda) finalised the negotiations for a region-to-region EPA. In 2016, the EU signed Economic Partnership Agreement with the SADC EPA Group comprising Botswana, Lesotho, Mozambique, Namibia, South Africa, and Swaziland (WTO, 2016).

Several African countries signed free trade agreements with the EU. The free trade areas have been in force with Tunisia (since 1998), Morocco (2000), South Africa (2000), Egypt (2004), Algeria (2005), Côte d'Ivoire (2009), and Cameroon (2014).

Africa's least developed countries (LDCs) benefit from the European trade preference programme Everything but Arms (EBA) implemented in 2001. The EBA is a part of the EU Generalised System of Preferences which provides tariff reductions for developing countries. Under the EBA, 34 African LDCs have duty-free and quota-free access to the European markets for all their export products with the exception of arms and ammunitions³.

The European Union negotiates agreements with individual African countries, groups of countries, and the African Union. It declares a partnership, insists on multilateral trade liberalisation by African countries but at the same time protects its own market. The EU-Africa trade relations are strengthened by trade-related development assistance provided by the EU Institutions and Member States. However, the assistance is highly conditional (Nowak, 2016). Generally, the EU-Africa trade relations have evolved over the years. They are mainly determined by European colonialism, the Cold war, and various stages of an enlargement of the European Economic Community and the EU (Hurt, 2010, p. 161). Europe and Latin America are linked by historical, cultural, political, and economic ties which are dated back to 1492. However, contemporary relations between the regions were regulated during the first EU-LAC (Latin America and the Caribbean) summit which was held in Rio de Janeiro (Brazil) in 1999. The summit established a strategic partnership between the EU and LAC. Since then, issues referring to a mutual cooperation in the area of free trade between the partners are discussed during biannual EU-LAC summits. The second summit was held in Madrid, Spain (2002), and the subsequent summits were in Guadalajara, Mexico (2004), Vienna, Austria (2006), Lima, Peru (2008), Madrid, Spain (2010), Santiago, Chile (2013), and Brussels, Belgium (2015). The summits bring together heads of state and government from both regions. In the years when the EU-LAC summits do not take place, the EU and the Rio Group⁴ meet at ministerial level. Since

¹ The following conventions were signed : Lomé I (February 28, 1975), Lomé II (October 31, 1979), Lomé III (December 8, 1984), Lomé IV (December 15, 1989), and Lomé IV-bis (October 20, 1995). The last convention expired on February 29, 2000.

² EPAs are trade and development agreements negotiated between the EU and ACP countries (African, Caribbean, and Pacific Group of States). The main aim of EPAs is to create a free trade area between the EU and ACP countries. There are a lot of studies on the EU-Africa EPAs, for instance: Ukpe (2010), Bach (2011), and Hurt et al. (2013).

³ The EBA imposed longer transition periods for banana, sugar and rice imports into the EU.

⁴ The Rio Group was established by Argentina, Brazil, Colombia, Mexico, Panama, Peru, Uruguay, and Venezuela in 1986. Eventually it was extended to 24 Latin American and Caribbean states. In 2010, it was succeeded by the Community of Latin American and Caribbean States (CELAC) which involves 33 states.

2011, the EU-LAC Foundation has been operating. It was created in 2010 to assist in the implementation of main objectives of the strategic partnership between the EU and LAC (Nowak, 2014, p. 554).

The European Union has privileged relations in trade with Mexico and Chile since 2000 and 2003 respectively. It also signed the trade agreement with Colombia and Peru⁵ in 2012. Moreover, the EU has been linked with Caribbean states through the EU-CARIFORUM States EPA⁶ since 2008. What is more, the free trade area has been fully in force with Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and Panama) since 2013. It is also worth noting that the EU is currently negotiating a trade agreement with Mercosur⁷ (Argentina, Brazil, Paraguay, Uruguay, and Venezuela). All trade agreements between the EU and Latin American countries relate to the deregulation and liberalisation of trade in goods and services.

3. MERCHANDISE TRADE OF THE EUROPEAN UNION WITH AFRICA

Over the period 2000-2014, the EU-Africa merchandise trade increased about 3 times. It was growing annually by 7.4%. The value of trade rose from USD 139.3 billion in 2000 to USD 406.3 billion in 2008 and USD 407.5 billion in 2014. During 15 years, Africa increased its share in the EU's total trade from 8.2% to 8.8%. The European Union imported more goods from Africa than it exported there. In the years 2000-2014, African countries accounted for 9.2% of the EU's total imports. At the same time, the EU exported 8.5% of its goods to the African continent. The average annual growth rate of the European imports from Africa was 6.7% while the growth rate of exports to Africa was 8.3%. The trends in merchandise trade between the EU and 54 African countries are presented in Figure 1.

In the years 2000-2014, the European Union increased its advantage over the United States in merchandise trade with Africa. At the beginning of the 21st century, Africa's bilateral trade with the EU accounted for 77.7% and with the US for 22.3% of its trade with both regions. After 15 years those shares were 84.7% and 15.3%, respectively (Figure 2a).

However, at the same time, the European Union has been steadily losing its advantage over China in the trade with African countries. During the analysed period, the share of the EU in Africa's trade with those two trading partners decreased from 93.0% to 64.8% (Figure 2b).

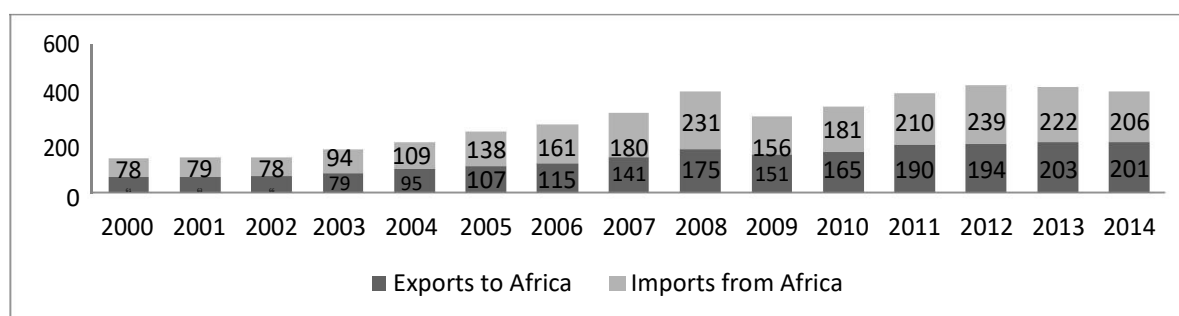


Figure 1: Trade in goods of the EU with Africa, 2000-2014 (USD billion)(own calculations)

⁵ In 2014, Ecuador initiated its accession to the trade agreement with Colombia and Peru.

⁶ CARIFORUM includes Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, the Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, and Trinidad and Tobago.

⁷ The negotiations were initiated in 2000. The access of Mercosur to the European agricultural market and the access of the EU to Latin American market of manufactured goods are the main subjects of the dispute (Roy, 2012, p. 8).

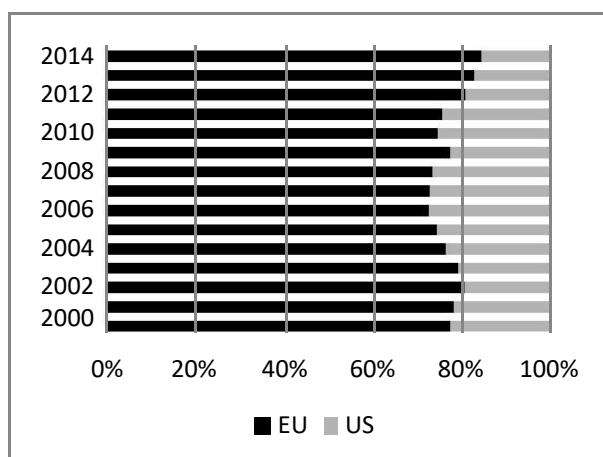


Figure 2a: Total trade of the EU and the US with Africa (own calculations)

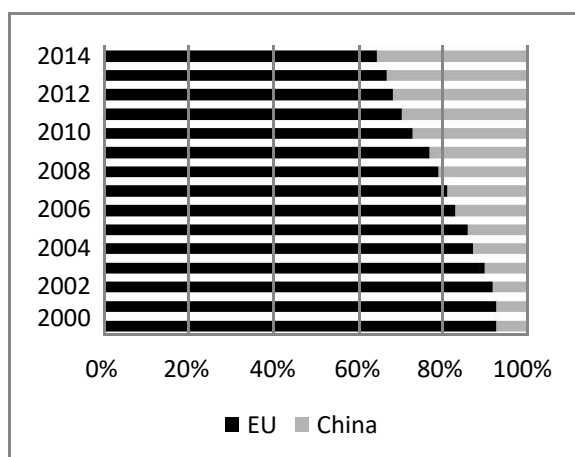


Figure 2b: Total trade of the EU and China with Africa (own calculations)

The European Union is the biggest trading partner for Africa⁸ but not for Africa's 34 least developed countries. Since 2010, China's bilateral trade with that group of African countries has been surpassing the European trade (Figure 3).

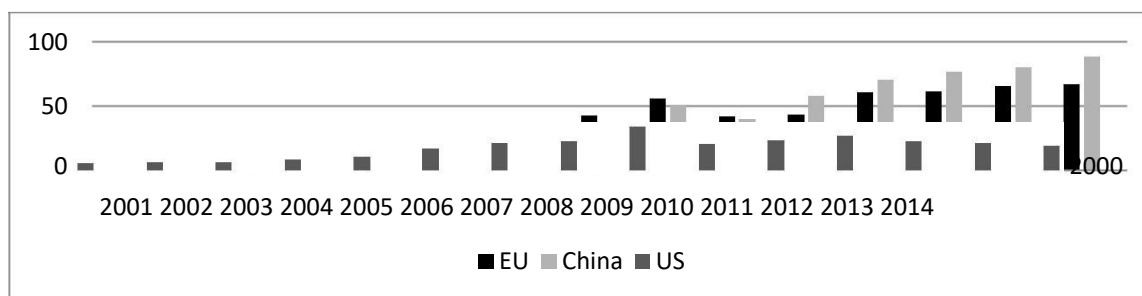


Figure 3: Trade in goods of the EU, China, and the US with Africa's LDCs, 2000-2014 (USD billion)(own calculations)

The EU increased its trade with Africa's LDCs from USD 17.1 billion in 2000 to USD 67.4 billion in 2014, while China's trade rose from USD 4.4 billion to USD 88.5 billion. On the other hand, the EU increased its advantage over the United States in the trade with the poorest African countries. The American trade with Africa's LDCs rose 3 times, from USD 6.0 billion to USD 18.8 billion.

The EU's significance as a major trading partner for African countries changed considerably after the beginning of the global financial crisis. For instance, in the years 2000-2008, China exported more goods than the EU to two countries in Africa and imported more goods from six African countries. From 2009 to 2014, the Chinese exports to Africa surpassed the European ones in 13 countries while imports in 17 countries (Table 1).

⁸ The EU is also a major trading partner for Sub-Saharan Africa (African countries excluding: Algeria, Egypt, Libya, Morocco, and Tunisia).

Table 1: African countries for which China was more important trading partner than the EU (own calculations)

Period	Exports of goods	Imports of goods	Bilateral trade
2000-2008	Benin, Lesotho	Angola, Sudan, Congo, Burkina Faso, Benin, Somalia	Sudan, Angola, Congo, Benin
2009-2014	Liberia, Benin, Tanzania, Sudan, Djibouti, Kenya, Ethiopia, Gambia, Zimbabwe, Lesotho, Somalia, Mozambique, Zambia	Angola, South Africa, Sudan, Congo, Zambia, Dem. Rep. of Congo, Mauritania, Sierra Leone, Benin, Mali, Chad, Burkina Faso, Eritrea, Gambia, Rwanda, Guinea-Bissau, Somalia	Angola, Sudan, Zambia, Liberia, Dem. Rep. of Congo, Benin, Congo, Tanzania, Djibouti, Sierra Leone, Gambia, Somalia, Zimbabwe, Eritrea
2000-2014	Benin, Liberia, Tanzania, Sudan, Djibouti, Lesotho, Gambia, Somalia	Angola, Sudan, Congo, Zambia, Dem. Rep. of Congo, Sierra Leone, Benin, Burkina Faso, Mauritania, Mali, Eritrea, Chad, Somalia, Gambia, Guinea-Bissau	Angola, Sudan, Congo, Zambia, Benin, Djibouti, Gambia, Somalia

Since 2009, the EU slightly improved its significance as a trading partner for African countries compared with the US. Before the global crisis, the United States imported more goods than the EU from Nigeria, Angola, Congo, Gabon, Chad, and Lesotho while after the crisis only from Chad, Angola, Gabon, and Lesotho. In the years 2000-2014, the EU dominated over the US in merchandise exports to Africa.

In the years 2000-2014, the European Union traded mostly with South Africa (16.0% of the EU-Africa bilateral trade), Algeria (15.5%), Libya (10.6%), Nigeria (10.0%), and Morocco (8.7%). The ranking of the EU's top five trading partners in Africa is presented in Table 2.

Table 2: The EU's top five trading partners in Africa, 2000-2014 (USD billion)(own calculations)

Rank	Exports of goods		Imports of goods		Bilateral trade with Africa	
	Trading partner	Value	Trading partner	Value	Trading partner	Value
1	South Africa	358.3	Algeria	419.8	South Africa	700.2
2	Algeria	257.8	Libya	378.1	Algeria	677.6
3	Morocco	232.5	South Africa	341.9	Libya	464.3
4	Egypt	211.4	Nigeria	276.3	Nigeria	437.0
5	Tunisia	174.0	Tunisia	151.2	Morocco	380.9

Generally, the EU trades with several rich African countries. During analysed 15 years, the top five African importers accounted for 61.5% of the European exports to Africa while the top five exporters accounted for 66.4% of the EU's imports from the region.

4. TRADE IN GOODS BETWEEN THE EUROPEAN UNION AND LATIN AMERICA

Latin America is less important trading partner for the European Union than Africa. Over the period 2000-2014, the EU increased its bilateral trade with 21 Latin American countries 2.7 times. It rose from USD 96.4 billion in 2000 to USD 260.5 billion in 2008 and USD 262.9 billion in 2014. The EU-Latin America bilateral trade grew annually by 6.9%. In the years 2000-2001 and 2013-2014, the EU experienced a surplus in trade with the region. From 2002 to 2012 Latin America was first of all the EU's import market. During analysed 15 years, Latin American countries accounted for 5.8% of the EU's total imports. The EU exported to those countries 5.8% of its goods, too. The average annual growth rate of the European exports to Latin America was 7.1% while the growth rate of imports was 6.7%. The trends in merchandise trade between the EU and 21 Latin American countries are presented in Figure 4.

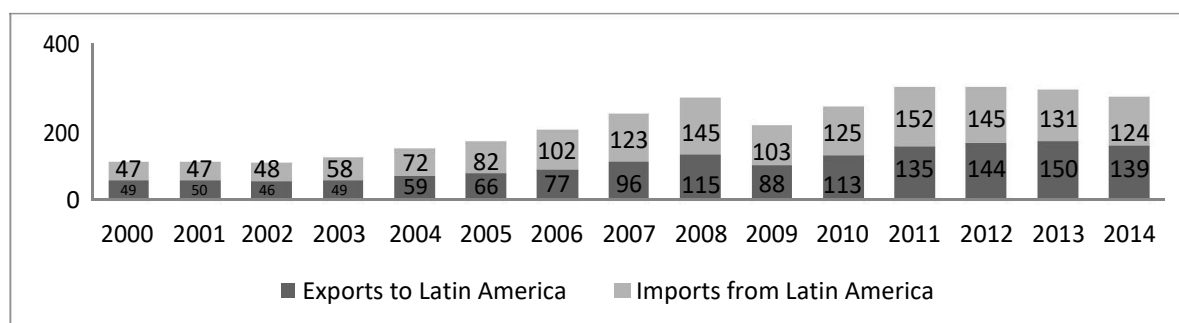


Figure 4: Trade in goods of the EU with Latin America, 2000-2014 (USD billion) (own calculations)

The European Union is the second (after the US) major trading partner for Latin America. It slightly increased its share in bilateral trade of Latin American countries with their two most important trading partners. In 2000, Latin America's trade with the EU accounted for 20.8% and with the US accounted for 79.2% of its trade with those two partners. After 15 years, the shares were 23.7% and 76.3%, respectively (Figure 5a).

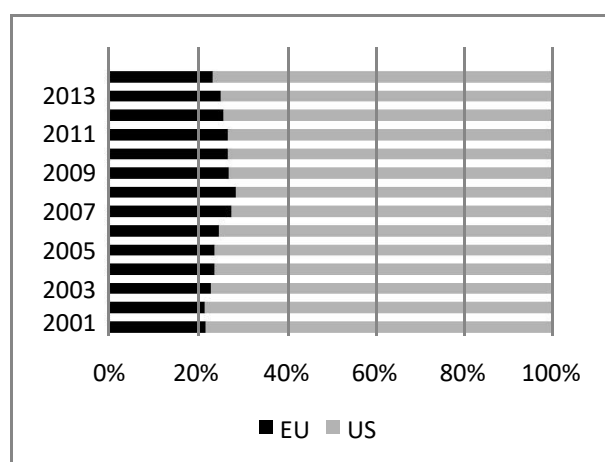


Figure 5a: Total trade of the EU and the US with Latin America (own calculations)

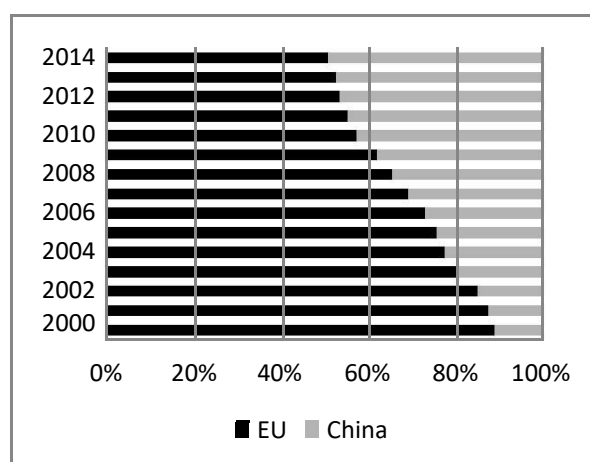


Figure 5b: Total trade of the EU and China with Latin America (own calculations)

Compared with the US, the European Union increased its significance as trading partner for Mexico (from 7.4% in 2000 to 10.1% in 2014) and for South America (from 42.1% to 42.7%). However, the EU experienced a 4.1 percentage point decrease in trade with Central America⁹ (from 24.9% to 20.7%).

Since the beginning of the 21st century, the EU has been systematically losing its share in the Latin American market for China. In 2000, Latin America's bilateral trade with the EU accounted for 89.0% and with China for 11.0% while in 2014, those shares were 50.7% and 49.3%, respectively (Figure 5b). Compared with China, the EU decreased its share in Central America's market from 82.3% in 2000 to 45.2% in 2014. It is worth noting, that since 2010, China has been more important trading partner for Central America than the EU. Moreover, the EU experienced nearly a 40 percentage point decrease in trade with South America (from 89.1% to 49.2%) and a 33.6 percentage point decrease in trade with Mexico (from 91.6% to 58.1%).

⁹ In the study Latin America covers seven countries of Central America (Belize, Costa Rica, Guatemala, Honduras, Nicaragua, Panama, Salvador), thirteen countries of South America (Argentina, Bolivia, Brazil, Chile, Columbia, Ecuador, Guyana, Paraguay, Peru, Surinam, Trinidad and Tobago, Uruguay, and Venezuela), and Mexico.

In the years 2000-2008, the EU exported more goods than the US to two countries in the region and imported more goods from eight Latin American countries. After the global crisis the EU dominated over the US in merchandise exports to four countries. What's more, the European imports surpassed the American ones in nine countries (Table 3).

Table 3: Latin American countries for which the EU was more important trading partner than the US (own calculations)

Period	Exports of goods	Imports of goods	Bilateral trade
2000-2008	Brazil, Argentina	Brazil, Argentina, Chile, Panama, Uruguay, Paraguay, Guyana, Suriname	Brazil, Argentina, Chile, Uruguay, Panama, Suriname, Guyana
2009-2014	Brazil, Argentina, Uruguay, Suriname	Brazil, Argentina, Chile, Uruguay, Paraguay, Peru, Panama, Suriname, Belize	Brazil, Argentina, Uruguay, Suriname
2000-2014	Brazil, Argentina, Uruguay	Brazil, Argentina, Chile, Uruguay, Paraguay, Panama, Suriname, Belize	Brazil, Argentina, Uruguay, Chile, Suriname

On the other hand, the European goods are steadily displaced by the Chinese ones. Before 2009, China exported more goods than the EU to Panama and Paraguay while in the years 2009-2014, the Chinese exports surpassed the EU's ones in eight Latin American countries. Moreover, China was more important than the EU destination market for five countries in the region (Table 4).

Table 4: Latin American countries for which China was more important trading partner than the EU (own calculations)

Period	Exports of goods	Imports of goods	Bilateral trade
2000-2008	Panama, Paraguay	—	Panama
2009-2014	Panama, Peru, Chile, Paraguay, Guatemala, Nicaragua, Uruguay, Honduras	Chile, Venezuela, Brazil, Peru, Uruguay	Panama, Chile, Venezuela, Peru, Uruguay
2000-2014	Panama, Paraguay, Nicaragua	Venezuela	Panama

Over the period 2000-2014, the European Union traded mostly with Brazil (34.5% of the EU-Latin America bilateral trade), Mexico (20.8%), Chile (9.1%), Argentina (9.0%), and Colombia (5.3%). The ranking of the EU's top five trading partners in Latin America is presented in Table 5.

Table 5: The EU's top five trading partners in Latin America, 2000-2014 (USD billion)(own calculations)

Rank	Exports of goods		Imports of goods		Bilateral trade with Latin America	
	Trading partner	Value	Trading partner	Value	Trading partner	Value
1	Brazil	462.6	Brazil	530.0	Brazil	992.6
2	Mexico	375.7	Mexico	224.9	Mexico	600.6
3	Argentina	111.5	Chile	163.0	Chile	261.9
4	Chile	98.9	Argentina	148.5	Argentina	260.0
5	Venezuela	70.8	Colombia	87.9	Colombia	154.1

The EU trades with the biggest Latin American economies. During 15 years, the top five Latin American importers accounted for 81.3% of the European exports to Latin America while the top five exporters accounted for 76.8% of the EU's imports from the region.

5. CONSLUSION

Africa is more significant trading partner for the European Union than Latin America. In the years 2000-2014, the value of the EU's bilateral trade with Africa was 1.5 bigger than with Latin American countries. The average annual growth rate of total trade with Africa was higher than with Latin America. However, the EU faster increased its trade with Latin American countries than with Africa after the outbreak of the global financial crisis. Africa and Latin America were mainly the EU's import market. The EU had a surplus in trade with Latin American countries in the recent years.

The European Union is a major trading partner for Africa. It increased its advantage over the United States in trade with the African continent but it has been steadily losing its advantage over China. Since 2010, China has been more significant trading partner for Africa's 34 least developed countries than the EU.

The European Union is still the second important trading partner for Latin America. However, China's trade with South America surpassed the EU's one in 2014. Besides, China has been more important trading partner for Central America than the EU since 2010. During analysed 15 years, the EU to a great extent lost its market share in Latin America than in Africa. Compared with China, the EU experienced a 38.3 percentage point decrease in bilateral trade with Latin America and a 28.2 percentage point decrease in trade with Africa.

LITERATURE:

1. Bach, D. (2011). The European Union and Africa: Trade Liberalisation, Constructive Disengagement, and the Securitisation of Europe's External Frontiers, *Africa Review*, 3(1), 22-47. DOI: 10.1080/09744053.2011.10597303
2. Hurt, S.R. (2010). Understanding EU Development Policy: history, global context and self-interest? *Third World Quarterly*, 31(1), 159-168. DOI: 10.1080/01436590903557488
3. Hurt, S.R., Lee, D. and Lorenz-Carl, U. (2013). The Argumentative Dimension to the EU-Africa EPAs, *International Negotiation*, 18(1), 67-87. DOI: 10.1163/15718069-12341250
4. Nowak, W. (2014). Sino-European Trade Competition in Latin America and the Caribbean, *Chinese Business Review*, 13(9), 552-561. DOI: 10.17265/1537-1506/2014.09.002
5. Nowak, W. (2016). Trade competition between Asia and the European Union in Africa, In: M.H. Bilgin and H. Danis (eds.), *Proceedings of the 17th Eurasia Business and Economic Society Conference*, (in press).
6. Roy, J. (2012). European Union-Latin American Relations in a Turbulent Era, *The Jean Monnet/Robert Schumann Paper Series*, 12, 1-33.
7. Ukpe, A.I. (2010). Will EPAs Foster the Integration of Africa Into World Trade? *Journal of African Law*, 54(2), 212-231. DOI: 10.1017/S0021855310000057
8. UNCD (2016). *UN Comtrade Database*. Retrieved 14.01.2016 from <http://comtrade.un.org/data/>
9. WTO (World Trade Organization) (2016). *Participation in Regional Trade Agreements*. Retrieved 05.08.2016 from https://www.wto.org/english/tratop_e/region_e/rta_participation_map_e.htm

ENTERPRISE ARCHITECTURE: THE CONFLICTS RESOLUTION INSTRUMENT OF BUSINESS MANAGEMENT

Yulia Bystraya

*Southern Federal University, Russia
ysbystraya@gmail.com*

Svetlana Stash

*Southern Federal University, Russia
lana.stash@gmail.com*

Tatiana Makarenya

*Southern Federal University, Russia
tamakarenya@sfedu.ru*

ABSTRACT

The theory of business management for the scientific existence changed under the influence of environment and realities of practical activities of management. Not always leads emergence of new stages of development, opening of new instruments of management to immediate improvement, often new opening bear new contradictions. So development of information technologies became not only achievement, but also threat. The enterprise architecture is urged to solve business management contradictions on the basis of information technologies.

Keywords: *Architecture of the enterprise, Contradictions, Enterprise, Evolution, Information technologies, Modeling, Theory of management, Zahman.*

1. INTRODUCTION [FONT TIMES NEW ROMAN, SIZE 12, BOLD]

In management theory laid two basic concepts: methodology and research in the field of management; technology and management practices. The first concept reveals the body of knowledge about the organization, including the laws and principles of establishment, operation, reorganization and liquidation of the organization. The second concept examines issues of socio-economic processes in the organization [1], which discloses the concept of the theoretical foundations of management.

Any control system consists of the object and the governing body, the governing body is in the feedback loop [2]. Control Object - the object to achieve the desired results of which are necessary and permissible special organizational control actions.

The purpose of management - value ratio of the coordinate values of the control object and change over time, which will ensure the achievement of the desired result operation of the facility.

2. SYSTEM MODEL

According to established practice, the term "governance" has a broader meaning than the term "management", because it applies to all types of control systems, including the technical, biological, environmental, political, military, social and others.

The process of enterprise management, modern authors consider two points of view as:

1) Control of any enterprise, for example, social, educational, military, government, and economic systems. Under this point of view, there was such a thing as self-management that is control person of his own life and work.

2) Management of enterprises, economic conditions in the market, for-profit. At the same time control the creation of the enterprise, the interaction of its parts, the production process, the development of the company, its relationship with other actors of the market environment.

Any company can be presented as an open system, built into the outside world. At the entrance of the company receives the resources from the external environment, the output it gives her the created product. Therefore, the enterprise is the ability to live productive activities in the broadest sense - by human activity, group of people, the state, aimed at the creation of new material and other valuables.

Total system model of the production process is shown in Figure 1 and comprises three basic processes:

- 1) Obtaining resources from the external environment (material, labor, financial);
- 2) Production of the product (the production process);
- 3) The transfer of finished goods or services to the external environment.

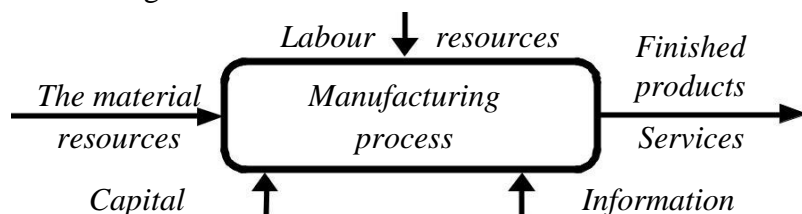


Figure 1. The model of the production process

As the resources needed to implement the business process, allocate personnel, equipment, raw materials, and the original information. A fundamentally important fact to attract resources in the implementation of business processes, which generates costs.

Ability to compare these costs to the result and the basis for allocation of business processes into an independent economic unit of the enterprise. Based on the above, the business process is defined as a set of actions, works in progress that, with the use of resources, creates an output having a value for the consumer.

There are a number of requirements for the allocation of business processes. Firstly, in the business process should be the final consumer, it may be within the enterprise and beyond. Secondly, the existence of the possibility of separation of the business process and defining its boundaries. Thirdly, the basis for the allocation of the borders of the business process is the request of the consumer. Fourth, experts in the field of separation of business processes are business - analysts, economists, managers, engineers and technologists do not.

One of the main tasks is to develop a process of coordination and harmonization of interests of different parts of the system under study.

All these processes are an integral part of existence for the enterprise. Shutdown at least one of the processes will result in the inability of the company continue to operate. Management is responsible for establishing and maintaining a balance between considerations of the process.

The basic approach to the consideration of enterprise management is as follows:

- Consideration of management companies in terms of the processes that take place within the enterprise;
- Consideration of enterprise management from the perspective of the processes enables the company to the external environment;
- Consideration of company management in terms of the implementation of its immediate activities.

Management is not equivalent to the whole of the company to achieve the ultimate goals, and includes only those activities that relate to the establishment of coordination and cooperation within the company, with the stimulus to activity from the target orientation of the various activities, etc. (Figure 2).

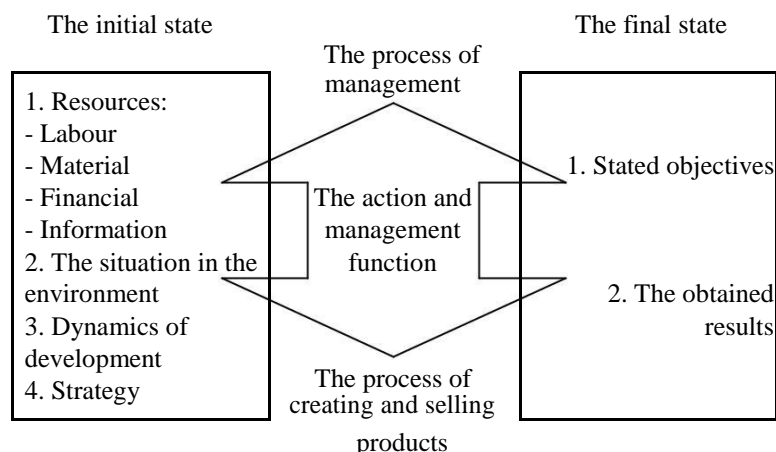


Figure 2. Place the management of the company

In the process of business management for many hundreds of years there have been many tools aimed at improving the system of enterprise management and conflict management. The evolution of management tools has led to the creation and use of information technologies that facilitate and accelerate the processing of data sets and getting ready reports, management has made the process easier and clearer. But as it turned out, information technology can not only facilitate the work, but also lead to serious accidents in the enterprise. At a time when the company fully automates its work through information technology every little failure can lead to serious losses, and at the serious problems of loss can reach huge volumes. Managers faced with the fact that information technology in the enterprise can lead to conflicts with the department responsible for them. Technical capabilities can't perfectly fulfill all the desires of control now; we need a clear and substantive interaction manager and technical units of the enterprise. So there was a serious conflict in the management of enterprises, and the quest to create a mechanism for its resolution led to the discovery of a new scientific and practical direction of "enterprise architecture".

And as we have already managed to make the appearance of the problems are, and means to address them, scientists and practitioners are not standing still. Thus, it began the creation of a system of management of information technology within the enterprise; build them through the creation of a clear hierarchy of information technology enterprise architecture.

3. SIMULATION AND ANALYSIS REFERENCES

Since the introduction of IT technologies for their introduction to the work of enterprises has become a mass phenomenon and each year is gaining momentum. Guide enterprises have realized the importance of IT technology in significant relief of their work, a clearer and quality of its execution. Over the years created new software for data processing, communications, customers, users, analysts, organizational structure, plans, work schedules, and many others. Such widespread use of IT technologies has necessitated the creation of a single system capable of clear and consistent way to combine all of this. The increasing complexity and diversity of organizations identified the growing complexity of its spectra and pieces of work.

The main idea of harmonizing the IT processes of the enterprise: it is necessary to start with the most important characteristics of the company, considering the most important substantive aspects. And spend it did not "mind" or "to" and to clearly set out the descriptions of the company, allowing you to see all of the essential relationship, and it means - his models [3].

Business Modeling has a central role in the organization, allowing you to see not only the present but also the future of her paintings, which helps in the decision making changes and develop an action plan for the transition from the current state to the desired. At the same time, the requirement of continuous improvement of business processes and the need to ensure strict

compliance with the specifications of IT business models has led the company to realize the importance of the formation of complex models that in the business simulation called "enterprise architecture» [4].

Over the past 28 years, scientists have developed a set of methodologies for constructing an enterprise architecture based on the use of different models. Currently 90 percent of cases, use one of the following four methodologies [5]:

- 1) The structure of the Zachman Framework for Enterprise Architecture;
- 2) TOGAF (The Open Group Architectural Framework);
- 3) The architecture of the federal organization;
- 4) Methodology Gartner.

In the early 1980s John Zachman proposed the idea; he came up with the first framework for describing complex systems, such as a corporation. Since then, the business structure modeling Zachman has become a major tool for building the necessary models, as well as methods for their determination. Zachman methodology is an amalgamation into one system a real business environment, conceptual model, logical model, technological (physical) model, the detailed implementation.

Zachman structure has become so universal that it can be applied as a model for the construction of a complex description of a very large enterprise, and on small enterprises. This structure does not give a ready answer to the application; it is an instrument of "Reflections" effective development model description of the company. The fundamental structure of Zachman has allowed her to become the basis for most modern methodologies of modeling and, at the same time, a tool to compare them. Building on the Framework Zachman architecture modeling are complete methodology describe enterprise architectures that help us answer questions about "What", "How?", "Who?", "Why?", "When?" and "Where?" we need to build.

Based on the Zachman, Steven Spivak in 1992 wrote a book «Enterprise Architecture Planning». It was an approach to information systems at the enterprise level. Sounded the term «Enterprise Architecture» it was for the first time.

Enterprise Architecture – is a very young science. Total 25 years. But this time, it has proven to be highly effective in practice. Over its development has dozens of research institutes, professional associations and consulting companies. Each operating time, the definition, methodology, terminology, etc., in Table 1 are some basic definitions of enterprise architecture.

Table following on the next page

Table1: Basic definitions of enterprise architecture

Author	/ Determination
Center of Information Systems Research MIT Sloan School of Management:	Enterprise Architecture - organizational logic for key business processes and IT solutions, reflecting the requirements of the operating model of the enterprise integration and standardization. The operating model - is the necessary level of integration and standardization of business processes.
Marc Lankhorst – the book «Enterprise Architecture at Work»:	Enterprise Architecture - a holistic set of principles, methods and models used in the design and implementation of organizational structure, business processes, information systems and technologies.
Federal Enterprise Architecture (FEA):	Enterprise Architecture - a management practice aimed at maximizing the impact of resources of the enterprise, IT investments, and efforts to develop systems in achieving the objectives of the enterprise.
Gartner – one of the leading consulting and analytical companies in the IT industry:	Enterprise Architecture - is the process of translating the vision and business strategy in an effective change of the company by creating, discussing and improving the key requirements, principles and models that describe the future state of the company and enable its development.
Linda Kyuton, CIO NASA:	Enterprise Architecture - a planning tool, which describes: 1. How IT assets are linked and function; 2. What companies really need from information technology; 3. A clear plan for implementing what is needed from the company's technology. He works in the context of setting priorities, making decisions, informing about these solutions and results - all that is called IT Governance.

Architecture, in accordance with the objectives of the enterprise business, as it renders all of the systems that are taking place within the organization. This is the basic information infrastructure: by the functions and objectives of the business, by the structural elements, by the relationship and the synchronization between them. It describes the implementation of the various functions - as an organization department and its staff - their function, utility responsibility. Information role in the concept of "architecture" is the specification and structuring of the basic information in the form of modern information technology elements: a database describing the various calculations and processes, text and visual files, charts - and many other storage media. That is, in the architecture of enterprise IT service plays the role of a binding and specifies the employee who stores all the important information.

The system architecture defines a set of methodological, technological and technical solutions for information support of the enterprise activity, determined by its business architecture, and includes application architecture, data and technical architecture. Model Enterprise Architecture accumulates knowledge of its processes, behavior, information and material flows, resource and organizational units, infrastructure and systems architecture. Thus the main purpose of modeling should be not only to increase integration of the enterprise, but also the support of his analysis in a variety of cuts (economic, organizational, qualitative, quantitative, etc.) for improvement of decision-making, control, coordination and monitoring of its various

parts. To have a complete understanding of the business, you must have answers to the questions - who, what, when, why, where and how to exercise.

Enterprise Architecture modeling environment must include four components. 1) The unit of the elementary facilities of the enterprise:

- Description (representation) of elementary objects (for example, a particular product/ services produced by the company at the present time);
- Vehicles used for the generation of ideas (data objects), according to certain rules (eg, ERP, SCM, CRM, DBMS).

2) Block model enterprise architecture:

- The actual models of different types (process-functional, information, resource, organizational, etc.), Consisting of the elements of abstract mapping elementary objects;
- Modeling tools that provide analysis, design and use of models

3) Block modeling languages and methodologies, including:

- General model design;
- The processes of modeling enterprise architecture;
- Tools that support the process of identifying and modifying methodologies and languages.

4) Languages Unit meta-modeling and meta-methodologies for describing the concept, syntax and semantics of the modeling methodologies and their application languages as well as to describe the processes of construction of these languages and methodologies.

Modeling Methodologies should regulate the sequence of steps and simulation steps, the rules of the transition from stage to stage, and a set of rules for constructing models on each of them. At this stage, the simulation architecture must provide top-down design major architectural layers in accordance with the general scheme of the enterprise architecture.

4. CONSLUSION

Modeling Enterprise Architecture first, must be formed on the fundamentals of management information systems. All of this is based on the basic pillars of management information systems. This can be explained by the control of the process, what we talked about in the beginning of this article. Enterprise management is not mechanical, but with the help of teams, team, in turn, are produced base on the information received. Therefore, process control - is primarily a process of receiving and processing information. Information systems are designed to properly organize the information you need. Create a business architecture is the next stage in the evolution of methods and tools for enterprise management. Thus, from the foregoing that the business architecture is a tool for managing the company, capable of resolving the contradictions of enterprise management, and to make the basis of the mechanism of identification and management of organizational conflicts in the enterprise.

LITERATURE:

1. Korobko V. I. (2012). *Theory of management: manual*. Unity Dana.
2. Dolyatovsky V.A., Dolyatovskaya V.N. (2003). Research of control systems: Educational-practical manual. *Rostov-on-Don: Publishing Centre "Mart"*.
3. Zinder E.Z. (2000). "3D-enterprise" the scheme of architecture of the transformed system. Mag. *"The director of information service"* # 4.

4. Meshkis D.K. (2006). *Management of development of a higher educational institution on the basis of process approach and methods of business simulation*. St. Petersburg, Meshkis D.K..
5. Seshns R. (2007). Company ObjectWatch, Inc. Comparison of four leading methodologies of creation of architecture of the enterprise. Open portal of Microsoft. Retrieved 20.01.2016 from <https://msdn.microsoft.com/ru-ru/library/ee914379.aspx>.
6. Sowa J.F., Zachman J.A. (1992). Extending and Formalizing the Framework for Information System Architecture. IBM Systems Journal: Vol. 31, # 3.

WHAT DRIVES THE DIFFERENCE IN DOMESTIC VALUE ADDED OF EU EXPORTS?

Natasa Vrh

*PhD student; Faculty of Economics, University of
Ljubljana natasa.vrh@ef.uni-lj.si*

ABSTRACT

The main feature of today's production chains is that different stages of production are divided between different participating countries in a way that each country adds value at certain stage of production. Consequently, a large part of today's export is not fully or originally produced in the exporting country but includes certain share of imported intermediates. Research emphasises the fact that trading countries can face an important concern regarding the part of exports created in the country and their position in global value chains (GVCs). Beside participation in GVCs, the significant importance lies in the amount of the value which is created in export-related industries, since it actually affects domestic employment (job creation) and growth (Banga, 2014).

Focusing on EU, share of domestic value added in exports (DVA) is in almost all industries in EU countries from Central and Eastern Europe (NMS-10) lower compared to core EU countries (EU-15). The paper looks at main drivers of the differences in DVA between this two groups of countries and it focuses on determinants of DVA. To decompose each country's exports into domestic and foreign content I use the methodology provided by Koopman et al. (2010) and industry-level data from the World Input-Output Database (WIOD). I show that there are many cases where the determinants have different effects on domestic content of export (exposure to foreign investment, capital endowment, intermediates from China etc.). Among the most evident are intangible capital investments in high knowledge intensive sectors, especially investments in economic competencies, suggesting that specific level of investments in intangible capital is required in order to even integrate in GVC.

Keywords: *Global value chains, International trade, Value-added in exports.*

1. INTRODUCTION

With the emergence of global value chains (henceforth GVCs) different countries in the production chain add value before final consumption. Consequently most of today's export is not fully or originally produced in the exporting country since it incorporates certain share of imported intermediates (Cheng & Fukumoto, 2010). Therefore around one fifth of country's export represents other countries' value added in imported intermediates. Research emphasises the fact that trading countries can face an important concern regarding the part of exports created in the country and their position in GVCs. The integration into GVCs is related with favourable employment situation, improved working conditions and workers' income gains which depend on the firm's position in value chain (Shingal, 2015). However, beside participation in GVCs, the significant importance lies in the amount of the value which is created in export-related industries, since it actually affects domestic employment (job creation) and growth (Banga, 2014). Thus, countries are increasingly focusing on improving value added earned per exports and are not solely concentrating on increasing their export market share (OECD, 2013).

Domestic value added in country's exports indeed represents an important measure of income from trade and thus an important development policy's guideline (Caraballo & Jiang, 2016).

Namely, the high country's volume of exports is not necessarily reflected in its economic growth as it was in the past, since only domestic part of country's total exports contributes to its GDP.

When DVA in exports is closely observed, some features of DVA in exports dynamics can be identified (Figure 1). First, in the period 1995-2011, DVA in exports declined in all sectors which is observable using different types of DVA in exports measures (Koopman et al, 2010, Koopman, Wang & Wei, 2014; Hummels, Ishii, & Yi, 2001; Dean, Fung, & Wang, 2007; Daudin, Riffart & Schweisguth, 2011; Johnson & Noguera, 2012). Second, manufacturing sector has the lowest DVA in exports shares compared to services and natural resources, what could indicate higher degree of cross-border production fragmentation (Johnson & Noguera, 2012). Third, DVA in exports increased in crisis year 2009. Regarding this increase, Stehrer and Stöllinger (2013) argue that crisis could have caused firms to start re-shoring before offshored activities, which lead to higher DVA in exports, especially if re-shoring activities were present in sectors with relatively high foreign VA in exports. The last observed feature on which my research is focused on represents the fact that NMS-10 have lower shares of DVA in exports than EU-15 countries. The paper's main research question is what are the main drivers of the differences in DVA share between EU-15 and NMS-10, and is aimed at exploring the role of FDI, intangible investments, capital endowment and financial development on DVA share in total exports. To decompose each country's exports into domestic and foreign content

I use the methodology provided by Koopman et al. (2010) and data from the World Input-Output Database (WIOD) (Timmer et al., 2015).

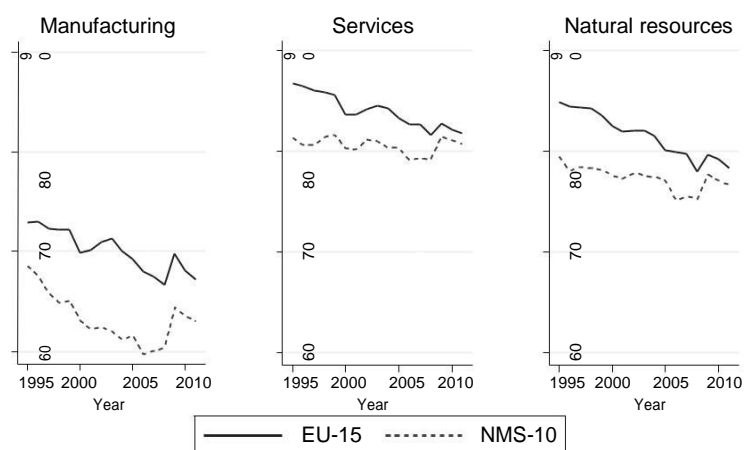


Figure 2: Share (%) of the domestic value added in exports for core EU countries (EU-15) and EU countries from Central and Eastern Europe (NMS-10), period 1995-2011, by sector groups (WIOD tables, own calculations).

The paper goes beyond the analysis of Koopman et al. (2010), since it explores the determinants that influence DVA in exports in EU countries and explains the heterogeneity among two groups of EU countries in terms of DVA in exports using industry-level data. Furthermore, the existing empirical studies mainly focus on evaluating the determinants that could facilitate the establishment of supply links i.e. the determinants that influence foreign value added in exports (Stehrer & Stöllinger, 2015; Rahman & Zhao, 2013), determinants of participation in GVCs (Van der Marel, 2015; Stehrer & Stöllinger, 2015; Kowalski et al., 2015) and determinants of trade in value added (Baldwin & Taglioni, 2011; Brooks & Ferrarini, 2012; Cheng & Fukumoto, 2010; Noguera, 2012; Choi, 2013).

The rest of the paper is structured as follows. Section 2 presents the evidence of the existing empirical research findings regarding the determinants of DVA (FVA) in exports. Section 3 describes regression specification and presents results and section 4 concludes.

2. POTENTIAL FACTORS OF THE VALUE ADDED IN EXPORTS

Although there is certain GVC related theoretical literature emerging (Milberg, 2004; Heintz, 2005; Li & Liu, 2014), GVC literature is mainly empirical.

Stehrer and Stöllinger (2015) research potential factors that foster and factors that hinder further economic integration for manufacturing sector. With Germany assumed to be, as described, an “anchor” of the Central European supply chain, this enables them to use the classical gravity model (country-level version) and thus to introduce the “distance to Germany” and “relative GDP to Germany” as controlled variables. They find that greater inward FDI is associated with higher foreign content in gross exports and that larger countries tend to have, *ceteris paribus*, a lower FVA. Similarly Kowalski et al. (2015) find, using TiVA data for 57 countries, positive and significant correlation between FVA and revealed openness to FDI (measured as a share of inward FDI stock as percent of GDP). As they explain in their analysis, in the observed countries inward FDI is likely to be more related with imports of foreign intermediates for exports processing.

Regarding the skill structure of the workforce Stehrer and Stöllinger (2015) find a negative coefficient for the medium-skilled labour which suggests that more medium-skilled labour (including an important group of skilled production workers), reduces FVA. They also find a negative correlation for the export sophistication since, as they explain, the more sophisticated a country's export base is the greater are country's skills and capacities. Thus the country uses less imported inputs and consequently decreases the share of FVA in exports.

OECD (2013) studies the role of knowledge based capital in GVC upgrading. Using data from Intan-invest database for 14 European countries (in which only two countries in the sample belong to NMS-10 group), they find that larger stock of knowledge based capital stimulates larger value-added in exports (measured in VAX terms). They find noticeable differences in size and significance when they observe estimated coefficients among three subgroups of intangible capital (computerized information, innovative property and economic competencies). By all of subgroups, the coefficient on economic competencies appears to be the largest and most significant, while for computerized information it is considerably smaller and not significant.

Caraballo and Jiang (2016) focus on the determinants which could explain the “value-added erosion” and find that increase of foreign high-skilled labour share embodied in country's imports has a negative impact on the share of value-added generated by exports. Additionally they find a positive correlation between the tariffs imposed on manufactured products and DVA share, suggesting that countries which practice limited protectionism or lack strong industrial policies are likely to face decrease in DVA share.

Kee and Tang (2016) perform a more detailed analysis, using customs transaction-level data and firm-survey data for Chinese firms in the period 2000-2007. Since China has, despite of the majority of other countries, increasing trend in DVA share, they research what led to China's resistance to falling DVA in exports to gross exports despite that China is strongly involved in GVCs. They find that rising DVA share can be related with firms' substitution of domestic for imported materials, both in terms of volume and varieties. Additionally they find that trade and FDI liberalization since 2000 promotes country's DVA through input-output linkages and spillover effects.

However, for firms that pursue the path of upgrading in GVCs based on formation of knowledge-based capital, the access to finance is crucial in this process. As noted by Manova and Yu (2016) strengthening capital markets represents an important precondition since, as presented in their study, the credit-constrained exporting firms from China are likely to conduct pure assembly with low value added (earn low profits) compared to less financially constrained firms which conduct import and assembly or even normal trade. However, as explained by OECD (2013) financial development might have a more significant contribution to DVA (in

VAX terms) in emerging economies. Namely, their study sample includes European economies that have relatively developed (advanced) financial institutions which could explain the insignificant coefficient on the measure of financial development when DVA is regressed on financial development indicator. The following section analyses the possible determinants of DVA in exports and their impact on DVA in each group of EU countries.

3. EMPIRICAL STRATEGY

3.1. Regression specification

Motivated by the differences in DVA shares between EU-15 and NMS-10 countries, the paper attempts to explain these differences. For this purpose a dummy variable (*NMS*) is introduced in order to compare the partial elasticities of two groups of EU countries (NMS-10 and EU-15). The indicator variable is interacted with each of selected variables and thus the following empirical specification is estimated:

$$DVA_{ijt} = \alpha + \beta_1 X_{ijt-1} + \beta_2 X_{ijt-1}NMS + \mu_i + \mu_j + \mu_t + \epsilon_{ijt} \quad (1)$$

where *DVA* represents estimated measure of DVA in exports¹ as a share of total exports relating to country *i*, industry² *j* and time *t*. ϵ_{ijt} is random error term, the μ 's are country-, industry- and time-fixed effects. X_{ijt-1} represent matrix of explanatory variables, $X_{ijt-1}NMS$ represent interaction terms between the explanatory variable and *NMS* dummy variable, where *NMS* = 1 if the observation belongs to NMS-10 and *NMS* = 0 for EU-15.

Based on the empirical evidences from the literature and theoretical predictions of the upgrading within GVCs, the main explanatory variables (*X*) included in equation 1 are hourly wage (*WAGE*), openness to FDI as a share of inward FDI stock in GDP (*IFDI*), physical capital endowment measured as capital stock per hours worked (*CAPend*), import of intermediates from China as a share of total intermediates consumption (*IMintCHN*), financial development (*FD*) and investments in intangible capital per hour worked (*INTAN*). All variables are transformed using natural logarithm. To reduce potential concerns of endogeneity³ and to allow for a deferred reaction of DVA, all explanatory variables are 1-year lagged.

Since data for intangible capital and financial development are not available at industry level, I rely on the methodology of OECD (2013) and Klasinc (2016). In this form the dependent variable is explained by interactions of a country characteristic with an industry characteristic (Nunn, 2007; OECD, 2013). Thus, following OECD (2013) and Klasinc (2016), industry level estimates of intangible capital are proxied by the industry knowledge intensity:

where *k* is the interaction term of the industry knowledge intensity in each country (high skill labour compensation as a share of total labour compensation) and *IK* is the investment in intangible capital of country *j* in time *t*. *IK* separately stands for all intangible investments, and three subsets (computerized information, innovative property, economic competencies)⁴ as well

¹ Methodology of measuring value added in exports used in this paper represents conceptual framework developed by Koopman, Powers, Wang, & Wei (2010, p. 5-21).

² Two industries are excluded from the analysis: Coke, Refined Petroleum and Nuclear Fuel (since EU countries (except UK) do not have their own production) and Private Households with Employed Persons (since the estimated DVA in the majority of countries has extreme values 0 or 1).

³ However, when considering the effect of selected determinants on a DVA in exports, the fact that the causality can also operate in the other direction has to be taken into account. Thus, it is difficult to determine the existence of a direct causal relationship between selected determinants and DVA, but nonetheless correlations are informative in many aspects.

⁴ *Computerized information* includes investments in software and databases. *Innovative property* includes expenses for R&D, design, new products and financial services, mineral exploration. *Economic competencies*

as *R&D* investments. As they point out, the use of proxies is reasonable since sophisticated knowledge, in order to be created and managed, requires advanced educational attainment. Following the explanation by Nunn (2007), a positive coefficient indicates that countries with higher intangible capital investment (*IK*) have relatively higher DVA in industries for which knowledge intensity (*k*) is more relevant. Positive coefficient thus suggests that correlation between DVA and investments in intangible capital is higher for knowledge intensive industries. Data for intangible capital investments⁵ are obtained from Intan-invest database⁶. In a similar way, following OECD (2013) and Klasinc (2016), financial development on industry level is proxied by an interaction with industry financial dependency:

where *f* presents financial dependency on industry level measured as input share of financial intermediation in each industry, provided from WIOD database. *CREDIT* represents country level measure of private credit by banks and other financial institutions as a share of GDP, provided by World's Bank Global Financial Development Database. A positive coefficient indicates that countries with better financial development (*CREDIT*) have relatively higher DVA in industries with higher financial dependency (*f*). All regression specifications are estimated with fixed effects model, which allows correlation between the vectors of industry and country-specific time-invariant effects (μ_{ij}) and the independent variable. Sargan-Hansen test statistic confirms the fixed effects as more appropriate than random effects model, which means that unobservable factors (i.e. shocks in business cycles, difference between industries, culture and history, participation in GVCs) are important in determining DVA in exports. In all regressions, standard errors are calculated using White's heteroscedasticity robust standard errors.

3.2. Results

The main coefficients of the explanatory variables indicate the effect on the DVA in exports for the average EU-15 country. For the NMS-10 countries the correlations are computed by summing main coefficient plus the coefficient of the interaction term (significance is verified by F test). Results for manufacturing sector⁷ are presented in Table 4. Columns (1) to (5) include time and industry fixed effects, while in columns (5)-(9) also country fixed effects are included. In columns (2)-(5) and (4)-(9) intangible capital investments are replaced by the subgroups. Estimated results show that hourly wage is positively correlated with DVA in exports in EU-15 countries. For NMS-10 countries the correlation is lower but still positive (columns 1-5). However, when country fixed effects are included (column 5-9) there are no statistically different results for NMS-10. The results indeed mean that lower wages are correlated with higher FVA share, what is in line with the theory of offshoring which assumes that countries offshore tasks in countries with lower wages.

include investments in brand equity (advertising and market research) and firm-specific resources (training, firm-specific skills, organizational structure) (Corrado et al, 2012).

⁵ OECD (2013) and Klasinc (2016) use data for intangible capital stock which is available only for 14 (especially EU-15) countries. Data for intangible capital investments are available for all EU countries.

⁶ For the methods and data sources for estimates see Corrado et al. (2012).

⁷ Estimations results of the baseline specification using services data show negative and significant elasticities with DVA for IFDI and imports of intermediates from China for EU-15 countries, while these results are not significantly different in NMS-10. In the group of intangible investments the investments in economic competencies, investments in innovative property and investments in computerized information are positively correlated with DVA in exports, but coefficients are significant only for EU-15 (F-tests are not significantly different from 0).

Table 4: Determinants of domestic value added in exports in manufacturing sector – comparison between NMS-10 and EU-15 countries

Dependent variable: DVA in exports

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
NMS	-0.0190 (0.167)	-0.251 (0.185)	0.138 (0.161)	0.0236 (0.182)	0.0440 (0.189)	0.279* (0.151)	0.380 (0.262)	0.278* (0.146)	0.351** (0.144)	0.154 (0.138)
WAGE	0.129*** (0.0222)	0.0513*** (0.0158)	0.167*** (0.0247)	0.121*** (0.0188)	0.115*** (0.0168)	0.0597** (0.0252)	0.0577** (0.0248)	0.0603** (0.0263)	0.0571** (0.0252)	0.0554* (0.0250)
WAGE x NMS	-0.051*** (0.0159)	-0.00347 (0.0176)	-0.098*** (0.0186)	-0.0551** (0.0186)	-0.0562** (0.0195)	-0.0124 (0.0551)	0.00330 (0.0504)	-0.00935 (0.0541)	-0.00296 (0.0515)	0.00342 (0.0500)
IFDI	-0.030*** (0.00719)	-0.034*** (0.00532)	-0.028*** (0.00736)	-0.033*** (0.00617)	-0.034*** (0.00598)	-0.0126** (0.00510)	-0.0129** (0.00512)	-0.0128** (0.00511)	-0.0130** (0.00507)	-0.0131** (0.00508)
IFDI x NMS	0.0151 (0.0175)	0.0167 (0.0156)	0.0125 (0.0181)	0.0160 (0.0169)	0.0172 (0.0166)	0.0151 (0.0159)	0.0157 (0.0158)	0.0154 (0.0159)	0.0158 (0.0158)	0.0159 (0.0158)
CAPend	-0.00715 (0.00846)	-0.022*** (0.00673)	-0.0144** (0.00639)	-0.0138* (0.00640)	-0.0151** (0.00618)	-0.0329** (0.0117)	-0.0322** (0.0118)	-0.0327** (0.0118)	-0.0322** (0.0117)	-0.0317** (0.0117)
CAPend x NMS	0.00459 (0.00947)	0.0161* (0.00742)	0.0107 (0.00730)	0.0103 (0.00733)	0.0105 (0.00718)	-0.0508 (0.0375)	-0.0546 (0.0369)	-0.0518 (0.0374)	-0.0527 (0.0369)	-0.0540 (0.0367)
FD	0.00528** (0.0017)	0.0065*** (0.0018)	0.0040** (0.00167)	0.0055*** (0.00171)	0.0057*** (0.00172)	0.00014 (0.00127)	0.00031 (0.00129)	0.00013 (0.00130)	0.00024 (0.00126)	0.000315 (0.00126)
FD x NMS	0.00172 (0.00204)	0.00210 (0.00225)	0.00307 (0.00222)	0.00252 (0.00221)	0.00307 (0.00229)	0.00256 (0.00193)	0.00227 (0.00204)	0.00246 (0.00197)	0.00240 (0.00199)	0.00224 (0.00202)
IMintCHN	-0.0186 (0.0117)	-0.0193* (0.0105)	-0.0153 (0.0116)	-0.0215* (0.0109)	-0.0216* (0.0105)	0.0180 (0.0169)	0.0173 (0.0170)	0.0180 (0.0170)	0.0171 (0.0170)	0.0169 (0.0170)
IMintCHN x NMS	-0.0211 (0.0186)	-0.0230 (0.0205)	-0.0204 (0.0177)	-0.0191 (0.0195)	-0.0175 (0.0200)	-0.066*** (0.0178)	-0.064*** (0.0183)	-0.065*** (0.0180)	-0.065*** (0.0182)	-0.0639*** (0.0184)
ALLintan x k	0.040*** (0.0115)					0.0228 (0.0149)				
ALLintan x k x NMS	-0.017* (0.00818)					-0.0547** (0.0182)				
COMPinf x k		-0.0051 (0.00470)					0.0165 (0.0114)			
COMPinf x k x NMS		0.0151*** (0.00417)					-0.0325** (0.0132)			
ECONcomp x k			0.057*** (0.0114)					0.0307* (0.0155)		
ECONcomp x k x NMS			-0.038*** (0.00871)					-0.0531** (0.0179)		
INNOVprop x k				0.0229*** (0.00409)					0.0212 (0.0131)	
INNOVprop x k x NMS				-0.011** (0.00384)					-0.0431** (0.0156)	
R&D x k					0.0146*** (0.00233)					0.0134 (0.0105)
R&D x k x NMS					-0.00710* (0.00375)					-0.0306** (0.0130)
Observations	1,478	1,478	1,478	1,478	1,478	1,478	1,478	1,478	1,478	1,478
R-squared	0.526	0.515	0.531	0.520	0.518	0.743	0.741	0.742	0.742	0.742
Number of industry	11	11	11	11	11	11	11	11	11	11
Time FE	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Industry FE	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Country FE	N	N	N	N	N	Y	Y	Y	Y	Y

Note: Robust standard errors in parentheses: *** p<0.001 **p<0.05 *p<0.1. All variables are in natural logarithm. Explanatory variables are lagged for 1 year. NMS=1 if the observation belongs to NMS-10. NMS=0 if the observation belongs to EU-15. Data included in regression cover period 2000-2010. All regressions include a constant term.

IFDI has a negative sign in all specifications, as expected. Inward FDI can be associated (particularly at the beginning) with higher volume of destination country's imports from country of FDI's origin, due to increased imports of intermediates and capital goods related with production offshoring (Aminian, Fung, & Iizaka, 2007) and is in manufacturing, as already found by Stehrer & Stöllinger (2015), positively correlated with FVA. However, the difference for NMS-10 is not statistically different from 0.

Capital endowment has a negative correlation with DVA in EU-15 and the difference for NMS-10 is not significant. However, when controlled with F-test the coefficients for NMS-10 are significant in specifications (5) to (9). Anyhow, the results are not in line with my expectations, since OECD (2013) finds a positive correlation with physical capital stock per hour worked and VAX ratio. In specifications (1)-(5) financial development is positively correlated with DVA share, which means that countries with better financial development have relatively higher DVA in industries with higher financial dependency. Positive coefficient is in line with the results of Manova & Yu (2016) and expected results of OECD (2013). The difference for NMS-10 is statistically different from 0.

Higher imported intermediate shares from China are, as expected, negatively correlated with DVA share, with no statistical difference in NMS-10 in specifications (1) to (5). When country fixed effects are included in (5)-(9), results show statistically significant negative correlation for NMS-10 (significant F-test). As Amador, Cappariello, and Stehrer (2013, p. 19) show, using WIOD tables for period 2000-2011, China represents an increasingly important source of imported value added for euro area member economies. These are also strongly integrated with Eastern European countries that have become their significant trade partners, especially for Germany.

Other estimates confirm that investments in intangible capital are positively correlated with DVA. The estimated correlation between DVA and all intangible investments in high knowledge intensive sectors for EU-15 is 0.04 per cent and significant with 1 percent level of significance. The coefficient for NMS-10 is 0.017 percent lower and statistically significant. However when controlled for country specific unobservable factors (column (6)), coefficient for EU-15 is not significant, while the difference and coefficient for NMS-10 is significant and negative (-0.03). The largest and most significant coefficient between different subgroups of intangible investments is observed for investments in economic competencies. Correlation coefficient between DVA and investment in economic competencies in sectors which are high knowledge intensive is positive for both EU-15 and NMS-10 countries, but significant 40% lower for the latter. However, when controlling for countries unobservables as well, the coefficient for NMS-10 becomes slightly negative (-0.02) and F-test confirms that it is statistically different from 0.

The results suggest that the size of DVA between NMS-10 and EU-15 countries varies with respect to intangible capital investments in sectors which are high knowledge intensive, especially investments in economic competencies. Similarly OECD (2013) finds that economic competencies stock has the largest correlation between all intangible capital stock subgroups with VAX ratio. However when controlled for country specific unobservable factors (column (6-10)), the correlation between DVA and intangible assets is slightly negative for NMS-10. A possible explanation could be that higher investments in intangible capital decreases the need for imported inputs in EU-15 but however in NMS-10 a specific level of investments⁸ in intangible capital is required in order to integrate in GVC⁹.

To check the robustness of the results I reestimate the basic specification. In first robustness check the industry-level data of business enterprise research and developments expenditure per hour worked (*BERD*) are used. These are the only available data of intangible capital investments on industry level. Coefficients remain robust in terms of sign (Table 5), although they lose its significance. However negative correlation between IFDI and DVA for EU-15 remains highly significant. Coefficient of intangible capital investments (*BERD*) remains positive for EU-15 and is slightly negative for NMS-10, as in basic specification. However it

⁸ Similar to *relationship-specific investments*. These represent the investments realized by suppliers in the value chain in order to obtain a certain required level of compatibility of their components with components of other suppliers (Alfaro, Antràs, Chor, & Conconi, 2015).

⁹ Explanation is based on findings of Stehrer & Stöllinger (2015) for export sophistication.

has to be noted that there are many missing data for *BERD* and consequently number of observations is reduced for almost one third.

Table 5: Determinants of domestic value added in exports in manufacturing sector – comparison between NMS-10 and EU-15 countries (Robustness check I)

Dependent variable: DVA in exports		
VARIABLES	(1)	(2)
<i>WAGE</i>	0.0217 (0.0360)	0.0526* (0.0265)
<i>WAGE</i> x NMS	0.00672 (0.0234)	0.0359 (0.0503)
<i>IFDI</i>	-0.051*** (0.00906)	-0.0198** (0.00627)
<i>IFDI</i> x NMS	0.0299 (0.0171)	0.0156 (0.0173)
<i>CAPend</i>	-0.00058 (0.00819)	-0.0382** (0.0156)
<i>CAPend</i> x NMS	-0.0121* (0.0064)	-0.0278 (0.0335)
<i>FD</i>	0.0083*** (0.0017)	0.0011 (0.0013)
<i>FD</i> x NMS	-0.00033 (0.0022)	-0.0029 (0.0017)
<i>IMintCHN</i>	-4.26e-05 (0.00654)	0.0208 (0.0197)
<i>IMintCHN</i> x NMS	-0.0108 (0.0217)	-0.0413* (0.0192)
<i>BERD</i>	0.00241 (0.00934)	0.0173** (0.00733)
<i>BERD</i> x NMS	-0.0156** (0.00553)	-0.0182*** (0.00458)
Observations	1,057	1,057
R-squared	0.438	0.683
Number of industry	11	11
Time FE	Y	Y
Industry FE	Y	Y
Country FE	N	Y

Note: Robust standard errors in parentheses: *** $p < 0.001$ ** $p < 0.05$ * $p < 0.1$. All variables are in natural logarithm. Explanatory variables are lagged for 1 year. $NMS=1$ if the observation belongs to NMS-10, $NMS=0$ if the observation belongs to EU-15. Data included in regression cover period 2000-2010. All regressions include a constant term.

4. CONCLUSION

In this paper I rely on a recent methodology for the decomposition of gross export into value added export provided by Koopman et. al (2010) and recent research findings regarding the potential factors of value added in exports (Stehrer & Stöllinger, 2015; Kowalski et al., 2015; Caraballo & Jiang, 2016; OECD, 2013). I am focused particularly on (1) DVA in exports, which represents an important measure of income from trade and thus it can be recognized as a crucial guideline of development policy (Caraballo & Jiang, 2016) and (2) on EU countries. The main contribution of my research compared to previous work is the distinction between NMS-10 and EU-15 countries, with intention to explain what are the main drivers of the differences in DVA in exports share between EU-15 and NMS-10 countries.

The results suggest that the size of DVA between NMS-10 and EU-15 countries varies with respect to intangible capital investments in sectors which are high knowledge intensive, especially investments in economic competencies. Elasticities between DVA and investments in intangible capital are positive for EU-15, but not for NMS-10 when controlled for country specific unobservable factors. A possible explanation for this could be that higher investment in intangible capital decreases the need for imported inputs in EU-15 but however in NMS-10 a specific level of investments in intangible capital is required in order to even integrate in GVC. By observing the elasticities of these determinants in two groups of countries, it can be

concluded that they have differentiated effects on DVA in exports for core EU countries and NMS-10 countries.

Nevertheless, considering some limitations (construction of I-O tables, quality of data), the results presented in the paper offer an insight into possible determinants of EU countries' domestic content of exports from value added perspective. Most of all, one could improve methodology of export decomposition to value added terms and use different source of input-output tables to compare the estimated results. Moreover, instead of using industry-level data one could extend this research and use firm-level data.

LITERATURE:

1. Alfaro, L., Antràs, P., Chor, D., & Conconi, P. (2015). *Internalizing Global Value Chains: A Firm-Level Analysis* (No. w21582). National Bureau of Economic Research.
2. Amador, J., Cappariello, R., & Stehrer, R. (2013). *Global Value Chains: A View From the Euro Area* (Working Papers 2014). Banco de Portugal, Economics and Research Department.
3. Aminian, N., Fung, K. C., & Iizaka, H. (2007). Foreign direct investment, intra-regional trade and production sharing in East Asia (RIETI Discussion Paper Series 07-E-064). Tokyo: The Research Institute of Economy, Trade and Industry.
4. Baldwin, R., & Taglioni, D. (2011). *Gravity chains: Estimating bilateral trade flows when parts and components trade is important* (ECB working paper series No- 1401).
5. Banga, R. (2014). Linking into Global Value Chains Is Not Sufficient : Do You Export Domestic Value Added Contents? *Journal of Economic Integration*, 29(2), 267–297.
6. Brooks, D. H., & Ferrarini, B. (2012). *Vertical Gravity*. ADB Economics Working Paper Series No.303. Metro Manila: Asian Development Bank.
7. Caraballo, J. G., & Jiang, X. (2016). Value-Added Erosion in Global Value Chains: An Empirical Assessment. *Journal of Economic Issues*, 50(1), 288–296.
8. Cheng, L., & Fukumoto, M. (2010). Vertical Specialization and its Implications for the Gravity Model of International Trade. Hong Kong University of Science and Technology.
9. Choi, N. (2013). *Measurement and Determinants of Trade in Value Added*. KIEP Working Paper 13-01. Seoul: Korea Institute for International Economic Policy.
10. Corrado, C., Haskel, J., Jona-lasinio, C., & Iommi, M. (2012). Intangible Capital and Growth in Advanced Economies : Measurement Methods and Comparative Results. Available at www.INTAN-Invest.net.
11. Daudin, G., Riffart, C., & Schweisguth, D. (2011). Who produces for whom in the world economy? *Canadian Journal of Economics*, 44(4), 1403–1437.
12. Dean, J. M., Fung, K. C., & Wang, Z. (2007). Measuring the Vertical Specialization in Chinese Trade (Working Papers No. 07-01). U.S International Trade Commission.
13. Heintz, J. (2005). Low-wage manufacturing and global commodity chains: a model in the unequal exchange tradition. *Cambridge Journal of Economics*, 30(4), 507–520.
14. Hummels, D., Ishii, J., & Yi, K. M. (2001). The nature and growth of vertical specialization in world trade. *Journal of International Economics*, 54(1), 75–96.
15. Johnson, R. C., & Noguera, G. (2012). Accounting for intermediates: Production sharing and trade in value added. *Journal of International Economics*, 86(2), 224–236.
16. Kee, H. L., & Tang, H. (2016). *Domestic Value Added in Exports : Theory and Firm Evidence from China*. *American Economic Review*, 106(6), 1402-1436.

17. Klasinc, J. (2016). Investment in green economy as a potential source of value added. *International Journal of Business and Economic Sciences Applied Research*, 8(3), 109–118.
18. Koopman, R., Powers, W., Wang, Z., & Wei, S. J. (2010). Give Credit where Credit is Due: Tracing Value Added in Global Production Chains (Working Paper No. 16426). National Bureau of Economic Research.
19. Koopman, R., Wang, Z., & Wei, S. J. (2014). Tracing Value-Added and Double Counting. *American Economic Review*, 104(2), 459–494.
20. Kowalski, P., Lopez Gonzalez, J., Ragoussis, A., & Ugarte, C. (2015). *Participation of Developing Countries in Global Value Chains*. OECD Trade Policy Papers, No. 179. Paris: OECD Publishing.
21. Li, B., & Liu, Y. (2014). Moving Up the Value Chain. Boston College Working Paper.
22. Manova, K., & Yu, Z. (2016). How firms export: Processing vs. ordinary trade with financial frictions. *Journal of International Economics*, 100, 120–137.
23. Milberg, W. (2004). The changing structure of trade linked to global production systems: What are the policy implications? *International Labour Review*, 143(1-2), 45–90.
24. Noguera, G. (2012). Trade Costs and Gravity for Gross and Value Added Trade. Unpublished Manuscript, University of Warwick.
25. Nunn, N. (2007). Relationship-specificity, incomplete contracts, and the pattern of trade. *Quarterly Journal of Economics*, 122(2), 569–600.
26. OECD. (2013). Knowledge-based capital and upgrading in global value chains. In *Supporting Investment in Knowledge Capital, Growth and Innovation* (pp. 215–252). Paris: OECD Publishing.
27. Rahman, J., & Zhao, T. (2013). *Export Performance in Europe: What Do We Know from Supply Links?*. IMF Working Paper No. 13/62.
28. Shingal, A. (2015). Labour market effects of integration into GVCs: Review of literature. Swiss Programme for Research on Global Issues for Development. R4D Working Paper 2015/10.
29. Stehrer, R., & Stöllinger, R. (2013). Positioning Austria in the global economy: Value added trade, international production sharing and global linkages. *FIW Research Reports series V-002, FIW*.
30. Stehrer, R., & Stöllinger, R. (2015). The Central European Manufacturing Core: What is Driving Regional Production Sharing? (FIW Research Reports 2014/15 N°02). FIW.
31. Timmer, M. P., Dietzenbacher, E., Los, B., Stehrer, R., & Vries, G. J. (2015). An illustrated user guide to the world input–output database: the case of global automotive production. *Review of International Economics*, 23(3), 575–605.
32. Van der Marel, E. (2015). Positioning on the Global Value Chain Map: Where do You Want to Be? *Journal of World Trade*, 49(6), 915–949.

TURKEY AS THE MOST IMPORTANT FACTOR IN STABILISING THE REGION

Mirosław Przygoda

*University of Warsaw, Faculty of Management
02-678 Warszawa, ul. Szturmowa 1/3, Poland
mirosławprzygoda@wp.pl*

ABSTRACT

Thanks to its unique geographical location on two continents, Turkey has been playing an important role in various areas of influence for a few centuries. Regardless of the past foreign policy of this country, it has always been focused on the Balkans and Central and Eastern Europe as well as on the issues related to the Middle East. The size of the country, the population, the economic potential, and the military power predispose Turkey to take the responsibility for the entire group of nations situated in this region. The privileged location of Ankara results in both the approval of loyal allies and the strong aversion of other countries that strive to dominate the region. Turkey was one of the greatest empires in the world almost to the end of the 17th century. Until World War I, it was a regional power, influential in the Mediterranean region. It lost the position of the leader after World War II. For several decades, thanks to a remarkable effort of the entire society, Turkey has been regaining its former influences and significance in the world. However, it seems that the increasingly tense situation between the nations complicates the current actions of the Turkish government aimed to achieve its goals. Based on the available economic data and the analysis of the political situation, it is possible to test whether or not Turkey is able to implement the far-reaching plans. To this end, it is necessary to analyse the opportunities for and obstacles to success. Such an analysis may trigger more detailed discussions and interesting considerations.

Keywords: Turkey, region, situation, opportunities, influences.

1. INTRODUCTION

The military coup attempt which occurred in Turkey in the night of 15th to 16th July 2016 surprised the public, the majority of leading politicians, and experts on the Middle East. After a dozen or so hours from the outbreak of the rebellion, major news agencies reported in their morning news that the coup had been suppressed (Dolan D., Solaker G., 2016). It can be said that the world took a deep breath after hearing the news. The pace of events, and the place where it happened, caused a hail of media speculations around Turkey. It made the public realise overnight that the current establishment, i.e. president Recep Tayyip Erdoğan and his government in Ankara, were important players in global politics. It became apparent to everyone that the Republic of Turkey is one of the main factors stabilising the region in its immediate vicinity and beyond. It should be added that what is meant here is an enormous area covering the Balkan countries, Black Sea countries, the entire Middle East, and vast areas in the eastern part of the Mediterranean Sea. The wide coverage in Western Europe and the United States of the events that occurred in Istanbul and Ankara highlights the importance of the country located on two continents. The value currently represented by Turkey is much higher and much more relevant than previously assumed. Today's position of the country in the region and the world has been driven by many different factors. These are of political, economic, religious, military, and historical nature.

2. RISE TO POWER

In order to understand the importance of modern Turkey in the region and the world, we need to study the country's history almost from the very beginning. A brief retrospect allows us to

understand the mentality and sense of unity of contemporary Turks, as well as economic and political ambitions of the elites representing the society. By going back in time, we can take a closer look at Turkey's journey from a small, half-tribal community to the Ottoman Empire and, after its collapse, at the transition to a modern European-style state. Turkey's uniqueness stems directly from its history, surroundings, as well as the activity and commitment of several distinguished statesmen who, by pursuing the work of their lives, contributed to the country's growth and prosperity. This explains the nation's continuous patriotism, its strive for might, pride of achievements, as well as concerns and longings in everyday lives both now and in the past. It also explains traditional directions of the country's expansion, the manner of achievement of set goals, and the effects of such activities.

3. TURKEY AND EUROPE

When discussing Turkey in the European context, it should be emphasised that we refer both to the Ottoman Empire, which had existed for more than six hundred years (1299-1923), and today's Republic, which is the Empire's successor officially established on 29th October 1923 by Mustafa Kemal Atatürk (1881-1938). There are reports claiming that the tribes of Turkish origin were present in Asia Minor as early as in the 11th century. However, current evidence of forming the first state dates back to the late 13th century. According to contemporary historians, the Ottoman principality (tur. *beylik*) was one of many small states established by the Turkmens who came to Anatolia from Central Asia (Pawlina A. 2016). The extraordinary success of the Ottomans is said to have been driven by their location close to the northeast border of Byzantium. This enabled them to take advantage of the empire's weakness and of political divisions in the Balkans. Providing military support to one of the pretenders to the Byzantine throne was crucial to the principality's development. This required the Turkish army to cross the Dardanelles to the European side of the strait. The successful campaign resulted in capturing the first outpost in the Balkans in 1352 (Kolodziejczyk D, Królikowska-Jedlińska N, 2016). From that moment we can talk of Turkey's permanent presence on the Old Continent. The outpost enabled rulers from the Ottoman dynasty to quickly expand westward and conquer individual Balkan states. In the late 14th century, Thrace, Thessaly, Bulgaria, and Serbia were under the Ottomans' rule. One curiosity about the Ottomans' state is that for more than ten years it was actually divided into two parts: European and Asian. Each part was ruled by a different sultan. It was the result of defeat of Bayezid I the Thunderbolt (1360-1403) in the battle of Ankara, after which in 1402 he was captured by the Mongolian ruler Timur (1336-1405). The fight between Bayezid's sons almost ended in the country's collapse. It was only Mehmed I (1389-1421) and his efforts that brought back the country's unity in 1413. An event of great importance, not only symbolic, was the capture of Constantinople on 29th May 1453. It provided an excellent capital city to the Ottoman state, strategically located in the centre of the territory, giving control of trade routes across the whole region. At the same time the Ottomans destroyed once and for all the anti-Turkish Byzantium, which put the then sultan Mehmed II the Conqueror (1432-1481) closer to the heart of Europe. The capture of Constantinople removed transport barriers between the two parts of the Ottoman state located on the opposite sides of the Bosphorus. In symbolic terms, the fall of Constantinople meant Islam's victory over Christianity in its eastern domain and the fulfilment of prophecies present among Muslims since the 7th century. What initially seemed a success, later contributed to diminishing Turkey's importance. After losing the capital of the Eastern Church, Western Europe, united around the message coming straight from the Vatican, consolidated and most often acted jointly against the threat coming from Turkey. In addition, Russia, at the time an emerging power, considered itself a successor and avenger of Byzantium, with all its consequences. So by getting rid of one weak enemy, the Ottoman state brought itself new ones all across Europe. Two of them turned out fatal in the future. These were Greece and Russia.

With a different faith and true to Islam, Turkey was never perceived as a reliable ally in the Old Continent. Despite numerous efforts, most often it was treated as a dangerous neighbour or a fierce enemy. Countless uprisings and rebellions in the occupied areas reflected the population's attitude to the Turkish rule. Despite open aversion of European peoples towards Turks, during their rise the Ottomans managed to conquer vast areas in Eastern Europe and the Balkans. These included the lands belonging to today's Austria, Bulgaria, Greece, Romania, Hungary, South Ukraine with the Crimea, Poland, Moldova, Albania, Kosovo, Serbia, Montenegro, Macedonia, Croatia, Bosnia and Herzegovina, and North Caucasus. Turkey was in its heyday during the reign of Suleiman the Magnificent (1494-1566). The ruler completed the conquest of southeast Europe at the turn of the 15th and 16th centuries. Major gains during that period include the capture of Belgrade in 1521 and Buda in 1541, and the subjection of Transylvania.

4. TURKEY'S EXPANSION IN ASIA

In parallel with the expansion in Europe, Turkey engaged in large-scale military expansion in the Middle East. It spanned over two hundred years starting from the 16th century. After successful wars with Persia and the Mamluk Sultanate in the early 18th century, Turkey stretched its rule over vast areas from Transcaucasia to Yemen and from Cyprus on the Mediterranean Sea to the coasts of the Caspian Sea. Huge territories of the following modern-day countries came under the Ottomans' rule: Azerbaijan, Armenia, Georgia, Iraq, Iran, Kuwait, Syria, Lebanon, Palestine, Jordan, the Egyptian Sinai peninsula, and the entire eastern coastline of Saudi Arabia. In 1517, the ruler of Mecca sent to sultan Selim I the Grim (1470-1520) keys to the holy cities (Mecca and Medina) and declared his submission. Annexation of these lands started a new era in the history of the Ottomans as they were no longer only a Turkish dynasty, but reigned over the very heart of the Islamic world, which meant the rising role of Islam as a source of legitimacy of their power. What is more, as a result of military campaigns of Selim I, the Empire also annexed Jerusalem, the holy city of the three monotheistic religions, and Damascus, the former capital of the Arab caliphs family of the Umayyad dynasty and the cultural centre of the entire Arabia. With conquests came weakness in the Ottoman state's social fabric, i.e. the purely ethnical Turkish element was gradually replaced by multicultural Arabic and Persian influences (Reychman J. 1973). As a result of its own activities, Turkey became a cosmopolitan state.

5. THE OTTOMAN EMPIRE'S ESTATES IN AFRICA

Turkey lost its African estates, which included today's Egypt, Sudan, and South Sudan, only in 1914 as a result of joining World War I on Germany's side. Nevertheless, these lands were only a fraction of the estates owned by the Ottoman Empire in Africa in previous centuries. As a result of a successful campaign against the Mamluk Sultanate and countless clashes and military conflicts with local tribes, Turkey extended its rule over almost the entire North African coast of the Mediterranean Sea as early as in the first half of the 16th century. The Empire's estates stretched from Port Said in today's Egypt to the southern coast of today's Morocco. The western coast of the Red Sea was conquered by Turks from the Gulf of Suez to Eritrea and the Gulf of Aden. In this way, taking into account the previously conquered coast on the Asian side, the Red Sea became Turkey's wholly internal basin and remained so until the second half of the 19th century. This gave Turkey free access to the Indian Ocean. The capture of areas in Africa bolstered the Ottoman power and their state became the largest and strongest Muslim country in the world.

6. PAX OTOMANUM

The period after 1453, which lasted with short intervals until the mid-19th century, can be referred to as “Pax Otomanum”. It is not an overstatement to compare the era to “Pax Romanum”, i.e. the time when the Roman Empire defeated its greatest enemies and enjoyed undisturbed growth. Likewise, for several hundred years, the Ottoman Empire enjoyed relative peace and functioned effectively in the former lands of the Eastern Roman Empire in its heyday. Using Byzantine models to manage the conquered provinces, Turks successfully utilized what we would today refer to as “abundant human resources” in the form of different peoples living in these areas. These included Greeks, Albanians, Serbs, Croats, Hungarians, Macedonians, Persians, Romanians, Bulgarians, Tatars, Poles, Armenians, Jews, Genoans, Venetians, and Arabs. Obviously, in order to be able to contribute to the building of the Ottoman power, one needed to meet a certain requirement, i.e. convert to Islam. Those who resisted the faith in the only god and his prophet had little chance of succeeding in the state’s administration or the military. The requirement did not apply to Jews and the Greek aristocracy. As a result, the “infidels” could only engage in activities such as trade, services, and farming. However, “Pax Otomanum” did not mean undisturbed peace at the borders. In the period between 1265 and 1918 the Ottomans fought for domination on the vast territories of Europe, Asia and Africa against a wide range of near and far countries and multiple peoples and organisations. These included (in alphabetical order): Albania, Armenia, Austria, Bosnia, Bulgaria, Byzantium, Crete, Croatia, France, Great Britain, Greece, Herzegovina, Hungary, Italy, the Janissaries, Knights of St. John, Macedonia, Mamluks, Moldova, Mongols, Montenegro, Persia, Poland, Portugal, Russia, Serbia, Spain, Venice, and Wallachia (Zawadzki T.) While living on the borders of the Ottoman Empire carried a risk but also provided the most talented individuals with many opportunities to move up the sultan career ladder, the territories closer to the capital offered a life of peace and relative prosperity and allowed to focus on increasing one’s wealth.

This excellent period in the history of the Ottoman state heavily influenced the lives and customs of the conquered nations. Fascination with everything that is Turkish can be seen, for example, in folk and national costumes, music, art, architecture, military customs, and loanwords. Even today Turkish influences on three continents can be seen with the naked eye. These influences manifest themselves in living elements, such as fezes on peasants’ heads in former Turkish provinces, slim minarets in mosques in many cities, colourful bazaars where you can get literally anything, or oriental moustache on the faces of older men. Traces of the Ottoman rule on vast areas also include a fairly large Turkish diaspora. Members of the diaspora form an increasingly well-educated and influential group lobbying for Turkish interests in the countries where they currently live in. They try to cultivate there the tradition and language. They also constitute large groups of devoted patriots who often return to their homeland in next generations.

Table 1: Current Turkish diaspora on territories of the former Ottoman Empire
(<https://www.cia.gov/library/publications/the-world-factbook/geos/tu.html>)

No.	Country	Turkish population	No.	Country	Turkish population
1.	Azerbaijan	38,000	9.	Lebanon	10,000
2.	Bulgaria	800,000	10.	Macedonia	80,000
3.	Egypt	40,000	11.	Northern Cyprus	260,000
4.	Greece	150,000	12.	Russia	100,000
5.	Iraq	500,000	13.	Romania	44,500
6.	Israel	30,000	14.	Saudi Arabia	120,000
7.	Kosovo	20,000	15.	Syria	88,000
8.	Kyrgyzstan	40,440	16.	Ukraine	8,840

The Turkish diaspora in developed western countries is of a completely different character. Above all, it is many times larger than the one which remained within borders of the former Ottoman Empire. Most often it is composed of the second or third generation of descendants of post-war immigrants from the second half of the 20th century. This population has a very patriotic attitude to everything that takes place in the country of their ancestors.

Table 2: Turkish diaspora in developed western countries
(<https://www.cia.gov/library/publications/the-world-factbook/geos/tu.html>)

No.	Country	Turkish population	No.	Country	Turkish population
1.	Australia	150,000	8.	Great Britain	500,000
2.	Austria	250,000	9.	Holland	400,000
3.	Belgium	200,000	10.	Italy	16,220
4.	Canada	50,000	11.	Japan	10,000
5.	Denmark	70,000	12.	Norway	15,500
6.	France	500,000	13.	Sweden	70,000
7.	Germany	2,812,000	14.	Switzerland	100,000

Often members of the diaspora in western countries have double citizenship (Turkish and of the country where they live and work). They are relatively well-educated and often run their own small and medium businesses. They keep in close touch with their country of origin. This community puts strong pressure on politics in their current country of residence. The most visible representation of their beliefs are demonstrations organised by Turks living in western Europe to show their support for Ankara's political actions. These often attract thousands of participants. What is easily noticeable is that despite many decades, the Turkish diaspora have failed to fully assimilate with the community they work and live in.

7. DECLINE OF THE EMPIRE

In the mid-seventeenth century, the first cracks appeared in the monumental structure of the Ottoman Empire. Due to the geographical expansion of the state spread over three continents coupled with poor transport and communication means, military organisation was rather sluggish, and the mobilisation of troops took forever. The Ottoman Sublime Porte also demonstrated aggravating economic and social problems. The economy was going down a slippery slope. The state deficit was growing, while the Ottoman treasury was running empty. In the seventeenth century, during the reign of Mehmed IV (1642-1693), when the state was managed by grand vizier Kara Mustafa (1634-1683), financial difficulties have reached a critical point. Despite the difficulties and constantly waged wars, the demographic potential of the empire was reproduced at a truly astounding pace. Compared to other countries, the Ottoman Empire enjoyed large human resources almost throughout its existence (Gaweda M., 2015).

Table 3: *Demographics of the Ottoman Empire - historical population (Karpat K.H., 1978)*

No.	Year	Population	+/- %
1.	1520	11.692.480	-
2.	1666	15.000.000	+28,3%
3.	1683	30.000.000	+100,0%
4.	1831	7.230.660	-75,9%
5.	1856	35.350.000	+388,9%
6.	1881 - 1893	17.388.604	-50,8%
7.	1905	20.884.000	+20,1%
8.	1906	20.975.345	+0,4%
9.	1919	14.629.000	-30,3%

The demographic slumps, indicated in Table 3, occurring in years: 1831, 1881-1893 and 1919, resulted particularly from intense military operations carried out in the years preceding these dates, combined with the loss of some of the most populous provinces of the empire in Europe, Asia and Africa.

However, the dramatic decline of the Ottoman Empire, in addition to the factors previously mentioned, i.e. exhausting wars and declines of the country's population, was also due to other circumstances. These mainly include:

- Lack of interest in the naval expansion to the New World (the North and South Americas), professed by England, France, Spain and Portugal
- Not using the knowledge on the new lands, of the brilliant admiral and geographer Piri Reis (1465-1553) in the service of Suleiman I the Magnificent (1520-1566).
- Overlooking the beginnings of the industrial revolution in Europe.
- Colonial rivalry in North Africa and in the Middle East doomed at the very outset, with the more developed Western countries, in particular France and Great Britain.
- Lack of state investment in industrial infrastructure and education.
- Primitive agricultural economy.
- Illiteracy of the majority of the population.
- State managed in accordance with Islamic religious doctrine.
- Only inferior roles available for women in all areas of life.
- Archaic and inefficient system of central administration, modelled on the Byzantine tradition.
- No own technical or scientific specialists.
- Corruption and nepotism at all levels of government.
- Ubiquitous secret police.

- Political and military conflict with Persia that lasted over three hundred years.
- Political and military conflict with Russia that lasted over two hundred years.
- Costly political and military commitment in the Balkans.
- Failure to use the free access to the Indian Ocean, and consequently to the treasures of India and the Far East.
- Betting on the wrong side during World War I, opting for the so-called Central Powers, including Germany, Austria-Hungary and Bulgaria.

The counterweight element of the factors above, uniting around the Turkish domination various nations and tribes, was the adoption by the Ottoman rulers of the title of Caliph, or spiritual and political leader of all Muslims. Abdul Hamid II (1842-1918) was the first to use this title and then, three dynastic successors of the Sultan. The last Ottoman caliph, Abdülmecid II (1868 - 1944), was overthrown by the Republican Turkish government in 1924. In previous centuries, the caliphate functioned as a normal state (e.g. the Umayyad Caliphate, the Fatimid Caliphate, the Caliphate of Córdoba, the Caliphate of Baghdad), but its role can also be understood symbolically, as a general idea of the unification of Muslim countries under the leadership of the Caliph, the successor of the Prophet Muhammad. A study by the Cairo University conducted in 2007 in four countries (Egypt, Morocco, Pakistan, Indonesia) found that 2/3 of today's inhabitants are in favour of such a unification (Gasior M. 2014).

8. THE MODERN STATE OF MUSTAFA KEMAL ATATÜRK

At the end of the nineteenth century and in early twentieth century, the Ottoman Empire inevitably headed toward the final downfall. In the last years of existence, its territory was ravaged by two devastating wars that nearly brought about the physical destruction of what was left of the great Empire. First, it was an armed conflict in the years 1877- 1878, called the "Tenth Russo-Turkish War." With time, the Russian proved to be dominant in the struggle. After the victory in the Battle of Aladzha (15 October 1877), the Turks were defeated and forced to retreat in the Caucasus. It was much worse was on the Balkan front. In January 1878, the Russian army, at the time approximately 315,000 men strong, was time after time successful fighting against the 180 thousands soldiers of the Turkish army. On the 4th of January 1878, tsar's troops took Sofia, on January the 9 Shipka-Sheinova, on January the 17 Filipopol, and on January the 29 they were victorious at Adrianople. As a result of this campaign, the Russians were at a distance of approximately 40 kilometres from the capital of the Ottoman Empire. The age-old dream of the tsars to return Constantinople to the Eastern Church and making it the capital of Russia was about to come true. And, probably, this is what would have happened, if it hadn't been for the intervention of the united Western countries concerned about the increase in the power of the Romanovs. Combined diplomatic efforts of Great Britain, France and Austro-Hungary put a stop to the further victorious march of the Russians. Plan for a possible mobilization of the army and the British fleet of battleships in Marmara Sea forced Petersburg to refrain from taking Constantinople and conquering the entire Turkey (Wawrzenczak M., 2015). The Ottoman Empire siding with the Central Powers in World War I produced a much worse outcome. As a result of the conflict also called the "Great War," the Sublime Porte lost its territories to Syria, Mesopotamia, together with the, only nominal at the time, sovereignty over Egypt and Kuwait. Then there was the "armistice in Mudros" – a humiliating capitulation that ended the hostilities of World War I between the Ottoman Empire and the Triple Entente.

At the San Remo conference in April 1920, League of Nations mandates have been defined that legitimised the right of the Triple Entente to administer the former lands of the Ottoman Empire in the Middle East. In the spring of 1920 Turkey partition plans, previously discussed among allies, were disclosed. In August 1920, they were sanctioned by the peace treaty signed in Sèvres, France (Clogg R., 2006). In fact, it was a document establishing the rules for the partition of Turkey between: Armenia, France, Greece, Italy and the United Kingdom. It additionally provided for the creation of autonomous Kurdistan and international demilitarized control zone covering the Bosphorus and the Dardanelles. Following the Treaty of Sèvres, postwar Turkey turned into a meagre amputee, having access only to the Black Sea coast, completely dependent both politically and economically from the winners. The Grand National

Assembly of Turkey (the first Turkish parliament) convened by Atatürk on the 23th of April 1920 in Ankara rejected the terms of the Treaty of Sèvres, claiming that they would lead to the partition of Turkey. This meant war with the Triple Entente. As soon as in 1919, Greece, emboldened by the weakness of the Turkish sultans, opted for the aggression. The government in Athens saw the opportunity to annex the Turkish territories that were partly inhabited by the Greek population and to consistently implement the "Megali Idea", i.e. a plan for the construction of the Great Greece, enjoying access to the seven seas. Hellas' plans to expand into Asia Minor were initially supported by the victorious countries. The role of Great Britain was particularly momentous as regards persuading Greece to intervene, especially its continuation extending far beyond the international mandate (S. Sarafis, 1999). During the Turkish - Greek war in the years 1919 – 1922, the Turkish state was hanging in the balance. In August 1921, Greek troops were in the proximity of Ankara (Smith M., 1998). Consolidation of Turkish troops, guerilla actions, great patriotism and the withdrawal of support for Athens by Western Europe all contributed to the defeat of the Greeks. Both wars, briefly described above, took place in the times of the famous Turkish benefactor, Mustafa Kemal Atatürk (1881-1938). During the tenth Russo-Turkish War, he was only seven years old. During the conflict with Greece, as a hero at Gallipoli, he led his nation to fight the invaders. His faithful troops began fighting against the Allied occupation forces, troops that pledged allegiance to Ottomans as well as the advancing Greek and Armenian armies. Kemal had a series of great victories over the forces of the Allies, ultimately achieving their evacuation. In the critical situation, the Turks established a political and military cooperation with the Soviet Union, which sadly resulted in the Red Army taking over the Southern Caucasus and in gradual elimination of the independent countries of this important region, including the Azerbaijan Democratic Republic, the Democratic Republic of Armenia and the Democratic Republic of Georgia, and in their subsequent conversion into Soviet republics (May 1920 – March 1921). It also meant that Turkey had to give up the so-called "Pan-Turanism" aspirations, i.e. an active policy in the strip of the Central Asian countries located along the eastern coast of the Caspian Sea. After having previously abandoned the plans for expansion in Europe, Turkey lost for several years its political and economic importance in the neighbouring regions. The Treaty of Lausanne signed on 24 July 1923 revised the territorial arrangements of the Treaty of Sèvres and minimised the limitations of sovereignty of Turkey to the matter of the demilitarisation of the Bosphorus and of the Dardanelles and of the Turkish borders with Greece and Bulgaria in Thrace. The Treaty established the borders of Turkey as they remain today. On 29 October 1923, the Grand National Assembly introduced the system of the republic and the office of the president to also act as the chairman of the parliament. The new Turkish government was internationally recognised soon afterwards. After the proclamation of the republic, the capital was moved from

Constantinople to the centrally located, though provincial Ankara. Mustafa Kemal Atatürk (1881-1938) was elected the first president of Turkey. An important point in the history of the republic was the abolition of the Islamic institution of caliphate on the 3rd of March 1924. Even before, on the 1st of November 1922, Turkey said goodbye to the sultanate. Mehmed IV the

last sultan of the Ottoman Empire, removed from power, left the country aboard a British warship HMS Malaya several days later. He died in exile in San Remo, Italy, on the 16th of May 1926. On the 20th April 1924 a new constitution was adopted to remain in force, with certain amendments, for the 36 years to come. In the 1920s and 1930s, Mustafa Kemal Atatürk, together with his power elite, began a large-scale modernisation of the country. The changes in Turkey were truly revolutionary. The society was to be secularized. Nationalism became the main conception uniting the nation and replacing religion in this respect. However, the patriotic ethnic component in the country ever since impeded the recognition of national minorities, mostly Kurds. In order to transform the state into a modern European-based entity, many reforms followed. The major ones involved (Szymanski A., 2016):

- Closing religious schools.
- Standardising public education.
- Making education available for women.
- Dissolving religious courts and introducing a secular penal code.
- Obliging government officials to wear European style outfits.
- Introducing the Latin alphabet (1928) to replace the Arabic one.
- Granting women the right to vote in local elections (1934).
- Introducing surnames.
- Making Sunday a holiday.
- Transforming Hagia Sophia into a museum (1934).
- Introducing the Gregorian calendar.
- Prohibiting the use of religious and Ottoman titles.
- Prohibiting pilgrimages to Mecca.
- Prohibiting public wearing of religious robes and symbols.
- Industrialising the country based on state intervention policy (including the adoption of five-year plans reproducing the Soviet model).
- Appointing the army to be the official guardian of the Constitution and of the secularity of the state.

All the time, the reforms were regulated centrally and carried out by the military and civilian elites. Since the ultimate goal was to build a modern state and society, it was deemed reasonable to counteract any kind of organised opposition. Labour unions were abolished, but at the same time, in June 1936 labour law was enacted that provided for 48 hour working week with one day off, regulation of the affairs of women and minors, paid leaves, introduction of the principles of occupational health and safety and insurance. A single party system was used as

the basis. After outlawing other political parties and groups, there remained but one on the political stage, i.e. the Republican People's Party (*Cumhuriyet Halk Firkasz*, later renamed *Cumhuriyet Halk Partisi* or *CHP*), which was established as a People's Party headed by Mustafa Kemal in September 1823. Activists of the outlawed opposition parties were harassed and repressed. Many of them lost their lives. The actions performed by the president, government, the military and the police stood in sharp contrast to the principles of the European democracy as we know it. However, according to Atatürk: "*The Turkish society was not ready for democracy at the time*" (Szymanski A., 2016).

9. LOCAL POLICY OF THE REPUBLIC OF TURKEY IN THE 20TH CENTURY

Wise in the both dramatic and tragic experience of the turmoil of the Great War, the ruling elites of the Republic of Turkey identified their primary task as retaining territorial integrity and modernising the country in terms of economy, civilisation and culture. Mustafa Kemal, knowing that it was by a sheer miracle that Turkey escaped utter annihilation, expressed his opinion in the following maxim:

"Peace at home, peace in the world."

Atatürk's successors implemented a state policy in line with this motto, also after the death of "the Father of all Turks." This, in practice, meant a cautious and realistic, active neutrality, which would not endanger the interests of Turkey in relations with the neighbouring states and protect it from the temptations of the great powers of the time. The young republic did everything to avoid political disputes and any international armed conflicts. The position of Mustafa Kemal Atatürk greatly affected Turkish history in the twentieth century and contributed to spreading strong pacifist and isolationist sentiments in the Turkish society (Kalycioglu E., 2005). Although Turkey was reluctant to engage in international relations, it did record some successes in this regard. In 1925 a Turko-Soviet treaty of friendship was signed to be extended in 1929 with a trade treaty. On the 28th of January 1929, Turkey joined the Kellogg–Briand Pact. It was an international treaty establishing the renunciation of war as an instrument of national policy. In 1932, Turkey joined the League of Nations. In the early 30s, the aggressive policy pursued in the Mediterranean by the leader of fascist Italy, Benito Mussolini, and the possibility of an alliance between Bulgaria and Germany made Kemal abandon previously neutral foreign policy. Turkey initiated measures to form an alliance between the Balkan states. These efforts resulted in the establishment of the Balkan Entente, on the basis of an agreement acceded to by Greece, Yugoslavia, Romania and Turkey, signed in Athens on the 9th of February 1934. The Balkan Entente agreement, also known as the Balkan Pact, was officially a political agreement. It contained, however, a secret military annex, providing for cooperation of command of the four participants in the defence of the existing borders in the Balkans. Also, relations were strengthened with Iran and an exchange of small borderlands was agreed that gave the Turkish army access to the eastern regions of Ararat. On the 8th of July 1936, Turkey signed the Saadabad Pact with Iran, Iraq and Afghanistan, drawn up and formulated to resemble the Balkan Pact. Turkey has also regained full control over the straits as a result of the Montreux Convention signed in summer 1936. Turkey has gained the right to control the movement of warships in the straits in time of peace, and the right to close the straits for foreign warships in time of war. In the same year, the French announced their intention to make Syria independent. This sparked protests of Turkey which laid claim to the district of Alexandretta. As a result of the British mediation of the support of the League of Nations, France agreed in 1938 to hold the elections, won by the Turkish majority who proclaimed the independence of the Republic of Hatay, which was incorporated to Turkey on the 29th of June 1939. On the 12 of May 1939, Turkey signed with England a mutual assistance pact, which subsequently, at the outset of World War II, on the 19th of October 1939 was extended to also include France. It was directed mainly against Italy, not Germany. Less than

two years later, to be exact on the 18th of June 1941, the government in Ankara signed a treaty of friendship and non-aggression with the Third Reich. Thus, the Republic of Turkey in fact became an ally of both feuding parties involved in the World War II hostilities (Szymanski A., 2016). Actually, pro-German sentiment was dominant in Turkey at the time, stemming from the inclination for the tried and tested ally from the Great War period. After Hitler attacked the Soviet Union on the 22nd of June 1941, on the 25th of June Turkey proclaimed its neutrality in the war. On the 17th of November 1943, Turkey secretly declared to the Allies that it would join the war against Germany at an unspecified date. At the same time, Ankara all the time avoided signing obligations detrimental to the Soviet Union. On the 2nd of August 1944, Turkey broke off diplomatic relations with Germany. On the 3rd of January 1945, Turkey broke off diplomatic relations with Japan, and on the 23rd of February 1945 it declared war on Germany wishing to become a founding member of the United Nations. During the Second World War, many Jews and refugees from Europe found refuge in Turkey. In retrospect, it can be said that persistent observation of the guidelines of "*Kemalism*" allowed Turkey to avoid the tragedy of World War II, suffered by many other countries. Seemingly neutral, all the time it pursued active foreign policy. These efforts resulted in an increase in confidence in the Turkish state among its neighbours in the Balkans and the Middle East. They also helped save thousands, or even hundreds of thousands of human lives. After the war was over, activities of the Soviet Union became the greatest threat for Turkey. In June 1945, authorities in Moscow listed Ankara renouncing provinces of Kars, Ardahan and Artvin to the Soviet republics of Georgia and Armenia as one of the conditions for further extension of the 1925 Treaty. Additionally, they demanded USSR ships to be given access to the bases near the straits, as well as the revision of the Convention of Monteux. To corroborate the claim, a few months later about 200,000 Soviet troops appeared on the Turko-Bulgarian border, assisted by armoured forces (Szymanski A., 2016). To protect itself against an aggression of its big neighbour, in the late 40s and 50s of the twentieth century Turkey decided to strengthen relations with Western countries, in particular with the USA. This context should also be taken into account when considering the initiation of democratic changes in the country. They were necessary for strengthening and justifying relations with the West. In accordance with the Truman doctrine, and then as a member of the Marshall Plan, in the 40s and 50s Turkey received financial and material aid. As a result of the policy pursued, Turkey became a member of the Council of Europe in 1949 and joined the NATO pact in 1952. To strengthen its position, Turkey looked for opportunities for cooperation with its nearest neighbours. In August 1954, it concluded a military agreement with Greece and Yugoslavia, called the Balkan Pact. The alliance opposed the attempts of the USSR to gain domination in the region. A similar objective led to signing of the Baghdad Pact. A bilateral agreement signed by Iraq and Turkey, on the 24th February 1955 aimed at preventing the spread of communism in the Middle East. In the same year the pact was joined by Great Britain, Pakistan and Iran.

Secure borders and improved position in the region were not, however, accompanied by domestic peace. Turkey was oftentimes shaken by military coups with a political background. They were organised in 1960, 1971 and 1980. In the 90s, Turkey was establishing its place in the region and its role on the international arena. It further approached the US as part of the cooperation under NATO. On the 1st of January 1996, a customs union with the European Union entered into force. Ankara pursued its efforts to become a full member of the EU. It also largely cooperated with Russia, especially in the construction and energy sectors. It failed, however, in its efforts to have a say in the policy of the former Soviet republics in Central Asia. It was too early for that. Being still politically and economically associated with Moscow, they preferred not to change the sphere of influence. The attempts to interfere in the affairs of Greece and Syria met considerable opposition in these countries, bringing Turkey to the brink of a conflict (Szymanski A., 2016). In the second half of the 90s of the twentieth

century, Turkey was phasing out the doctrine of Kemalism. It was replaced by the so-called political Islamism which referred to the centuries-old history of the Bosphorus state. In 2001, as a result of economic collapse following a financial crisis, power was taken by the conservative Justice and Development Party (tur. *Adalet ve Kalkınma Partisi*, AKP), established previously that year. The state was now ruled by a single party, led by its charismatic leader, Recep Tayyip Erdoğan.

10. MODERN TURKEY

The state organisation of today's Turkey proves to be altogether different in comparison with the former Ottoman Empire. The cosmopolitan and multinational Sublime Porte was united by Islam and continuity of the Ottoman dynasty. Turkey is a country that appeared both in name and on the map as late as in 1923. Shaped by pasha Kemal Atatürk, it is a national and consistently secular republic with its inherent ubiquitous nationalism that defines the nation and the state as one. In the course of several dozens years of the existence of the Republic, its developments changed the citizens, who previously represented the Muslim Orient, into Europeans aware of their uniqueness (Latka J. S., 2003). In the middle of the second decade of the twenty-first century, Turkey saw a rapid economic growth and a stable economic situation. Relative key data with added general information on the country are presented in *Table 4*.

Table following on the next page

Table 4: Turkey economic indicators
(<http://www.tradingeconomics.com/turkey/indicators>)

TURKEY				
1.	Capital	Ankara	4.588 mln	2014
2.	Largest city	Istanbul	14,030 mln	2015
3.	Area	783.356		km ²
4.	Population	79.463.663		2016
5.	President	Recep Tayyip Erdoğan	Justice and Development Party	
6.	Prime Minister	Binali Yildirim	Justice and Development Party	
7.	Currency	Turkish lira (TRY)	\$ /TRY 1:3.03	04.08.2016
8.	Gross Domestic Product (GDP)	Nominal	\$ 751 Billion	2016 estimate
9.	GDP	Per capita	\$ 9.562	2016 estimate
10.	Gross Domestic Product (GDP)	PPP*	\$ 1.665 Trillion	2016 estimate
11.	GDP (PPP*)	Per capita	\$ 21.198	2016 estimate
12.	GDP Annual Growth Rate	4,8 %		Mar/2016
13.	Government Debt to GDP	32,9 %		Dec/2015
14.	Government Budget of GDP	-1,2 %		Dec/2016
15.	Foreign Direct Investment	\$ 16.800 Million		Dec/2015
16.	Balance of Trade	\$ - 6.659 Million		Jun/2016
17.	Interest Rate	7,5 %		Jul/2016
18.	Deposit Interest Rate	16,77 %		Dec/2014
19.	Foreign Exchange Reserves	\$ 139.618 Million		May/2016
20.	Gold Reserves	479 Tonnes		Mar/2016
21.	Inflation Rate	8,79 %		Jul/2016
22.	Food Inflation	9,69 %		Jul/2016
23.	Weapon Sales	\$ 291 Million		Dec/2015
24.	Military Expenditure	17.669 Million		Dec/2015
25.	Unemployment Rate	9,3 %		Apr/2016
26.	Youth Unemployment Rate	16 %		Apr/2016
27.	Employed Persons	27.638.000		Apr/2016
28.	Unemployed Persons	2.824.000		Apr/2016
29.	Retirement Age Women	58		Dec/2015
30.	Retirement Age Men	60		Dec/2015
31.	Minimum Wages	1647,00 TRY/Month		Jun/2016

* PPP – Purchasing power parity

After the election of the 3rd of November 2002, the Justice and Development Party enjoyed an almost continuous popularity. Winner in the next two parliamentary elections, it has been in power for almost fifteen years. This is a unique period in the history of Turkey. What we observe today could be called a vision reified by Recep Tayyip Erdoğan of what the country and the policy pursued by its government should look like. This time can be described as an accelerated economic development based on traditional values associated with religion and family. In recent years, Turkey is seeing a significant increase in the importance of the state in the international arena. The Republic of Turkey has become an important player both in the

region and in the world. In addition to efforts in the economic sector, it has undertaken an enormous effort to make the country a military superpower that can impose its point of view to the neighbours. Well, this plan was also a complete success. Turkey is currently classified as the second greatest force in NATO (after the United States) and the tenth most powerful army on the planet. Global Firepower Internet portal, prepared a ranking of 100 most powerful armies in the world based on fifty different factors. In this ranking, however, there were not taken into account nuclear forces of all the countries concerned due to the fact that, according to the creators of this list, they cannot in any way be compared with the potential of the USA and Russia. The place of the state in the ranking is determined specifically for the classification by so-called "Power Index" (PwrIdx). The smaller is the value, the higher is the place of the army in the prepared list according to its strength. For the purposes of this study, 10 largest armies in the world were selected.

Table 5: Countries Ranked by Military Strengh 2015
(<http://www.globalfirepower.com/countries-listing.asp>)

Nr	Country	Power Index (PwrIdx)
1.	United States of America	0.1661
2.	Russia	0.1865
3.	China	0.2315
4.	India	0.2695
5.	United Kingdom	0.2743
6.	France	0.3065
7.	South Korea	0.3098
8.	Germany	0.3505
9.	Japan	0.3838
10.	Turkey	0.4335

Its economic and military resources provide grounds for the authorities in Ankara to conduct an independent policy in the region by political means, and using raw force. From a certain perspective, it must be said that Turkey is increasingly successful in both of these fields.

11. CURRENT REGIONAL POLICY OF TURKEY

In modern times, despite significant historic achievements, the Republic of Turkey is not involved as it used to be in current affairs and events in North Africa. Neither was it, however, completely passive in this region. Speaking of the southern Mediterranean, it is necessary to bring up Erdoğan's tour of the "Arab Spring" countries. Late in the summer of 2011, when he was Prime Minister of Turkey, Erdoğan visited Egypt, Tunisia and Libya. In each of these countries, he declared the intention to strengthen political and economic cooperation as well as support for the Palestinian nation in its conflict with Israel. This attitude won him many supporters and great popularity in all Arab countries. As regards the Jewish state, Erdoğan took an unwavering stance. Commenting on the actions of Tel Aviv, he said "that Israel can no longer do as it pleases in the Mediterranean", adding: "that if the need arises, Turkish warships will accompany the ships supporting Gaza" (Ciaston R., 2011). By speaking so boldly, not only did he risked the hostility of Washington and the Jewish lobby in the US, but also showed who in fact was the most influential in the area. Such episodic instances aside, it should be noted that since the second half of the twentieth century until the beginning of the first decade of the twenty-first century, the regional policy of Turkey has been limited to two building blocks. The first was the Balkan, and in the wider context also the European policy. The other was the policy

in the Middle East. The situation changed dramatically at the end of the first decade of this century. The emergence of the so-called Islamic State (originally, it was the Islamic State in Iraq, then the Islamic State in Iraq and the Levant, and now Islamic State of Iraq and Sham - ISIS) changed the previous understanding of regional policy. The problem of millions of refugees, genocide and terrorism, and the doctrine of aggressive expansion of Islam involves both Western Europe and the Middle East. In the case of Turkey, they transformed the regional policy composed of two separate parts into an interconnected system. In our eyes, local issues transformed into global problems. However, for analytical purposes, in a traditional sense of sorts, regional policy of the Turkish Republic will be shown from two viewpoints: in the Middle East and European contexts.

11.1. The Middle East context

At this point, the dream of the greatness of the state conceived by Recep Tayyip Erdoğan, essentially came true. Following the success in the dangerous dispute with Israel regarding the Gaza Strip and, simultaneously, a grave crisis of state structures, and really in the fight for the survival of the existing power in Syria and Iraq, Ankara is at the moment the most influential player in the Middle East. Significantly weakened by internal problems, other important participants of the game, such as Egypt, Iran, Jordan and peripherally located Saudi Arabia and Kuwait, are no longer in the foreground. Currently, Turkey is the largest sovereign power in the region, and its president has become the leader of the Muslims in the area. The whole jigsaw is somewhat spoiled by Russia, but it also recognised the dominant role of Erdoğan. It is well illustrated by the facts. As the most important representative of another country, no other but President Erdoğan was invited to the opening of Europe's largest mosque in Moscow in September 2015. Other guests included presidents of minor countries where Islam is professed, such as Azerbaijan, Palestine, Kazakhstan and Tatarstan. It is worth noting that Turkey has partly covered the cost of erecting this temple in the heart of Russia. This deep-running respect, bordering on awe, for Ankara, was even more pronounced on the 24th of November 2015, when a Russian SU-24 bomber was shot by a Turkish F-16 fighter. Official protests from the Kremlin were the most radical steps to be taken. It was a blow to the image of Russia and its President Vladimir Putin worldwide. The creation of the so-called "Islamic State" was initially a merely regional problem. Territorial expansion and the growing threat produced by this quasi-state has soon reshaped the reality. Ankara deftly used its existence for its own purposes. It seems that Turkey, which is the tenth biggest military power in the world, could alone physically eradicate ISIS and its command in one week at most. But this is not happening. There are several reasons behind this:

- The Kurdish issue has been transferred in its military aspect from the territory of Turkey to the ISIS conflict region. This way, the forces associated with the leadership of the Kurdistan Workers Party hope to create their own state outside of Turkey, which is welcomed by the government in Ankara.
- If governments in Damascus and Baghdad fall, and their subordinate state organisms crumble, Ankara can take over the administration of the areas in northern Iraq and northern Syria, and then absorb these areas lost after World War I as a result of the conspiracy of the great European powers.
- Millions of refugees from Syria and Iraq are fuelling the economy of the Republic as a cheap labour force. This force also includes well-educated physicians and specialists in various fields.

- The Islamic State, by exporting at a greatly reduced price oil and natural gas to most countries in the region, regulates economic trends of its importers (including Syria, Jordan, Lebanon, Israel and Turkey). The resulting low prices of oil and gas are now in fact enjoyed by pretty much everyone in the world.
- The problem of Northern Cyprus, given the threat posed by the Islamic State, is no longer so important.
- It is for the same reason that the Armenian genocide that took place in the years 1915-1917 is no longer so widely discussed.
- Turkey has become a valuable ally, providing a barrier for the penetration of terrorists and religious extremists into Europe and southern regions of Russia.
- Ankara allows ground troops of France, Britain and the United States not to be involved in the conflict region.
- By issuing Turkish passports to millions of war refugees and settling them in the Turkish Kurdistan, President Erdoğan secures for himself hundreds of thousands of votes in the next election and alters the ethnic proportions in the unstable region of the country.
- It would be awkward to blame the most powerful ally of the NATO in the region for deviating from the principles of democracy.
- For many years to come, Turkey emerged as the only real force capable to stop the further march of the Islamic State and to ensure stability in the region.

11.2. The European context

Although the European part of Turkey, i.e. Eastern Thrace, makes up no more than approximately 3% of the national territory, this fact, first for the Ottoman Empire, and after its fall for the Republic, has been of great importance. As long as Turkish expansion continued in Europe, the Ottoman state mattered in global reckoning. But when the territories governed by the Sublime Porte in the Old Continent began to shrink, the power of the state ruled by sultans from the Bosphorus consequently faltered. Modern solutions imported from Europe in the field of the military, organisation of state and government, education and women's rights laid the foundations for the emergence of modern Turkey and Mustafa Kemal Atatürk and allowed the entire nation to survive. It is therefore hardly surprising that the desire to imitate Europe is the eternal pursuit of the Turks. Unfortunately, professing a religion different from the rest of the Old Continent and pursuing the policy of conquest built an impassable barrier and delineated the borders of the zone of influence of the Empire. The image of Turks in the Balkans, mainly in Bulgaria and Greece, is also affected by recent history. Persecutions of the Turkish minority in these two countries after the First and Second World Wars revived old animosities and deeply rooted prejudices. They also resulted in the cooling of the relations that Ankara has with Sofia and Athens. Modern Turkey has since long been knocking at the door of the West in the Old Continent, personified by the European Union. As early as in 1963, the then European Economic Community granted Turkey the status of an associate member. On the 14th of April 1987, Ankara filed an official application which formally started the negotiation process regarding the accession to the European Union. The 1997 Luxembourg Summit blocked the

way to the EU for Turkey. The opposition of Greece was decisive in the matter. However, the European Council summit in Helsinki in 1999 revoked the previous decision and recognised Turkey as an official accession candidate. Turkish negotiations with the European Union started on the 3rd of October 2005. The main obstacle to membership is still the Cyprus issue. Turkey undertook to extend the customs union to all new EU members. However, it refused it to Cyprus, as it does not recognise that state. This froze the accession procedure for many long years. The situation saw a dramatic change as refugees from the Middle East started to flood Europe (Alderman L., 2016). Millions of illegal immigrants threatened the stability of the EU. Then it turned out that the only hope in the difficult situation laid with Turkey, which agreed to receive unwanted newcomers on its territory in exchange for an aid of EUR 6 billion, acceleration of the accession process and granting all citizens of Turkey entry visas by mid-2016. A failed military coup and the repressions that followed quenched the aspirations of Ankara to join the integration group. Implications of failure to respect the rule of law, introduction of a state of emergency in the country, closing opposition newspapers, radio and television stations, thousands of arrested people, purges in the army and a plan for restoring the death penalty led to the German government stating, through its spokesman Steffan Seibert, that: *"in the current political situation, it considers unthinkable to open new chapters in negotiations with Ankara on Turkey's accession to the EU"*. Also the procedure to grant entry visas to the EU to citizens of Turkey was suspended. Once again, Turkey was removed from the group of European nations. However, in the case described above, the authorities in Berlin made a mistake by speaking so boldly on behalf of the entire Community. President Erdoğan threatened that if the EU does not keep its promises, his country will no longer hinder the influx of immigrants to Europe. Germany, a self-proclaimed leader of the EU, and the heads of European states now, until October 2016, have the time to make up their minds, before the new ultimatum of Turkey regarding visas expires. Unfortunately, there are no good decisions at the moment. Either they will accept the Ankara's ultimatum and reveal their own weakness, or they will disagree and produce yet another wave of refugees in the Old Continent, which, in practice, will be the end of the European Union.

12. CONCLUSION

Due to the complicated international situation, both in the eyes of Europe and from of the Middle East, modern Turkey has become the most important stabilising factor for both regions. It should be noted that, if it hadn't been for the great leap in terms of civilisation, culture and economy of the country in the last several years and the fundamental rule of Mustafa Kemal Atatürk, the consequences of the decisions of the Entente after the First World War could now prove tragic for Europe and the world. Let us not forget that the Republic of Turkey is in today's world an element without which everything could crumble into destruction.

LITERATURE:

1. Alderman L., (2016), *Greece starts deportations under deal with Turkey*, International New York Times, Tuesday, April 5, p. 1, La Défence, France.
2. Ciaston R., (2011), *Turcja i Izrael: strategiczne przewartościowanie*, psz.pl, from <http://www.psz.pl/116-bezpieczenstwo/turcja-i-izrael-strategiczne-przewartosciowanie>
3. Clogg R. (2006), *Historia Grecji nowożytnej*, Wydawnictwo: Książka i Wiedza, pp. 113-115, Krakow.
4. Dolan D., Solaker G., (2016), *Turkey rounds up plot suspects after thwarting coup against Erdogan*, Istanbul/Ankara, Reuters World, Sat Jul 16, 2016 10:12pm EDT, from www.reuters.com/article/us-turkey-security-primeminister-idUSKCNOZV2HK
5. Gasior M. (2014), *Spokojnie, to tylko kalifat*. Przewodnik po Islamskim Państwie, które dzihadysty stworzyli w Syrii i Iraku, Dawno temu, czas na temat, from

- <http://natemat.pl/108169,spokojnie-to-tylko-kalifat-przewodnik-po-islamskim-panstwie-ktore-dzihadysci-stworzyli-w-syrii-i-iraku#>
6. Gaweda M., (2015), *Imperium Osmanskie*, from <http://oim.wargamer.pl/pl/strony-konfliktu/imperium-osmaskie.html>
 7. Karpat K.H.,(1978), *Ottoman Population Records and the Census of 1881/82-1893*, International Journal of Middle Eastern Studies Volume 9, Issue 02, pp.237-274, Cambridge University Press.
 8. Kalaycioglu E., (2005), *Turkish Dynamics: Bridge Across Troubled Lands*, Edition: Palgrave Macmillan, p. 47, London, New York.
 9. Kolodziejczyk D, Królikowska-Jedlińska N, (2016), *Imperium Osmanskie*, Dzieje Turkow, Polityka, Pomocnik historyczny, Nr 3/2016, pp. 26-27, Warszawa.
 10. Latka J. S., (2003), *Posel Lechistanu*, Gistoria Powszechna, t. XIII, Wydawnictwo Naukowe PWN, p. 163, Krakow.
 11. Pawlina A. (2016), *Skad Turcy przybyli*, Dzieje Turkow, Polityka, Pomocnik historyczny, Nr 3/2016, pp. 12-13, Warszawa.
 12. Reychman J., (1973), *Historia Turcji*, Wydawnictwo, Zaklad Narodowy im. Ossolinskich, pp. 66-67, Warszawa, Krakow, Gdansk.
 13. Sarafis S. (1999), *O Elas*, p. 11, Edition: Ekdoseis Epikairthta, Athen.
 14. Smith M., (1998), *Ionian vision: Greece in Asia Minor, 1919-1922*, Hurs & Co. Publishers, pp.233-234, London.
 15. Szymanski A., (2016), *Republika Turcji*, Dzieje Turkow, Polityka, Pomocnik historyczny, Nr 3/2016, pp. 105-111, Warszawa.
 16. Wawrzenczak M., (2015), *X wojna rosyjsko-turecka*, Historia.org.pl, from <http://historia.org.pl/2015/05/17/x-wojna-rosyjsko-turecka-foto/>
 17. Zawadzki T., (2016), *Z kim walczyli Osmanowie i Turcja*, Dzieje Turkow, Polityka, Pomocnik historyczny, Nr 3/2016, p. 9, Warszawa.

SUSTAINABLE DEVELOPMENT AS A STRATEGIC GUIDING PRINCIPLE

Robert Svetlacic

*PhD Student at Faculty of tourism and hospitality management
Opatija, Croatia
rsvetlacic@gmail.com*

Dinko Primorac

*University North, Croatia
dinko.primorac@unin.hr*

Goran Kozina

*University North, Croatia
goran.kozina@unin.hr*

ABSTRACT

Due to the pursuit of profit, individuals, and communities, often forget where their roots are actually coming from. It is frequently forgotten that a man is a part of the nature and that he should live in accordance with its laws. However, contrary to this idyll is the term "risk society", which characterizes today's society. The consequence of this way of thinking and living has led to the fact that there is no synthesis between the natural and social life. They are seen as two sides of human existence. While on the one hand there is a tendency for the realization of a large wealth, on the other hand nature suffers. This problem was counteracted by the introduction of a comprehensive concept of "sustainable development" that should be the main guiding principle in contemporary business.

Keywords: *business, family hotels, small hotels, sustainable development.*

1. INTRODUCTION

Sustainable development implies the preservation of the physical and social environment and the application of the concept of sustainability, which is of vital importance to tourism, while the less points out in various other activities, only because tourism depends on the preserved nature which is the basic resource.

Sustainable development is defined in numerous ways. The most frequently quoted definition of sustainable development is certainly of Brundtlandinog report which describes sustainable development as "development that allows meeting the needs of present generations without compromising the needs of future generations". The concept of sustainability promotes growth and development with the largest conservation and rational use of resources to achieve long-term economic and social development, also known as "zero development". Sustainability should always be monitored on a global, worldwide level. In this way individual projects have a positive contribution but unless a global development is in compliance with the principles of sustainability, the concept will not be fully integrated within. Sustainable development requires a longer period of time and cannot be applied immediately and that leads to conflicts with political authorities who are trying to win over voters with fast and efficient solutions. Human needs should be satisfied with taking care of equality and justice. Everyone has an equal right to satisfy their needs and desires without harming others and the environment. To improve the quality of life today and tomorrow is the essence of the concept of sustainable development. Sustainable development is based on three main principles that constitute environmental sustainability; socio-cultural, economic and technological viability. These principles

specifically describe and elaborate additional, final principles. Sustainability is usually related to environmental protection, however, for their effective implementation it is necessary to comply with the other three principles. Environmental sustainability promises a balanced development, in line with the preservation and maintenance of essential ecological processes, biological diversity and biological resources. Socio-cultural sustainability guarantees compatibility of development with the preservation of the culture and value system of people that this development affects, and permanently preserve and emphasize identity of the local community. Economic sustainability promises that the development is economically efficient and that the management of resources is such that it could be used in the future. Technological sustainability implies the development and application of technology in a way that the use of technology in addition to economic effects contains elements of the environment protection.

It is important to point out that human beings are the focus of sustainable development, and have the right to a healthy and productive life in harmony with nature. Sustainable development is most easily achieved by the participation of all concerned citizens at all levels and the state should encourage public awareness and provide all necessary information so that sustainable development becomes a strategic guideline.

2. SUSTAINABLE DEVELOPMENT

2.1. Defining and characteristics

Sustainable development can be defined as 'development that meets the needs of the present generations without compromising future generations' (Črnjar and Črnjar, 2009). From the definition it is possible to conclude that this is a term that implies equality between this and the next generations. However, although this definition is accurate and comprehensive, it is important to point out that the term sustainable development implies a much broader context that this definition has not highlighted. Sustainable development can be described as a development that takes into account economic, social, cultural and social aspects. Sustainability must be understood as a concept that operates internationally and even globally, and the challenge of this century. Figure 1 shows one of the possible interpretations of sustainable development which was pointed out that sustainable development implies harmonization of nature, society and economy. At the point where the interests of all three fields meet, we can talk about the presence of sustainable development.

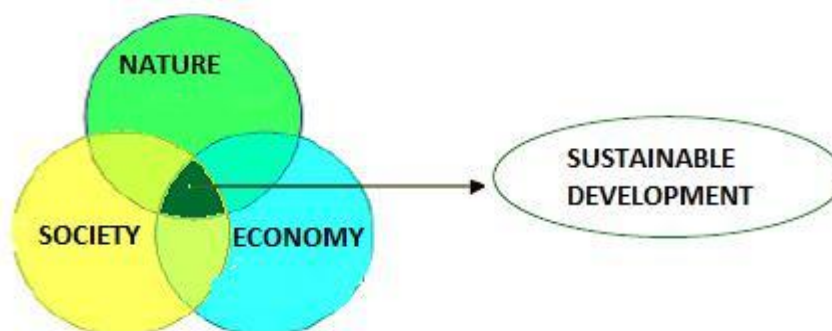


Figure 1: Sustainable development - an adjustment of nature, society and economy (Črnjar and Črnjar, 2009).

In this display environmental, social, and economic components are included. It is a simple and colorful way to describe what sustainability is. All three components should be seen as a whole and this way to define the concept of sustainability and to implant in the consciousness this way

of thinking. Although these terms seem opposed, for example, the pursuit of economic benefits sometimes requires "trampling" of the interests of nature, the opposite is true. This connection allows finding new ways of development that will tend to preserve the living conditions and thus enable the benefits for all parties involved. So, even though sustainable development is a homogeneous whole, in a broader sense, it covers three aspects of sustainability (Črnjar and Črnjar, 2009, pp. 89):

- Social sustainability,
- Economic sustainability,
- Environmental sustainability.

Sustainability is from this aspect perceived as a three-dimensional phenomenon. Social sustainability means management of resources, the relationship of the community and the individual, respect for moral principles and other components that affect the creation of social justice, and reducing inequality. Closely related to social sustainability is the economic sustainability which primarily emphasizes the sustainable exploitation of the stock of capital. It is important to point out that the definition of capital includes not only natural but also the social and human capital. It is important that the concept of sustainability takes into account the environmental sustainability which indicates compliance with the limits of the natural capacity, optimal use of energy resources and appropriate waste disposal. Such a notion of sustainability is easily explained by the image of reality. There are discussions on a daily basis about inequality between different countries in the world, and creating a growing gap between rich and poor which imposes the necessity of creating social sustainability.

It is important to consider the social aspect. It is known that rich countries daily throw away huge amounts of food and swarming obese people, while on the other side of Africa children die every day from hunger and disease. Is not that unfair? It is very easy to explain the economic unsustainability for which three words are sufficient: world economic crisis. Improper attitude towards financial resources led to this problem that occurred in developed countries, and then spread to the whole world. Newspapers are full of terrifying negative figures that affect development. So, despite the fact that a man appears to be smarter every day, it seems that he is not. How else to explain this situation in which we have brought ourselves? The Almighty computer will not give an answer this time, the man himself has to save the sinking ship. It can be very simple to explain what environmental sustainability and unsustainability are. Good proof are piles of garbage that are continually becoming larger, the ozone hole, global warming, and melting glaciers. However, although human activity has created such problems, the question is whether we will be able to solve this. When describing the concept of sustainable development it is inevitable to mention its principles (Črnjar and Črnjar, 2009, pp. 84):

- Respect and care for the community,
- Improving the quality of life,
- Protecting the vitality and diversity of the Earth,
- Minimize the depletion of non-renewable resources,
- Respect the limits of acceptable capacity of the Earth,
- Changes in personal attitudes and practices,
- Enable communities to care for their own environment,
- Creating a national framework for integrating development and protection,
- The creation of a global alliance.

Principles are numerous and comprehensive, and are related to the planet Earth, and they emphasize the protection of biological and animal diversity and respect for the capacity of the Earth, which means that the business environment and the lives of individuals should be in accordance with the possibilities that the planet provides, because in case of exceeding exploitation of a given capacity we will exhaust the resources. It is important to emphasize that the principles respect the global level of environmental protection and conservation communities, but it is also important to look at sustainability from the national, local aspect and from the aspect of the individual. It is necessary for each country to create a legal framework to regulate environmental issues and community, guided by the social aspect and moral principles. But it is also important that each individual strives to change personal attitudes and actions and thereby contribute to preserving the environment.

2.2. From the preservation of resources to sustainable development

Sustainable development implies intergeneration and intergenerational equity, which means that resources should be optimally used to be sufficient for the needs of this and future generations. This understanding of the concept of sustainable development primarily points to the aspect of how organizations use resources. It is important to single out several types of resources. First of all it is important to emphasize the role of natural resources, including those which renewable and non-renewable ones. Every day threads are opened regarding the use of renewable resources, which each socially responsible company should take into account. Except material, it is necessary to take into account the human resources, which are the engine of the entire business and whose satisfaction indirectly affects the profit increase.

To understand the essence of preserving resources, it is important to explain the difference between renewable and non-renewable resources. "The main feature of renewable resources is that their stocks are not permanent and may increase or decrease. The resources will be increased if they are allowed the "regeneration", but it cannot go on forever because the limited capacity of ecosystems "(Črnjar, 2002, pp.113). Renewable resources are for example, forests, solar energy, wind, waves etc. However, although this group is renewable, as the name implies, if the rate of exploitation is higher than growth of such resources it will lead to their exhaustion indicating a need for their rational utilization. Despite the existence of the possibility of their complete elimination, it is important to point out that it is desirable to use such resources as this will help to conserve the environment.

In explaining of the importance of non-renewable resources it is inevitable to start from the very definition of the term. "The main characteristic of non-renewable resources is that their quantity is constant so the concept of sustainable use of resources cannot be applied, for renewable resources the rate of disappearance and the total amount of resources is more important" (Črnjar, 2002, pp.121). It is especially important to emphasize responsible access to such resources to avoid their disappearance which would have many negative consequences. It is necessary to provide guidelines on the utilization of resources in the form of law to be "forced" on their optimal use. It is especially important to emphasize responsible access to such resources to avoid their disappearance which would result with many negative consequences. It is necessary to provide guidelines on the utilization of resources in the form of law to be "forced" on their optimal use.

In addition to natural resources, we should emphasize the role of produced resources. In fact, they are created by human labor, from natural resources, and increasing their amount reduces the amount of natural resources. Their role is significant because the natural resources are not

always suitable for use. In addition to the material, human resources should be taken into account. Human resources are a significant cost or a business expense, but without people not a single company can accomplish their goals. Human resources must be satisfactory, not only from the quantitative, but also the qualitative point of view, and from the standpoint of personnel who have appropriate qualifications, knowledge and skills to perform their organizational tasks (Pupavac and Zelenika, 2003, pp. 787-808).

Emphasis should be put on the appropriate deployment of available human resources. The goal is to make the most of the potential, but at same time to avoid a negative attitude towards the employees while benefiting from them. Quite the contrary, it is necessary to increase employee satisfaction by providing earned awards and bonuses for the work. For the fair treatment of employees managers are primarily responsible and therefore is introduced the term "social responsibility manager which means social sensitivity, which means simply the ability of managers or corporations to connect their actions and harmonize them with the social environment in ways that benefit society and the corporation, or management "(Črnjar and Črnjar, 2009, pp. 184). It is also important to emphasize that in addition to material and human resources other stakeholders should be taken into account, primarily because it is socially responsible business concept in which an entity decides voluntarily to contribute to a better society and a cleaner environment, interacting with other stakeholders. The term stakeholders include individuals, communities or organizations that interact with the company. They can be internal, the most important are employees, who have already been mentioned, and owners who create a scheme of operations of the company and determine whether they will respect the principles of sustainability. External stakeholders comprise customers, suppliers, shareholders, local communities and the like.

2.3. Seven sustainability problems

In the mid-80s of the twentieth century began the search for solutions to the problem of the growing environmental pollution and social inequality. There are three key questions: why is it so difficult to effectively implement measures for achieving sustainability, why is it so difficult to move from the story to work, and why, even when organizations decide to introduce such measures, they quickly become "dead letter on paper"? Since then numerous studies have been conducted, and it is interesting to single out the research of Bob Doppelt. It was conducted in a way that the author has explored the way in which 25 public and private organizations have joined the issue of sustainability (Doppelt, 2008). Doppelt in his research separates seven problems of sustainability and seven interventions to address them, which are listed in the following Table 1.

Table 1 lists the seven problems of sustainability and seven interventions for their solution. It may be concluded that the problems identified are in a close relation with the knowledge or lack of knowledge. The first problem, which is considered the largest refers to old-fashioned thinking that leads to false security. Specifically, this problem occurs in companies that use autocratic leadership style, which hinder the freedom of individuals. This problem can be remedied by intervention, which describes the way in which it is possible to change the dominant thinking by emphasizing the imperative of achieving sustainability. With this intervention it is pointed out that legal standards are needed in the company, but are not the only criteria by which companies should be guided in their operations. In contrast, it is necessary to encourage companies to develop new methods and ways of working, to introduce democratic style and accept the innovation and creativity of employees. Another problem that occurs in companies is that the access to environmental and socio-economic issues is perceived as a particular program, it is separated as a separate link. Sustainability should become

comprehensive in the company, as a part of every business function, as a principle to which all should aspire. This problem was solved intervention which emphasizes how different structures and changes in the mindset of all employees should be the solution of the existing problems. It stresses the need for reorganization and modern management approach. The third problem arises from the fact that sustainability is a relatively new concept and it is not incorporated into the vision of enterprises, and in general there is no clear picture on how to implement sustainability. Organizations are trying to comply with laws, but that is not enough, it is necessary to set sustainability as one of the main goals of the company. Therefore, the mentioned problem could be solved by creating a vision and guiding principles of sustainability.

Problems	Interventions
Old-fashioned thinking that leads to false security	Change the dominant thinking emphasizing the imperative of reaching sustainability
"Silo" approach to environmental and socio-economic issues	The reorganization of parts of the system with the help of "teams for a change"
The lack of a clear vision of sustainability	Changing objectives by developing the ideal vision and guiding principles of sustainability
Uncertainties related to the causes and consequences	The restructuring of the rules through the adoption of new strategies
Insufficiency of information	Change of information flow to ensure continuous and tireless communication of purpose, vision and strategy of achieving sustainability
Insufficiency of mechanisms for learning	Correct feedback in a way that learning and innovation are supported and rewarded
Unsuccessful institutionalization of sustainability	Adjust parameters by adjusting organizational system and the structure to sustainability

Table 1: Seven sustainability problems and interventions for their solution (processing according to author Bob Doppelt: Seven sustainability problem, Quantum 21, July 2008, <http://portal.wlw.hr/Uploads/1461/1/3/884/1156/q21-doppelt-%EF%BF%BDlanak.pdf>)

The next issue relates to the lack of clarity regarding the causes and consequences. The logic requires that it should be necessary to prevent the cause in order to prevent the consequences, rather than to sanction the consequences. This problem is linked to the previous one, because the vision of the ideas that are oriented to the future should adapt to the principles of sustainability, and thereby prevent the causes that lead to negative consequences for the environment and the community. The fifth problem refers to insufficiency of quality information. This is a consequence of lack of communication in the company, particularly between superiors and subordinates. That definitely leads to ignorance, so employees do not know the advantages of doing business based on the principles of sustainable development. In pursuit of change and transition to a sustainable business, companies should take into account

the need for education of employees, which is discussed in the sixth problem. They should be given the opportunity to present new ideas and the creativity and innovation so they could contribute to goals of the company. The organization must reward their employees, their innovations, projects, skills and knowledge. Last, the seventh problem which Doplett lists actually combines all the previously mentioned problems, and actually indicates that the concept of sustainability should become the cornerstone of thinking and behavior in the organization, that is the foundation of daily activities, processes, policies and culture. We should bear in mind that achieving sustainability is not a fixed point in time, but a continuous process that assumes constantly changing and adapting the company dynamic environment.

3. SUSTAINABLE DEVELOPMENT AS A RESULT OF THE GLOBALIZATION PROCESS AS A STRATEGIC GUIDING PRINCIPLE

The term globalization is derived from the word "global" meaning the totality, and globalism is a way of looking at events in general. Globalization would also imply a social process that tends to universality and unity of the world (Tufek, 1999). Globalization of which we speak and write a lot today could be set up as a model of development that does not represent a choice, but it is the reality of contemporary international relations. Without going into a different analysis of the concept, content and main actors of globalization, perhaps at this point it is best to quote lapidary definition by Deputy Secretary of State, S. Talbot, who said: "what happens there has a meaning here." The head of the World Trade Organization (WTO), Renato Ruggiero has set a formula that should link economic and political aspects of globalization, and in his view globalization = growth, development and peace of mind, international relations grounded in the cooperation. In any case, the ideology of globalization is ideology of rich and developed countries, primarily the United States. Although the contemporary process of globalization may talk about the structure of the global system, which has the shape of polycentricity, leading global power, the United States possess especially important role (Vukadinovic, 1999). Everyone suggest that the world has become a global village, but what does it really mean? (Frankel, 2000, pp.55). Globalization as a concept refers to the "reduction" of the world, but also to raising awareness of the world as a whole. For globalization one can argue that it is one of the consequences of the development of science, modern technology, the market economy, democracy. Globalization has allowed the free movement of capital, goods, information and people through the expansion and the elimination of borders. Ecological, cultural and social side of globalization is often ignored in relation to its political and especially economic dimension, but in recent times they get more and more space. We should mention anti-globalists, human rights activists, animal rights, Greenpeace. Globalization has both negative and positive aspects, but it certainly introduces significant changes. The developed world is the holder of the globalization process and it took the best advantage of the current global circumstances. With the development of information and communication technologies the world has become a single system, and the connection between the two subjects in different parts of the world is made within a few minutes (Lončar, 2005, pp. 91). The positive effects of globalization are (Čečuk, 2002, pp. 20):

- ✓ good organization of work,
- ✓ development of new technologies and manufacturing techniques,
- ✓ rationalization and development of new materials,
- ✓ development of new sources of energy,
- ✓ restructuring of production where labor-intensive manufacturing is being located in developing countries because of a cheaper labor cost, and capital-intensive manufacturing is located in areas of developed countries,
- ✓ transfer of knowledge, technology, education workers, the possibility of technological and productive education of young people,



free movement of persons, the transfer of knowledge and know-how.

Even though globalization has positive, innovative and dynamic aspects, it also has negative, eruptive and marginalized aspects (Staničić, 2000, pp. 919):



uniformity of taste, customs, habits, and even encounter of various world cultures,



the gap between rich and poor countries,



the increasing connectivity of organized international crime, terrorism and illegal migration and corruption,



destruction of the environment.

The biggest environmental pollutants are the largest industrialized countries, but the third world is also compelled to exhausting nature to provide at least a basic survival. The market has developed in the last 200 years into the market without any understanding of the ecology. Natural disasters in recent centuries suggest that this rate of attrition of nature will not be able to continue for a long time and that we are destined to the global catastrophe of gigantic proportions, if it we do not change a lot in the very near future.

3.1. The importance of sustainable development in the globalization process

Despite numerous integration, networking and similar benefits of globalization, it entails many negative consequences. In fact, globalization and sustainability become opposites that cannot be carried out in parallel. Humanity is on an accelerated path to spend all the social, cultural and ecological value. The process of economic globalization today, boosted primarily by information technology, leads us strongly in the wrong direction of development, primarily due to lack of appropriate framework conditions of the world economy focused on sustainability (Radermacher, 2003, pp. 22). It is generally known that globalization connects the developed countries, but that fact all the more increases the gap between developed and underdeveloped countries. As a result, global economic and ecological status is deteriorating. The importance of sustainable development is increasingly recognized, as well as links that can save a chain that is intertwined in the wrong direction. To understand the significance of the constant emphasis of the concept of sustainable development and its importance, it should be compared with the related terms of economic growth and economic development.

Economic development is defined as the broader concept of economic growth and "covers the process of economic growth while improving the standards and quality of life of people by increasing income and changing economic and social structures" (Novalić, 2003, pp. 96). However, it is evident that this term does not emphasize the quality and sustainability of meeting the needs of individuals, businesses, or the community. Therefore, it is necessary to go a step further, and look for a comprehensive term. Precisely the answers to the previous definition and ambiguous questions reveal the concept of the sustainable development. Sustainable development implies a very broad concept, and in today's conditions can be regarded as the only outlet for mankind. Hence the importance of acting in accordance with the given principles and inevitable connection of the concept of sustainable development in terms of economy and globalization. The quote of Herman Kahn is quite suitable; he says that "the key to accelerating economic development is not primarily in the natural resources that can be exploited, or in economic aid, or birth control. This key is in education, inventions, savings and investments, and the institutional changes that encourage the development of products in creative, innovative activities that create new sustainable human values "(Novalić, 2003, pp. 97).

It is clear that sustainable development involves a constant series of changes, but with the continuous improvement and respect for the limited resources that support the development and

progress. It is important to emphasize the relationship of quantitative and qualitative growth. Even though one term implies the existence of the other and complement each other in terms of sustainable development it is important to point out that the quantity is a precondition for the existence of quality. The quantitative expression implies the existence of sufficient quantities of natural resources to meet the increased needs of the population. While in the case of decomposition, the qualitative aspect takes into account the ability of ecosystems to withstand the pace at which the inputs are worn out and find a way to absorb the piles of waste generated by the use of output, in order to avoid a gap between quantitative and qualitative sense of development and the key role has a constant acquire of new knowledge, better organization, technological efficiency and the pursuit of innovation and finding new solutions. Otherwise, if they fail to match all components of development there is going to be an imbalance. Therefore, sustainable development is the only way out of the ecological and social crisis that has taken on global proportions, and it is the only way out for the survival of modern society. "The aim is to overcome poverty, reduce the gap between rich and poor, reducing conflict and violence, reducing environmental damage, reducing the use of resources, stop population growth at a certain level, increase solidarity among the people" (Novalić, 2003, pp. 98).

Even though sustainability is a problem that manifests itself at the global level, it is important to think about the solution to the well-known principle of "think globally, act locally", i.e. that individuals do the best they can, and that each individual can contribute. Also a big role is on the economy and businessmen. "The process of globalization makes many companies become aware that the leading industrial nations can permanently remain competitive only if they use knowledge as a production factor in a better way. Structural changes to the labor-intensive business fields based on knowledge are constantly happening. Companies are increasingly selling knowledge or intelligent products" (North, 2008, pp. 1). It is clear that globalization is bringing numerous changes, and requires a continuous adjustment, while companies must direct their power toward survival and strive to constantly increase the competitiveness by the adoption of new knowledge, while it is inevitable to operate under to the principles of sustainability. Even the global crisis that is currently being felt in nearly all parts of the world shows the need for a different way of thinking. Globalization brings more risks and it is important to emphasize the need for the optimum utilization of resources, financial, physical and human.

5. CONCLUSION

At the end of the 1980s, a growing problem in the world, related to the impact of economic development on public health, natural resources, environment, and quality of life in general, have led to the creation of the concept of sustainable development. The very concept of sustainable development is defined as "development that meets the needs of the present, while not compromising the ability of future generations to meet their own needs" (Kandžija, 2003, pp. 27). Sustainable development achieves a balance between the demand for improvement in quality of life (economic component), for achieving social welfare and peace for all (social component) and the requirements to protect environmental components as a natural resource which present and future generations depend upon. Respect for the principles of democracy, gender equality, social justice and solidarity, legality, respect for human rights and the preservation of natural resources, cultural heritage and the environment contribute to the preservation of the Earth to sustain life in its entire diversity. In this way sustainable development is achieved through a dynamic economy with full employment, economic, social and territorial cohesion, a high level of education of citizens, high level of health protection and the preservation of the environment. The right of the present generation to exploit the resources and the environment, should not compromise the same rights of future generations. Today the

world has fully accepted that sustainable development and economic efficiency because it involves the rational use of natural resources, economical use of energy and space,. At the same time, it recognizes the efficient allocation of results of economic activities in the communities, in order to increase the general welfare, to protect human health and reduce poverty that affects certainly the global economic crisis. The strategy of sustainable development defines sustainable development as a goal-oriented, long-term, comprehensive and synergetic process that affects all aspects of life (economic, social, environmental and institutional) at all levels. Sustainable development is focused on the development of models in a quality manner which meets socio-economic needs and interests of citizens, but at the same time eliminates or significantly reduces the influences that pose a threat to or damage the environment and natural resources.

Long-term concept of sustainable development implies continual economic growth which, in addition to economic efficiency and technological progress, higher participation of clean technologies and innovation of the entire society and socially responsible operations, ensuring the reduction of poverty, better use of resources in the long term, improving health conditions and quality of life, while reducing pollution levels the level of absorption capacity factors of the environment, prevention of future pollution and preservation of biodiversity. Creation of new jobs and decrease in unemployment rate, as well as reducing gender and other inequalities, stimulating employment of youth and persons with disabilities, and people from marginalized groups, are among the key challenges of sustainable development. Sustainable development implies the realization of three general objectives (Strategy for Sustainable Development of the Republic of Croatia, 2009, pp.2):

- stable economic development,
- social equity and
- environmental protection.

In the realization of these goals following should be achieved (Strategy for Sustainable Development of the Republic of Croatian, 2009, pp.3):

- protect the earth's capacity to support life in all its diversity, respect the existing limits on the use of natural resources and ensure a high level of protection and improvement of environmental quality, prevent and reduce environmental pollution and promote sustainable production and consumption as economic growth does not necessarily mean the degradation of the environment;
 - ✓ respect national specificities;
 - ✓ promote the economy based on prosperity, development changes, spirit of competition and the social responsibility, an economy that ensures the quality of life and full employment;
 - ✓ promote democratic, social, inclusive, cohesive, healthy, safe and just society with respect for fundamental rights and cultural diversity that creates equal opportunities and combats discrimination in all its forms;
- use scientific and technical knowledge to develop a system of protection of human health, including the remediation of existing environmental burdens;
 - ✓ encourage the establishment of democratic institutions in the region and the world and defend their stability, based on the universal right to peace, security and freedom
- actively promote sustainable development in the region and the world;
 - ✓ strengthen partnership among all segments of the community.

LITERATURE:

1. Čečuk, A., *Financijska globalizacija*, 2002, Graf form, Split, Croatia;
2. Črnjar, M., *Ekonomika i politika zaštite okoliša*, 2002, Ekonomski fakultet Sveučilišta u Rijeci i Glosa, Rijeka, Croatia;
3. Črnjar, M., Črnjar K., *Management održivoga razvoja: ekonomija, ekologija, zaštita okoliša*, 2009, Ekonomski fakultet Sveučilišta u Rijeci i Glosa, Rijeka, Croatia;
4. Doppelt, B., Sedam problema održivosti, *Quantum* 21, srpanj 2008. [http://portal.wlw.hr/Uploads/1461/1/3/884/1156/q21-doppelt %EF%BF%BDlanak.pdf](http://portal.wlw.hr/Uploads/1461/1/3/884/1156/q21-doppelt%EF%BF%BDlanak.pdf)
5. Frankel, J. A., *Globalization and Financial Markets: A Challenge for Economic Policy*, 2000, *Zagreb Journal of Economics*, 4(5), pp. 55;
6. Kandžija, V., *Gospodarski sistem Europske unije*, 2003, Ekonomski fakultet u Rijeci, Rijeka, Croatia;
7. Lončar J., *Globalizacija – pojam, nastanak i trendovi razvoja*, 2005, *Geografski odsjek*, pp. 91, Zagreb, Croatia;
8. North, K., *Upravljanje znanjem: Vođenje poduzeća usmjereno prema znanju*, 2008, Jasterbarsko: Naklada Slap, Zagreb, Croatia;
9. Novalić, F., *Rasipanje budućnosti*, 2003, Alineja, Zagreb, Croatia;
10. Pavić, Rogošić, L.: Društveno odgovorno poslovanje, *Odras*, www.odraz.hr (06.05.2016.);
11. Pupavac, D, Zelenika, R., *Upravljanje znanjem i zadovoljstvom zaposlenika - čimbenik kompetitivnosti prometnih tvrtki*, 2003, *Ekonomski pregled*, 54 (9-10);
12. Radermacher, F. J., *Ravnoteža ili razaranje: eko-socijalno-tržišno gospodarstvo kao ključ svjetskog održivog razvoja*, 2003, Intercon - nakladni zavod Globus, Zagreb, Croatia;
13. Tufek, F., *Globalizacija i globalna sigurnost*. 1999, Hrvatska udruga za međunarodne suradnje, varaždin, Croatia;
14. Vukadinović R., *Globalizacija i globalna američka politika*, 1999, *Politička misao*, 36(1)

THE EFFECT OF PUBLIC ADMINISTRATION REFORMS UNDER THE POST-NEW PUBLIC MANAGEMENT PARADIGM

Tatiana-Camelia Dogaru

National University of Political Studies and Public Administration, Romania
dogaru_tatiana@yahoo.com

ABSTRACT

It is becoming increasingly apparent that the reform of public administration is a sort of Achilles heel of modern state especially, because the bureaucracies could not give up to the features of old public administration. However, the public administration, under the pressure of some international driving forces (global economic crisis, interaction with the EU system, Europeanization etc.) and development of several paradigms (new public management, post-new public management, corporate governance) has to adjust its policies, procedures, structures and relations with citizens and business and to function more effectively within the EU framework.

Today, public administration is moving in new directions. Reforms are focusing on the quality of services for citizens and business on the efficiency of administration. The focus of the paper is on selected reform area in Romanian public administration, namely de-bureaucratisation and simplification of the procedures for citizens, business and administration to achieve the European standards and to be defined by transparency, predictability, responsibility, adaptability and effectiveness. As research methodology, the study adopts a case-oriented approach to advance its arguments, using both quantitative and qualitative data, published by European and national institutions.

Keywords: *post-new public management, de-bureaucratisation, public administration.*

1. INTRODUCTION

Public administration in the 21st century is undergoing dramatic change, especially due to globalization and Europeanization processes. Policy problems faced by governments are increasingly complex, wicked and global, rather than simple, linear, and national in focus. Several frameworks have been developed to classify and analyse different approaches to public administration and public sector reforms (Robinson, 2015, p. 4). Most of these focus on the transition from the Old Public Administration to the New Public Management that occurred in the 1980s and 1990s.

While this approach has been oriented for improving efficiency, both scholars and practitioners (Hood, Peters, 2004, pp. 269-270; Vabø, 2009, p. 18; Christensen, Lægreid, 2007, p. 8, p. 239) have observed a series of paradoxes and problems in implementation its principles. In this sense, the New Public Management critics believe the management reforms failed to achieve its original objectives of efficiency and effectiveness (Dunn, Miller, 2007, p. 350), therefore the public administration theorists have proclaimed for some years that we are in a post-NPM period. Therefore, since 2000 there was a discernible trend towards an emerging model variously termed the “post-New Public Management”, the “new public governance” or the “new public service” (Dunleavy, Hood, 1994; Osborne, 2006). The post-NPM generation of reforms advocates a more holistic strategy (Bogdanor 2005).

2. PUBLIC ADMINISTRATION REFORM: THEORETICAL FRAMEWORK

A considerable literature has grown up concerning general trends regarding especially the transition from New Public Management (NPM) to post-New Public Management post-NPM) school of thought. The concept of New Public Management was widely adopted and

internationally since its emergence (Pollitt, Bouckaert, 2004). As a dominant doctrine for modernising the public sector, the New Public Management has been widely deployed by governments seeking to modernise and transform its public sector (Lapsley, 2009). Thus, many countries launched their reforms based on the principles of NPM (Bovaird, Löffler, 2003).

Scholars stated that, the reforms that were undertaken under the label NPM represented major changes compared with the “old public administration”, and they paved the way for further reforms and transformations in the post-NPM era. Therefore, after two decades of dominance by New Public Management it became that there was increasing dissatisfaction with its limited focus (Lapsley, 2009) and a part of literature (Dunleavy et al. 2006; Dunn, Miller, 2007; Osborne, 2006; Stoker, 2006) started searching for alternatives. In contrast to the New Public Management reforms, a new generation of reforms initially labelled “joined-up government”, later known as “whole-of-government”, and now labelled “post-New Public Management” was launched (Christensen, Lægreid, 2007 referenced by Christensen, Lægreid, 2009 p.11). The images associated with the “whole-of-government” or “joined-up government” initiatives that have characterized post-NPM reforms readily bring to mind the idea of repairing and putting back together something that is broken, has fallen apart or become fragmented (Gregory, 2006).

According to (Dunleavy et al., 2006), in a sharp view, the New Public Management is allegedly dead and we are facing a paradigmatic shift towards a new reform movement underlining networks, partnerships, increased integration, coordination and central capacity. However, it is fair to say that NPM is still very much alive in many countries, and NPM reforms are normally not replaced by new reforms but rather revised or supplemented by post-NPM reforms (Pollitt, 2003).

From some points of view (Jun, 2009, p. 165) the post-New Public Management is the latest framework for government administration and is much more difficult to define than New Public Management, although shares some similarities with NPM as it is based on economic theory and managerialism. Post-NPM has been influenced by changes in government and external pressures from politics and the global economy (Christensen, Lægreid, 2007, pp. 1-4) and, tries to reinforce control and coordination by combining structural and cultural elements. Yet post-NPM is not all about returning to “old public administration”. Its notion of governance is more broadly defined than that, for it entails reaching out to society, enabling individual and organized private actors in civil society to be better informed about public policy and to participate in making that policy more representative and in implementing it - all elements taken from output models (Christensen, Lægreid, 2009 p.11). The post-NPM reforms are culturally oriented governance efforts. They focus on cultivating a strong and unified sense of values, teambuilding, the involvement of participating organizations, trust, value-based management, collaboration and improving the training and self-development of public servants (Ling, 2002). Post-NPM has a vertical and a horizontal dimension (Christensen, Lægreid, 2007). In post-NPM reform, efforts have focused particularly on the problems that arose as a result of greater vertical and horizontal specialization in New Public Management (Christensen, Lægreid, 2007).

On the vertical dimension, using more central resources to coordinate subordinate institutions and levels and using stronger instruments of central control have enabled political executives to regain a degree of political control and pursue consistent policies across levels. On the horizontal dimension, cross-sectoral bodies, programs or projects are increasingly being used to modify the “pillarization” or “siloization” of the central public administration brought about by the strong specialization by sector (Pollitt, 2003).

3. SELECTED APPLICATION: *de-bureaucratization and simplification of the procedures (D-BSP) in Romanian public administration*

For adapting itself and implicitly for responding more efficiently to the challenges of the current socio-economic context in which it is Romania, public administration should focus on its classical mission, implementing public policies and law and, providing public services on a modern and innovative approach. In Romania, public administration both at central and local levels has gone through major reforms since 1989, culminating in accession to the North Atlantic Treaty Organization in 2004 and to the European Union in 2007 and continuing with the efforts for convergence to the European mechanisms of governance and relatedness other administrations of EU Member States. These waves of reforms were based on the different philosophies of the above paradigms, at the time being attention goes to the Post-New Public Management.

The main period of reform is the period before accession to the European Union, when Government has adopted two successive strategies for public administration: (a) Strategy for the acceleration of public administration reform 2001-2003 and, (b) Updated Strategy for the acceleration of public administration reform 2004-2006. These two documents represented the basis for implementing a series of reforms in key field, such as: public policies, decentralisation and civil service. Unfortunately, since 2007 there has never been a full strategy for public administration, although the institutions of central public administration took several initiatives that addressed aspects of public administration reforms, but in a fragmented way.

3.1. D-BSP for citizens and business: status-quo and future approaches

One of the main priorities set out by Government for 2014-2020 period consist of de -bureaucratization and simplification for citizens, businesses and administration. In this sense, the Government proposes electronic takeover documents and data from citizens and business environment (SSPA, 2014-2016). Therefore, in relation to public administration (central and local level), the citizens and business will be able to choose between two ways:

- direct delivery of documents and data, which will be processed through electronic means by civil servants. In this case, the citizens addressed directly to *unique physically bureau* established at the local or central level.
- on-line delivery of documents and data, (possibly completing electronic forms available). In this situation, the citizens addressed to *unique virtual bureau* established and functioning on public institutions' web-site.

According to the Strategy for Strengthening Public Administration 2014-2020, that strategic priority is focused on three directions, namely: (a) de-bureaucratization or reducing red tape for citizens; (b) reducing red tape for business environment; (c) de-bureaucratization inter and intra-institutional. For all of these, the public authorities take into considerations the following dimensions: (a) organizational; (b) procedural; (c) law-making; (d) financial and infrastructural. Over 27 years, Romania based on different schools of thought conducted several waves of public administration reforms for improving the efficiency and the quality of public service providing. However, the last Country Report issued by the European Commission (2016), pointed to particular challenges for Romania's economy the following one (among others), „*the effectiveness and efficiency of the public administration are limited and the business environment has hardly improved*”.

In this context, the current analysis following a comprehensive process of assessment of certain indicators for regulation, including bureaucratization shows several efforts and results got by

Romania after the public administration processes. In relation with citizens and business the status-quo on aspects regarding the procedures the paper emphasis a couple of changes. For instance, *paying taxes procedure* recorded few improvements in 2016 and 2015, although the changes made in 2011 and 2010 did it more difficult. The evolution of the main elements of this procedure is reflected by the below chart.



Chart 1: Components of paying taxes procedures (the author based on Doing Business Reports' data, 2005-2016)

Romania made paying taxes less costly for companies by reducing the rate for social security contributions and the rate for accident risk fund contributions paid by employers from 20.8% to 15.8% from October 1, 2014. The changes made since 2009 till 2012 (during the economic crisis) increased the payments to 113, while in 2006 were 62 payments. From 2013 the payments number decreased, at this time (2016) being only 14 payments. In Romania, it can use the internet for tax collection and payment - with the aim of reducing the scope for bureaucratic discretion and even corruption and increasing the tax system's transparency, efficiency and cost-effectiveness. In this field, the National Agency for Fiscal Administration has continued its reorganization process by rearranging large and medium taxpayers' portfolio, restructuring the large taxpayers' administration directorate, establishing medium taxpayers' administrations at regional level and establishing a directorate of enforcement for special cases. As a result of this extensive reorganisation process, the main tax administration indicators registered a real improvement in 2015. Another procedure studied in this paper is *construction permits*. By law, construction works may be undertaken only after a building permit is issued by the relevant authority. Law no.50/1991 on authorizing the execution of construction and housing represents the legislative framework in this area. The building permit is issued for the implementation of construction works, reconstruction, consolidation, modification, extension, change of destination or rehabilitation of buildings of any kind, as well as the related facilities, except for certain works which do not alter the structure of resistance, baseline characteristics of the buildings or their architectural appearance, works that do not require a building permit.

The building permit is issued based on a documentation submitted to the competent authorities. Due to the many procedures the cutting red tape in construction permitting represents a milestone of the reform process. At the time being there are 15 procedures for getting a construction permit and it takes about 257 days. The below chart presents an evolution of the main components of construction procedure in Romania.

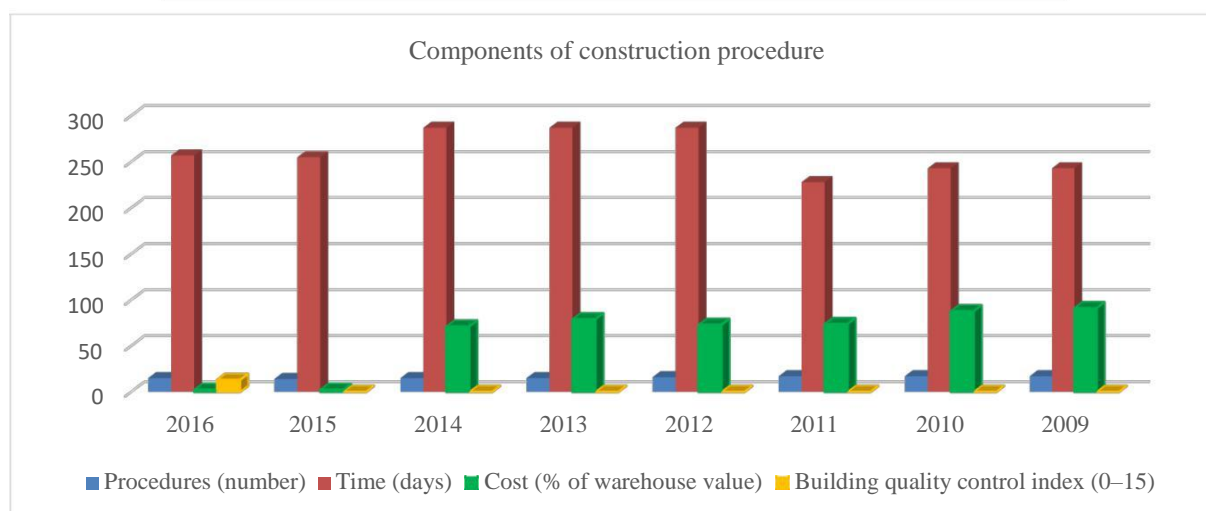


Chart 2: Components of construction procedures (the author based on *Doing Business Reports' data, 2005-2016*)

It can be remarked that the number of procedures decreased from 17 (2009 and 2010) to 15 in 2016. However, it is impressive that although in 2009 were 17 procedures and the time for getting construction permit was 243 days, respectively 228 days, while in 2011-2013 period when the number of procedures decreased to 15, the time increased to 287. Nowadays, an actor after filling a number of 15 procedures can get the construction permit in 257 days. Therefore, to sustain the public and private investments the Romanian government foresees the simplification of the procedures for obtaining the construction authorization as following:

- upgrading the systems already implemented through the projects Territorial Observatory and PICSUERD (Informatics Platform at national level for Communication for Implementing the European Union Strategy for Danube region) together with the subsequent collection and validation of spatial data aiming at developing gradually at national level the e-Government system for Planning and Construction Authorization;
- standardizing the data sets of the documentations for the Spatial and Urban Planning;
- drafting the Code for the Spatial and Urban Planning and Constructions and creating an application for accessing the legislation, technical regulations, and the approval and authorization flows as well (NRP, 2016).

Regarding the *electricity service*, the actors have to go through 8 procedures (2016), with one more then 2012-2015 period and to wait 182 days.

Chart following on the next page

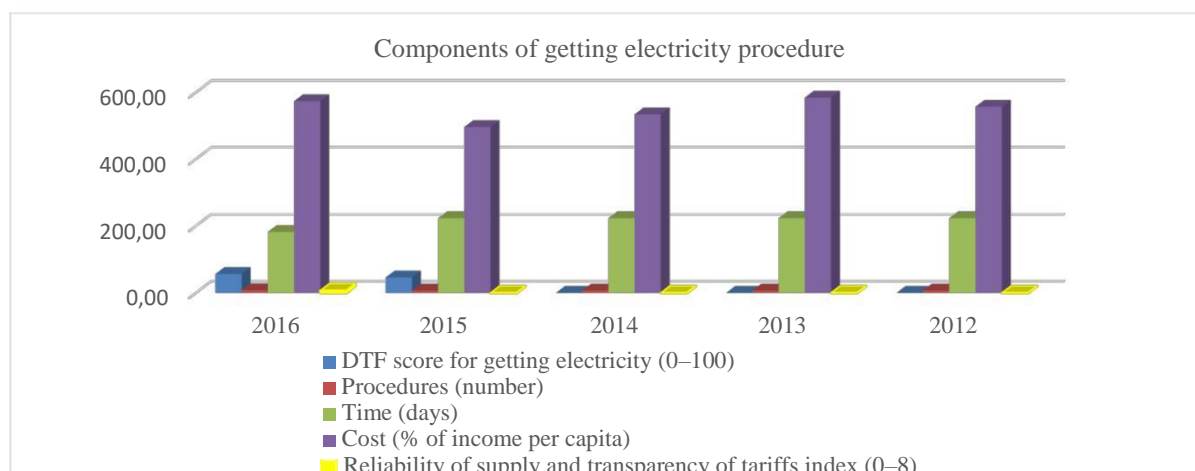


Chart 3: Components of getting electricity (the author based on *Doing Business Reports' data, 2005-2016*)

The progress made by Romania through the reform process carried out in this filed consists on decreasing the number of days for getting electricity from 223 to 182.

In the field of *registering property*, Romania made significant progress in decreasing time (days) of processing application from 170 in 2005 to 19 in 2016. As part of the reform, from 2015 systematic registration of land in Romania is part of the National Program for Cadastre.

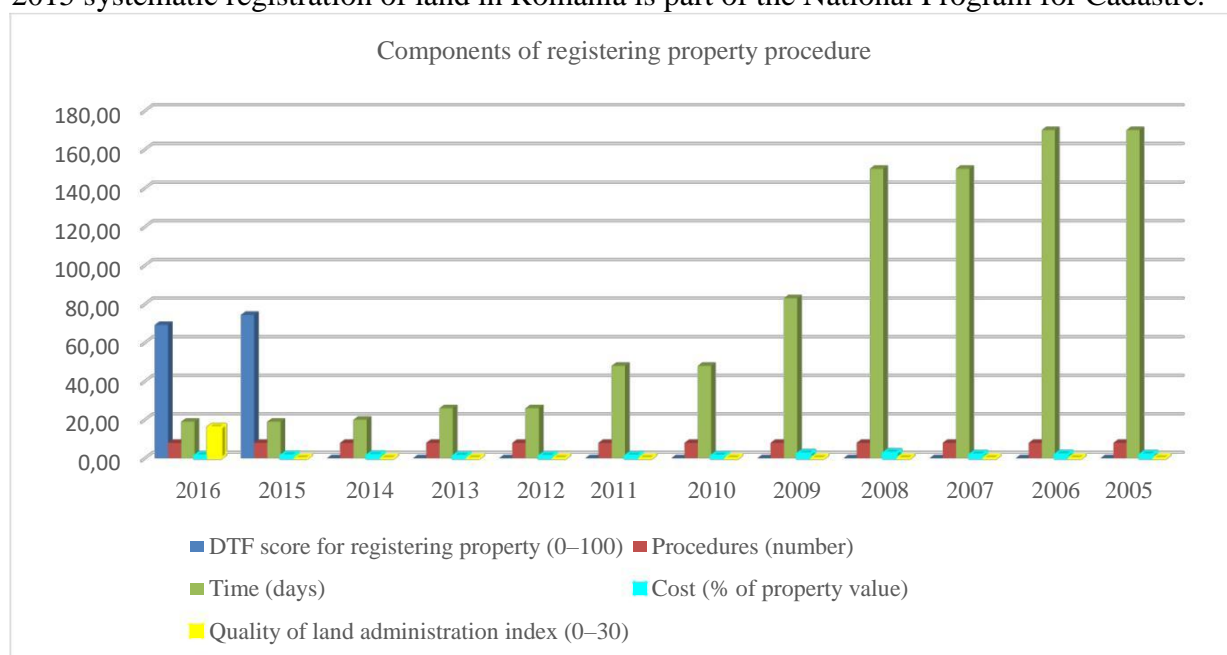


Chart 4: Components of registering property (the author based on *Doing Business Reports' data, 2005-2016*)

The Romanian Government is committed to create a favourable environment for public and private investment, within an extensive process of de-bureaucratization and simplification of the administrative procedures. By the end of 2020, to reduce the competitiveness gap against EU Member States, the Government assumed specific targets for the simplification/optimization of the procedures that sustain the SMEs/enterprises along their lifecycle (NRP, 2016).

Since 2005, Romania give a special attention to business environment and several changes have been made for improving the procedures concerning doing a business.

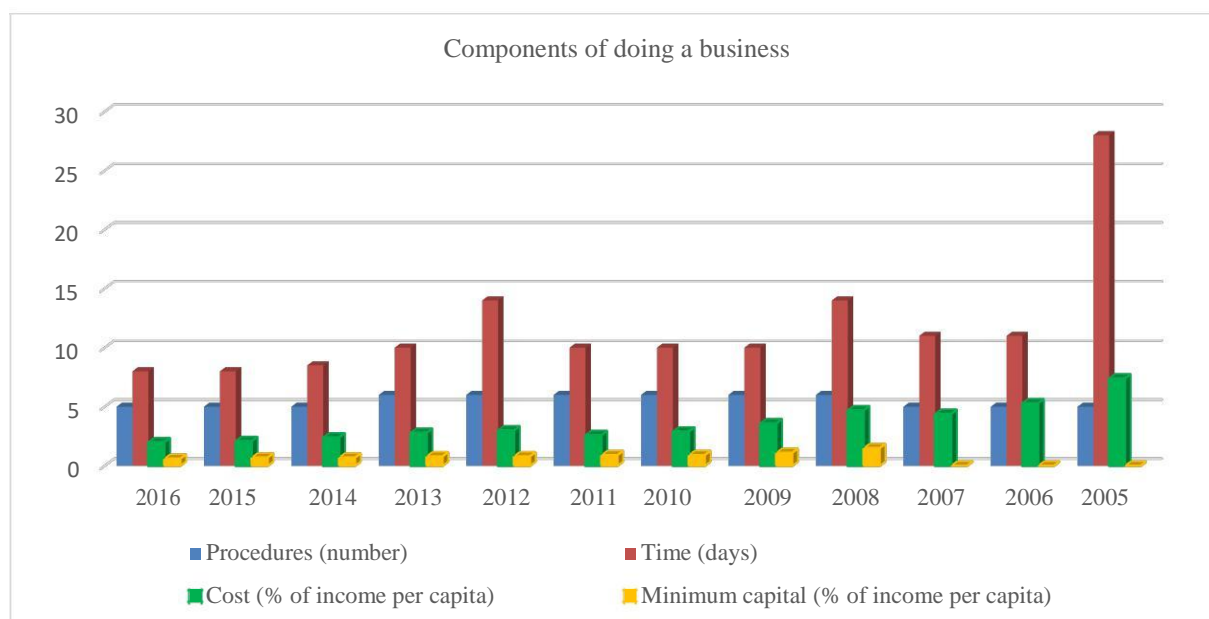


Chart 5: Components of doing a business (the author based on *Doing Business Reports*' data, 2005-2016)

Keeping almost the same number of procedures (5 procedures), Romania succeeded in decreasing the time from 28 days to 8 days. Romania made starting a business easier by transferring responsibility for issuing the headquarters clearance certificate from the Fiscal Administration Office to the Trade Registry. Reforms from Romania were inspired by competition, with entrepreneurs in an EU member country able to incorporate their company in any other one. Concerning the insolvency, starting 16 July 2015 the new provisions on improving and simplifying the procedures on the dissolution, liquidation and removal from the trade register are being applied. Romania improved its insolvency system by:

- introducing time limits for the observation period (during which a reorganization plan must be confirmed or a declaration of bankruptcy made) and for the implementation of the reorganization plan;
- introducing additional minimum voting requirements for the approval of the reorganization plan;
- clarifying rules on voidable transactions and on payment priority for claims of post-commencement creditors.

In 2015 the number of the insolvency proceeding openings registered into the register of the insolvency proceedings bulletin (IPB) significantly decreased, respectively by 50% over the previous year, and the interconnection with insolvency registers in seven EU Member States was achieved (NRP, 2016).

As regards reducing bureaucracy for citizens and business taking all of these into consideration, an integrated plan to simplify administrative procedures for citizens was approved by the National Committee for Coordinating and Implementing the Strategy for Strengthening Public Administration in March 2016.

3.2. D-BSP for inter and intra-institutions: status-quo and future approaches

According to National Reform Programme 2016, the public administration reform focuses on three main pillars: (a) civil service reform, (b) central public administration reform and (c) local public administration reform. Concerning the second pillar, the aim is to increase the efficiency,

performance and stability of the public policy framework and of fiscal-budgetary framework at central level, and to place the citizen at the centre of the public service delivery system, especially *by administrative simplification and reduction of bureaucracy*. In this context, two months ago, the Romanian Government adopted a series of measures for de-bureaucratisation through Emergency Ordinance no. 41/2016 on the establishment of certain measures for simplification at central public administration level and for amending and supplementing some normative acts.

Regarding the *de-bureaucratisation and simplification of the procedures inter and intra-institutions* the objectives are focused on (GD no. 909/2014): (a) simplifying inter and intra-institutional communication and collaborative procedures; (b) simplifying the procedure for public procurement; (c) simplifying the procedures relating to the implementation of projects financed from structural funds. Although it is a young project, de-bureaucratisation of public administration became representative for the current government. Among the initiatives proposed by this project are the following ones: (a) reducing the tracks (routes) and documents within the ministry and between the ministries; (b) developing the e-government services and strengthening a unique online office for the relationship between actors (individuals and business) and public institutions; (c) government cloud computing – creating a cloud infrastructure for public administration; (d) achieving the interoperability of informatics systems at national level for ensuring the interconnection of databases, so that civil servants can resolve as soon as possible the demands of actors (state intranet). Therefore, the personal data necessary for providing a public service that is collected, held or managed by another public authority or institution shall be taken directly to that authority if this has been explicitly requested by the beneficiary of public service, or if there is his express consent. For instance, the civil servants will not ask the citizen for criminal record, and they will obtain it from the Ministry of Interior. The certified copies for a number of items will be removed. The certification will be made by the civil servants who request these documents according to the original (GEO no. 41/2016).

The main strength of the de-bureaucratisation project is that a part of the measures comes from citizens and companies after a consultation process launched through the www.maisimplu.gov.ro web site in February 2016. Through this mechanism the government received 3300 proposals from 32000 persons. At the base of this project are the following principles: (a) simplification, (b) integration, (c) transparency and (d) digitization.

4. CONSLUSION

Generally speaking, the post - NPM represents a new era of administrative reforms replacing the former reforms of NPM. New Public Management reforms are chiefly about structural devolution, horizontal specialization, market and management principles and efficiency, while post-NPM focuses more on central capacity and control, coordination within and between sectors, and value-based management (Christensen, Lægreid 2007, Pollitt, Bouckaert 2004). At the time being the bureaucratic cost for citizens is 3 billion Euro, and the administrative burden for business environment also, approximately 3 billion Euro (Ministry of Economy, Trade and Business Environment Relationship, 2016). Between 2005 and 2016, according to the global rankings for doing business, Romania recorded the following rank for different indicators (see the below chart).

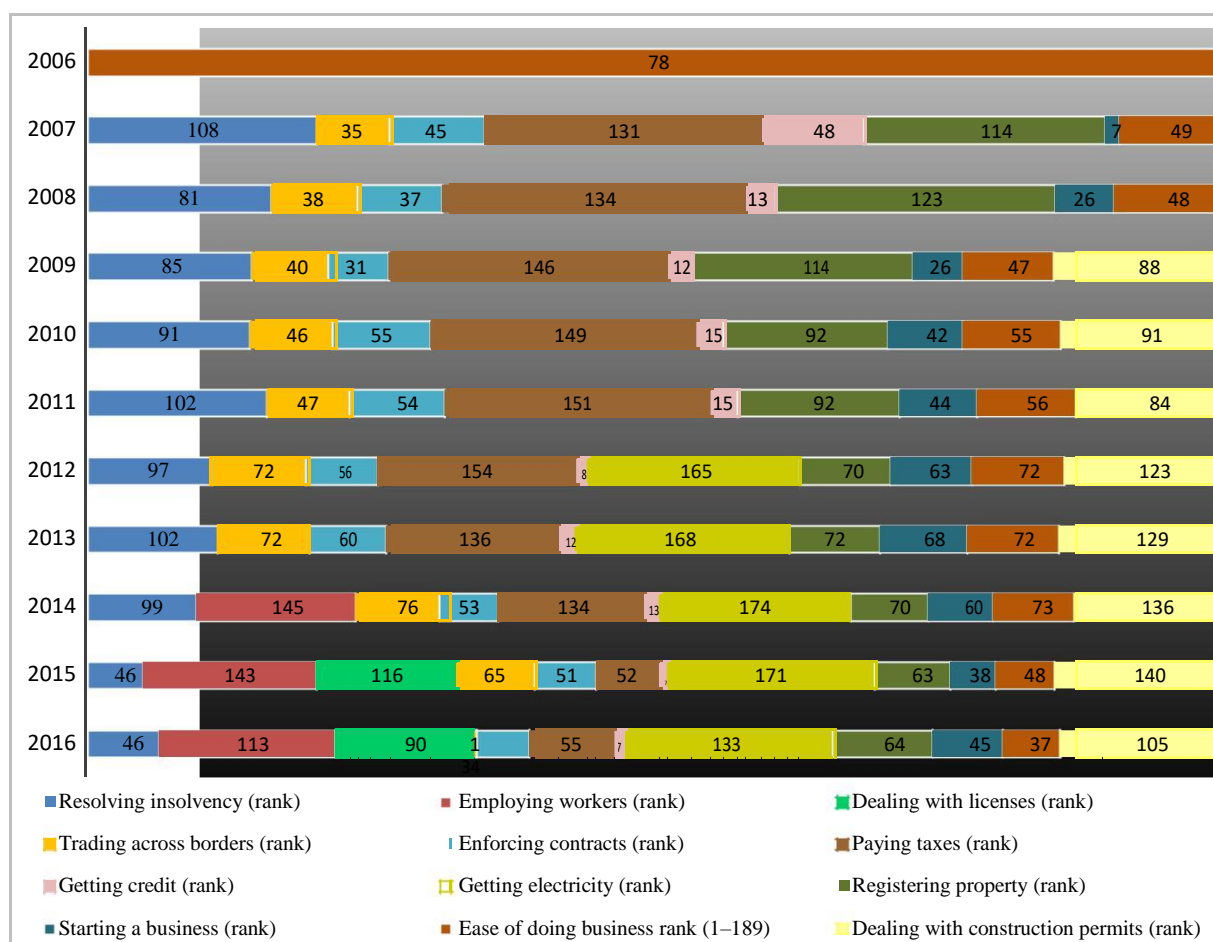


Chart 6: Ranks for different indicators for doing business in Romania (the author based on *Doing Business Reports* data, 2005-2016)

The main goal of post-NPM reforms has been to gradually counteract the disintegration or fragmentation brought about under NPM and to restore public-sector organizations to a situation of greater integration and coordination (Christensen, Lægreid 2007). In this context, Romania started a new process for reforming public administration through be-bureaucratisation and citizens-oriented.

LITERATURE:

1. Bogdanor, V. (2005). Introduction, in Bogdanor, V. (ed.). (2005). *Joined-Up Government* British Academy Occasional paper 5. Oxford: Oxford University Press.
2. Bovaird, T, Loeffler, E. (2003). Evaluating the quality of public governance: indicators, models and methodologies, *International Review of Administrative Science*, no. 69, pp. 313-328.
3. Christensen, T, Lægreid, P. (eds.). (2007). *Transcending New Public Management: The Transformation of Public Sector Reforms*. Burlington, VT: Ashgate Publishing Company.
4. Christensen, T, Lægreid, P. (2007). The whole-of-government approach to public sector reform. *Public Administration Review*, vol. 67, no. 6, pp. 1059-1066.
5. Christensen, T, Lægreid, P. (2009). Democracy and administrative policy: Contrasting elements of NPM and post-NPM, <http://soc.kuleuven.be/io/egpa/org/2009Malta/papers/EGPA%202009%20Tom%20christensenPer%20laegreid.pdf>
6. Dunleavy, P, Hood, C. (1994). From Old Public Administration to New Public Management. *Public Money & Management*, vol. 14, No. 3, pp. 9-16.

7. Dunleavy, P. et. al. (2006). New public management is dead -long live digital-era governance. *Journal of Public Administration Research and Theory*, vol. 16, no. 3, pp. 467-494.
8. Dunn, W, Miller, D. (2007). A Critique of the New Public Management and the Neo-Weberian State: Advancing a Critical Theory of Administrative Reform. *Public Organization Review*. vol. 7, No. 4, pp. 346-350.
9. European Commission, 2016. Country Report Romania 2016. SWD(2016) 91 final, http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_romania_en.pdf
10. Government Decision no. 909/2014 for approving the Strategy for Strengthening Public Administration 2014-2020,
11. Government Emergency Ordinance no. 41/2016 on the establishment of certain measures for simplification at central public administration level and for amending and supplementing some normative acts.
12. Gregory, R. (2006). Theoretical Faith and Practical Works: De-Autonomizing and Joining-Up in the New Zealand State Sector, in Christensen, T, Lægreid, P. (eds.), *Autonomy and Regulation: Coping with agencies in the modern state*. London: Edward Elgar.
13. Hood, C, Peters, G. (2004). The Middle Aging of New Public Management: Into the Age of Paradox? *Journal of Public Administration Research and Theory*. vol. 14, No.3, pp. 267-279.
14. Jun, J. (2009). The Limits of Post-New Public Management and Beyond. *Public Administration Review*. vol. 69, No. 1, pp. 161-165.
15. Lapsley, I. (2009). New Public Management: The Cruellest Invention of the Human Spirit? *ABACUS*, vol. 45, no. 1, pp. 1-21.
16. Ling, T. (2002). Delivering Joined-Up Government in the UK: Dimensions, Issues and Problems. *Public Administration*, vol. 80, no. 4, pp. 615-642.
17. Ministry of Economy, Trade and Business Environment Relationship, 2016. *Working Paper*, http://www.minind.ro/presa_2016/iulie/DEBIROCRATIZAREA.pdf
18. Osborne, S. (2006). The New Public Governance? *Public Management Review*, vol.8 no.3, pp. 377-387, Retrieved from <http://spp.xmu.edu.cn/wp-content/uploads/2013/12/the-New-Public-Governance.pdf>.
19. Pollitt, C. (2003). Joint-Up Government: a Survey. *Political Studies Review*, no.2, pp. 34-49.
20. Pollitt, C. (2003). *The Essential Public Manager*. Maidenhead: Open University Press.
21. Pollitt, C., Bouckaert, G. (2004). *Public Management Reform: A Comparative Analysis*, 2nd ed. Oxford: Oxford University Press.
22. Robinson, M., (2015). *From Old Public Administration to the New Public Service Implications for Public Sector Reform in Developing Countries*, Global Centre for Public Service Excellence
23. Romanian Government. 2016. National Programme Reform 2016, http://ec.europa.eu/europe2020/pdf/csr2016/nrp2016_english_en.pdf
24. Stoker, G. (2006). Public Value Management: A New Narrative for a Network Government? *American Review of Public Administration*, vol.36, no. 1, pp. 41–57.
25. Strategy for Strengthening Public Administration 2014-2020, http://www.mdrap.ro/userfiles/strategie_adm_publica.pdf
26. Vabø, M. (2009). New Public Management: The Neoliberal Way of Governance. *Working papers*; No. 4, Retrieved from http://thjodmalastofnun.hi.is/sites/thjodmalastofnun.hi.is/files/skrar/working_paper_4-2009.pdf
27. World Bank, Doing Business' Reports. 2005-2016, <http://www.doingbusiness.org/reforms>.

THE INEVITABILITY OF THE ALIENATION OF COMMUNICATION IN THE ERA OF GLOBALISATION

Tatiana Leshchenko

*Lomonosov Moscow State University, Leninskie Gory, Moscow, 119991, Russian
Federation tatvy@yandex.ru*

Irina Sokolova

*Russian State Social University, Wilhelm Pick str., 4, Moscow, 129226, Russian
Federation piter2003vo@mail.ru*

Liubov Teplova

*Lomonosov Moscow State University, Leninskie Gory, Moscow, 119991, Russian Federation
liubovteplova@mail.ru*

ABSTRACT

The paper analyses the problems of the global transformation of communication processes associated with the pervasive influence of the various communication systems on the economy, politics, culture and social system as a whole. The superfluity of such influence has given birth to a phenomenon of “the alienation of communication”, which is regarded as an objective entity of social reality. The authors adduce a typology of the alienation of communication occurring in a variety of communicative situations at any level of the social structure. This typology is primarily based on the specificity of the “clash” of individual and social in determining the meaning of communication: the original sense and the following reading of this meaning; the intention and the degree of the twisting of the meaning due to the mismatch of social needs, interests and values of the subjects of communication; the impact of this clash on the nature of social interaction. It is specified that in the social and cultural diversity context the processes of social adaptation, socialization and resocialization become of paramount importance for sustainable development of society. However, omnipresent phenomenon of the alienation of communication inhibits these processes significantly. Mass media contribute to an effect of the fractal proliferation of alienation that leads to its transformation into an indispensable attribute of the information society. The authors come to a conclusion that the reality of alienated meanings inevitably comes into existence and becomes the bellicose element of social environment, which explains a necessity of scientific conceptualization of the phenomenon. The approaches to the study of the alienation of communication are suggested.

Keywords: *Alienation of Communication, Fractal, Reality of Alienated Meanings.*

1. INTRODUCTION: GLOBAL TRANSFORMATION OF COMMUNICATION PROCESSES AND ALIENATION

Substantial growth in the amount of communication, the complexity of their structure and their increasing influence on all social processes and relationships are obvious facts. However, despite the variety of its real manifestations social communication is a well-defined integrity. Being social and cultural system by its nature, social communication is a dynamic entity which is constantly changing immanently and has an ability to form its own “destiny”. This self-determination was called by Pitirim Sorokin “the principle sui generis which predetermines the disclosure of immanent potentialities of the system” (Sorokin, 2006, p. 815).

It is important to clarify that the authors understand the system of social communication as the totality of communication inherent in the modern human society at the interpersonal, group, and societal levels. Of course, here we refer to a conscious communicative interaction, exchange of meanings and values, and not to the information and communication infrastructure.

Even more important is the aspect relating to the term “social”, which is taken as the general characteristics of communication in the sense mentioned above. This is not a special case or an approach used by many authors to refer to communication in the field of social work with those in need. So, following our line of reasoning, the social communication problems arising in the course of continuous human activity are the problems of the system itself. This does not mean that we exclude from the research the impact of the environment on the system. The environment can impact the system of social communication in a variety of ways but the latter will react only due to the built-in ability to digest the impact (be it a requirement or an offer) irrespective of the type of interaction whether it is a cooperation or a conflict. In a globalising world, the communication system meets all the challenges of globalisation and becomes an interface of both globalisation and glocalisation as its antipode, only modifying the shape.

Mass communication is nowadays the most broad and obvious phenomenon of social communication, which has drawn attention not only of humanities and social sciences but also of technologies, especially in the context of the information society (Carey, Adam, 2008; Curran, Fenton, Freedman, 2016; Orlova, Osipova, Sokolova, 2014). The problem is that the studies of the phenomenon of the mass media are focused on answering the question “How do the mass media and communication affect the person and society?” This question was answered by Niklas Luhmann (Luhmann, 2000). Meanwhile, more significant is the question “Why?”.

We will find a lot of attempts to explain the latter by means of an answer to more specific questions: “Who?” and “What is the purpose?”. The actual problem lies in the fact that there is practically absent the more correct formulation of the question “What is going on with the whole communication system and how does this affect its functioning?”. What Luhmann has called the reality of the mass media, is currently becoming “the reality of alienated meanings” (Leshchenko, 2015), evident in the media discourse (Matheson, 2005, pp. 18-19). But not only there. Opportunities of Internet communication were first considered by users as a way to individualise their own information space. Social networks have also emerged as a vain attempt to create an alternative to an alienated media discourse. Today, social media discourse with its often anonymous nicknames, informal vocabulary, lots of empty discussions and meaningless cross fires is also becoming a variant of “the field of alienation”. There arises a number of specific communication effects: “the absence of presence”, “ignoring behavior” and others. All these are faces of “the alienation of communication”¹. The meaning of communication is losing sense and the first place is being taken by the form. Following the paradigm of visual sociology (Sztompka, 2007) it is logical to assume that Instagram appeared as a result of the growing visualisation of the communication processes. We consider it to be the result of the growing alienation. The man is not physically able to maintain meaningful communication to the extent that he is offered today by the society. Therefore, it is natural for the man to simplify communication, to turn it into objects and to release it into the world, where the images created by man no longer belong to him. For the selfhood it has much more significant consequences than materialised labor. Why do we pay so much attention to the phenomenon of the alienation of communication? First, communication is central to the process of association, alongside with the perception and interaction. Second, the alienation acquires a total character thanks to the rise of the “network society” (Castells, 2015) and network communication. And third, the alienation of communication becomes the dominant type of social relations.

¹ It is necessary to make the terminological specification. According to Hegel’s doctrine the authors understand the concept as a process. It follows that now the concept of “the alienation of communication” proposed by the authors is in the process of clarifying and determining its content. Single and universal moments of the alienation of communication investigated by the authors are at the stage of forming definitive judgment. The concept of “the alienation of communication” is not yet complete. It exists as an idea, which is the unity of the concept and reality. The alienation of communication is estrangement from communication as understood by Marx. This is a form of being under contemporary conditions.

2. THE ALIENATION OF COMMUNICATION AS AN OBJECTIVE PHENOMENON OF SOCIAL REALITY

Social communication is a part of the social world, its backbone element due to which the social life is continually reproducing itself. In this sense, the concepts of “communication” and “social communication” are identical. Communication is the only way to reproduce society. Hence, social communication is a universal, objectively existing phenomenon, i.e. a social fact. The very fact which can be seen as a thing (Durkheim, 1962, pp. 51-55). And as a result of its sociality it can also be seen as a universal phenomenon of the “movement of meanings in social time and social space” (Sokolov, 2002, pp.30-32).

If we turn to the understanding of the original meaning as an absolute transcendent selfhood in a philosophical interpretation suggested by Alexey Losev, the thing is the embodiment of this selfhood, but “one and the same thing requires or involves an infinite number of its various interpretations” (Losev, 2008, p. 75). Communication, taken as a thing, is a grip of an absolute meaning-sense, which in fact occurs in the form of a continuous movement of verbalised meanings. “What comes first: the specified objectified sense, original meaning, or the meaning given by consciousness in the communication process (including autocommunication)?”. This question is removed with the help of dialectics. One does not exist without another one; the thing in existence cannot be understood without its antipode. It is therefore possible to assume that there is a unity of an absolute internal meaning and an external one, demonstrated through endless interpretations. Here lies an understanding of alienation as becoming of meaning. A deeper problem is in a correspondence of the senses attributed to the objects of reality which become the objects of communication through their verbalisation (naming). The higher is the degree of correspondence of the senses to the objects the lower is their alienation potential when they later undergo multiple interpretations and eventually acquire the quality of autonomous discourse, understood as “the meaning field” of social communication.

According to a well-known five elements communication scheme (sender – encoding – message – decoding – recipient) the point where twisted meaning (whether intentionally or unintentionally) occurs in the social space can primarily be misinterpretation at the stage of decoding and further reflection on the message. In objective reality any subject of communication may be both the initiator of the information movement and the recipient (often there is a transformation, sometimes instant, of the recipient into the initiator), and the interpreter, who connects to the communication process at any stage in an open and unpredictable manner. He can perform both a function of enhancing the effectiveness, adequacy of understanding of the original meaning and a function of noise or barrier. And in some cases he can perform a function of intentional twisting of the meaning at the very beginning of the message construction.

Social and cultural processes such as formation of value systems, spatial-temporal processing of the meaning field, dynamics of social structure include a wide range of problems of social communication at interpersonal, group and mass communication levels. Meaning making transformation in the form of widely spread interpretations, “simulacra” (Baudrillard, 1995; Deleuze, 1990, p. 46) becomes a communicative conduct activator for subjects of communication (both the initiators-senders and primarily passive recipients), and affects the functioning and internal integration of the elements of the system of social communication which means it affects the strength of its impact on the social environment by which it is generated. The environment counteracts and in the context of information society this counteraction turns into the alienation of communication as the process, as a formed system, and in fact as the opposite to understanding. Total misunderstanding is at the very heart of uncontrolled social process from migration to terrorism. This is exactly the communication misunderstanding, not always due to insufficient knowledge or culture, but mostly due to the reluctance to understand.

Meanings are a product of human consciousness, and through communication they can become consensual and universal. In the mental layer of culture they are “pressed together” into a set of a priori values, archetypes, behavioral patterns, phraseological units and so on (Kotsyubinskaya, Teplova, 2014). They manifest themselves to individuals in the process of socialisation, as collective consciousness, objectively existing system of values and norms to be absorbed. This “meaningful matter” is alienated in the process of social relations development. As noted by Jurgen Habermas, “in the forms of communication through which we reach an understanding with one another about something in the world and about ourselves, we encounter a transcending power” (Habermas, 2003, p. 10). Does this mean that the alienation of communication is inherent in the very nature of communication? In fact, we can analyse the message (a letter, an online post, a book, a picture, etc.) as a form of thought which has been turned into an object and then alienated. And it is alienated intentionally and voluntarily. But the recipient is dependent. And in the era of globalisation, people are increasingly becoming the recipients (and your computer constantly reminds you of this through contextual advertising).

So, the alienation of communication is objectively conditioned by two main factors: the nature of communication and the dependent position of subjects who are deprived of the right to initiate communication, which leads to antagonistic contradiction-unity of communication and alienation, in which the latter is growing due to the increase in global communication.

3. WAYS TO COGNISE THE ALIENATION OF COMMUNICATION

3.1. A tentative typology of the alienation of communication

Discussion on the typology of the alienation of communication requires some prior clarification, first of all, with regard to the approaches to the typology construction. In one approach, the typology is based on some theoretical positions. This involves creating an ideal model of the object under consideration, which is approached as a system with certain structural levels and structure forming connections between them. In addition, generalised attributes of an object set are selected and a principle of description of this set is determined. This approach to the typology is a method of cognising which operates with an idealised type as an abstract construction. In our case this idealised type is a type of the alienation of communication.

Taken as an eternal ideal essence this type precedes communication, exists in its depth and appears as its prototype. Following this line which roots back to Plato and Aristotle, the prototype of communication is the alienation of meaning, as the need in the movement of the meaning initiated by a subject: personal, social, or substantial one. By sphere of consciousness, such as that described by Mamardashvili and Piatigorsky (Mamardashvily, Piatigorskii, 2011). Any variability here is the becoming, the intermediate stage, imperfection of the meaning.

Methodologically the type of the alienation of communication allows one to reconstruct the most significant characteristics of the elements of the social communication system under consideration. In this case attribution of the alienation of communication as the dominating type of communication interaction makes it in theory a representative of the entire set of these interactions. The typology of the alienation of communication is an abstract structural typology, which, above all, allows us to analyse the relationship of alienation between communication elements. This approach is not intended to be an exhaustive mapping of the system of the social communication, as a theoretical typology can contain comparative and historical, generative or other criteria, but it has, according to the authors, the most relevant potential for the study of processes of the alienation of communication.

In another approach, the typology is based on an empirical position. At its core is the ascent from the concrete to the abstract through the generalisation, systematisation and data interpretation. The empirical typology of the alienation of communication makes it possible to examine the indicators, functions, and connections between elements of the social

communication systems as objects of reality, to compare them, to describe and classify them typologically and by this to verify the above methodological assumption.

Probably it is not for the first time that researchers ask whether it is possible to create an integral typology in general and the integral typology of the alienation of communication in particular. On the one hand, a type of the alienation of communication is a sort of a structure of communication being, it is an abstraction. On the other hand it is an empirically observable kind of communication. The approach to communication as an event leading to the co-existence, allows the authors to take as a principal criterion for the typology the nature of the “clash” of individual and social in determining the meaning of communication: the original sense and the following reading of this meaning; the intention and the degree of the twisting of the meaning due to the mismatch of social and communication needs, interests and values of the subjects of communication; the impact of this clash on the nature of social interaction. “The twisting of the meaning” can be a short name for this criterion.

To put this construct into a multidimensional social space, it is necessary to determine the set of essential features of the alienation of communication that identify a particular character of social communication relations as conditioned by the type of the alienation of communication. Two phenomena that have already been studied in science can serve as illustrative examples: the “new generation gap” (Weiss, Schneider, 2014) and the Internet addiction (Varlamova, Goncharova, Sokolova, 2015). The above mentioned gap is associated by its authors with the very fact that “digital natives often neither see nor hear their elders because, from a communications standpoint, digital immigrants and digital natives are literally “not in the same room” (Weiss, Schneider, 2014). In the second case, Internet addiction is directly related to a negative transformation of social ties up to their rupture (see Appendix).

Both phenomena, on closer examination, may be interdependent. It is important for us to fix them as markers of the alienation of communication which gradually becomes the primary cause of rejection and exclusion of any other. Increasing social estrangement manifests itself today at all levels of the social structure and in all spheres of reality. Among the growing trends there are divorce, alienation of parents and children, teenage suicide, involvement in virtual relationships, alienation of otherness, of “the other”, of “the unlike”, i.e., the so-called “HIV carriers” in the post-Soviet countries (Leshchenko, 2016), international conflicts, migration flows, information warfare and many other social facts. All these social and cultural processes are largely due to a variety of social estrangement, such as the alienation of communication. Consequently, all this can be considered as its markers.

The features and then the types of the alienation of communication can be classified on various criteria. Here are some of them. Following the aforesaid authors’ criterion of “the twisting of the meaning” it is necessary to identify the degree of misunderstanding between the subjects of communication and its critical level, the achievement of which leads to social change. When dealing with any communicative interaction whether at an interpersonal, group or mass level, the authors find it important to pay attention to its character. What it is: an imitation, a dialogue or direction? The degree of understanding is, of course, influenced by an attempt to control communication (in the sense of its (not) adequate understanding), and therefore, the meaning and the nature of its movement. The lack of control and regulation has the same effect. The

“meaninglessness of communication” is one of the types of its alienation. It may also be conditioned by imitation. “Purposeful twisting of the meaning of communication” is another type. It can be formed in the process of a dialogue, when the original focus on the achievement of mutual understanding is undergoing a transformation into a conflict.

It is evident that features of both types can be observed at all levels of the social structure. The scope of this article does not allow the authors to give a detailed picture, so we define only reference points that can be markers of the alienation of communication: communication deficit – communication gap – deviant behavior – anomie – social passivity; unreliability of

communication – disbelief – rejection – abruptness – aggression; redundancy of communication – communication stereotyping – communication addiction – transformation of mass consciousness – transformation of values. These reference points are not always in a rigid linear sequence, a “tree” (fractal) structure is also possible. These series will be further refined through specific empirical studies. The authors argue that finally they may be reduced to two main types of the alienation of communication: the meaninglessness of communication and purposeful twisting of the meaning of communication.

3.2. The approaches to the study of the alienation of communication

Global communication system generated by an absolute sociogenic need is inherently able to undergo any changes dictated by its self-sufficiency and development. The reality, with new people coming into the world time and again, reproduces this need incessantly, but the formed communication system satisfies this need in a different way. The reality of signs is replaced with the reality of alienated meanings.

The emergence of this “reality” is a consequence of a pervasive, and in a sense, infinite phenomenon of the alienation of communication that has become the dominant type of social estrangement and has acquired the quality of autotelia. The world of alienated meanings is in opposition to a community of interacting people, forcing them to adapt to its own laws and dictating them its rules. This secondary world, which is in fact simulated, is rapidly gaining superiority. The trends in the transformation of the alienation mentioned by the authors address the issue of the very foundations of the human existence and are embodied into the alienation between the state and society and into the alienation between the individual and the society. The latter is a direct consequence of a failed socialisation, resocialisation, acculturation, which are deformed due to the alienation of communication. There is almost a direct indication of the relationship of alienation and social communication in the dichotomy of “anti and pro-social communication” (Kinney, Porhola, 2009).

It is obvious, that the study of the phenomenon of the alienation of communication requires a multidisciplinary approach. The inseparability of the essence and existence of the alienation of communication requires, first and foremost, a harmonious connection of philosophical and sociological foundation in a scientific comprehension of its subject field. In a search of a compromise or grounds for integration likely paradigmatic areas for this might be: the philosophy of communication, social philosophy; theoretical or historical sociology. George Gurvich insisted that philosophy and sociology should not be confused, as it leads to the dissolution of them in each other. According to him these subjects are in relationships of dialectical complementarity and implication, and only dialectics allows for a systematic approach to studying “total social phenomena” (Gurvich, 2001, pp. 288-289). After George Gurvich and Alexander Zinoviev (Zinoviev, 2002; 2006) the authors support this position on the heuristic capacity of dialectics in cognition of the alienation of communication.

Further deployment of the multidisciplinary subject field of research into the alienation of communication includes the following aspects of the phenomenon: a) origin, essence and manifestations forms of the alienation in the social communication system; b) regularities of formation and development of this synthetic phenomenon, its impact on the social structure, the individual and public consciousness; c) updating, clarifying, designing general and special categories and concepts in the process of reflection on this phenomenon; d) features of structuring and functioning of an alienated communication environment as an actual and virtual reality; e) humanitarian expertise and social forecasting.

A possible explanatory model of this subject field can be “a fractal of the alienation of communication”. Its topological qualities are a twisted meaning and a modified character of the movement of meanings. In the information society these qualities are easily reproduced in all branches of the self-similar figure, because the traditional media and new media contribute to

multiple reproduction of twisted meanings. Structuring communication chaos a fractal of the alienation of communication seems a protective mechanism of alienation, and its concrete manifestation. And at the same time it is a mechanism for systematic changes of social communication.

The fractal of the alienation of communication is a special case of the fractal of communication, the basis of which is the meaning making. It is the fractal of communication that allows for tracing the movements of unit of meaning from the consciousness of the individual through the totality of social relations to public consciousness, and finding out how the system of social communication works. Through the fractal approach any problem in this area is classified as characteristic, aspect, intermediate or final result of the functioning of this self-reproducing system.

4. CONSLUSION

Taking into account the substantial negative impact of the alienation of communication on the social structure of the information society, the authors believe the research into formation processes of alienated meanings to be an important preventive measure for a well-timed reduction of large-scale social problems, such as the destruction of public, national or cultural identity, uncontrolled migration, social aggression. This will help avoid the devastating effects and make the social changes which are inevitable in the era of globalisation less disruptive.

LITERATURE:

1. *Anti and Pro-Social Communication: Theories, Methods, and Applications*. T. A. Kinney, M. Porhola. (2009). New York: Peter Lang Publishing Inc.
2. Baudrillard, J. (1995). *Simulacra and Simulation. The Body, In Theory: Histories of Cultural Materialism* (First Edition). MI: University of Michigan Press.
3. Carey, J. W., Adam, G. S. (Foreword). (2008). *Communication as Culture, Revised Edition: Essays on Media and Society* (Second Edition). New York: Routledge.
4. Castells, M. (2015). *Networks of Outrage and Hope: Social Movements in the Internet Age* (Second Edition). Cambridge: Polity.
5. Curran, J., Fenton, N., Freedman, D. (2016). *Misunderstanding the Internet: Communication and Society* (Second Edition). New York: Routledge.
6. Deleuze, G. (1990). *The Logic of Sense* (Revised ed. Edition). New York: Columbia University Press.
7. Durkheim, E. (1962). *The Rules of Sociological Method*. New York: The Free Press of Glencoe.
8. Gurvich, G. D. (2001). *Dialectics and Sociology*. Krasnodar: Kuban State University.
9. Habermas, J. (2003). *The Future of Human Nature* (First Edition). Cambridge: Polity.
10. Kotsyubinskaya, L., Teplova, L. (2014). The Cognitive Structure of the Language Unit (Based on Studies of English Phraseological Units). *Bulletin of the Pushkin Leningrad State University. Series Philology*, Issue 7, № 1, pp. 38–47. St. Petersburg: Pushkin Leningrad State University.
11. Leshchenko, T. (2016). Fluctuations of Alienation in Media Representations of the Concept of “Health”. *Health of the Russian Society in the XXI Century: the Sociological, Psychological and Medical Aspects*. Book of Proceedings of X Sorokin Reading, pp. 15-

17. Moscow: Lomonosov State University. Retrieved 12.04.2016 from http://www.socio.msu.ru/documents/science/Sorokinskie_sbornik_%_2016.pdf.
12. Leshchenko, T. (2015). The Philosophy and Sociology of the Alienation of Communication. *Education and Society Journal*, 5 (94), pp. 117–119. Orel: The Academy of Pedagogical and Social Sciences.
13. Losev, A. (2008). *The Thing and the Name. The Quintessence*. Moscow: Abyshko's Publishing House.
14. Luhmann, N. (2000). *The Reality of the Mass Media: Cultural Memory in the Present*. Cambridge: Stanford University Press.
15. Mamardashvily, M., Piatigorskii, A. (2011). *Symbol and Consciousness*. Moscow: Azbuka: Azbuka-Atticus.
16. Marx, K. (2010). *Economic and Philosophic Manuscripts of 1844 and other early philosophical works*. Moscow: Academic project.
17. Matheson, D. (2005). *Media Discourses: Analysing Media Texts* (First Edition). England: Open University Press; New York: Two Penn Plaza.
18. Orlova, I., Osipova, E., Sokolova I. (2014). *The Sociology of Mass Communication*. Moscow: Academy.
19. Sokolov, A. (2002). *The General Theory of Social Communication*. St. Petersburg: Mikhailov's Publishing House.
20. Sorokin, P. (2006). *Social and Cultural Dynamics*. Moscow: Astrel.
21. Sztompka, P. (2007). *Visual Sociology: Photography as a Research Method*. Moscow: Logos.
22. Varlamova, S., Goncharova, E., Sokolova, I. (2015). Internet Addiction of Youth in Megacities: Criteria and Typology. *The Monitoring of Public Opinion: Economic and Social Changes Journal*, 2 (125), pp. 165-182. Moscow: Russian Public Opinion Research Centre (VCIOM).
23. Weiss, R., Schneider, J. P. (2014). *Closer Together, Further Apart: The Effect of Technology and the Internet on Parenting, Work, and Relationships*. Arizona: Gentle Path Press. Retrieved 25.05.2016 from <http://www.gentlepath.com>
24. Zinoviev, A. (2006). *The Factor of Comprehension*. Moscow: Algorithm: Eksmo.
25. Zinoviev, A. (2002). *The Logical Sociology*. Moscow: Socium.

APPENDIX

Following on the next page

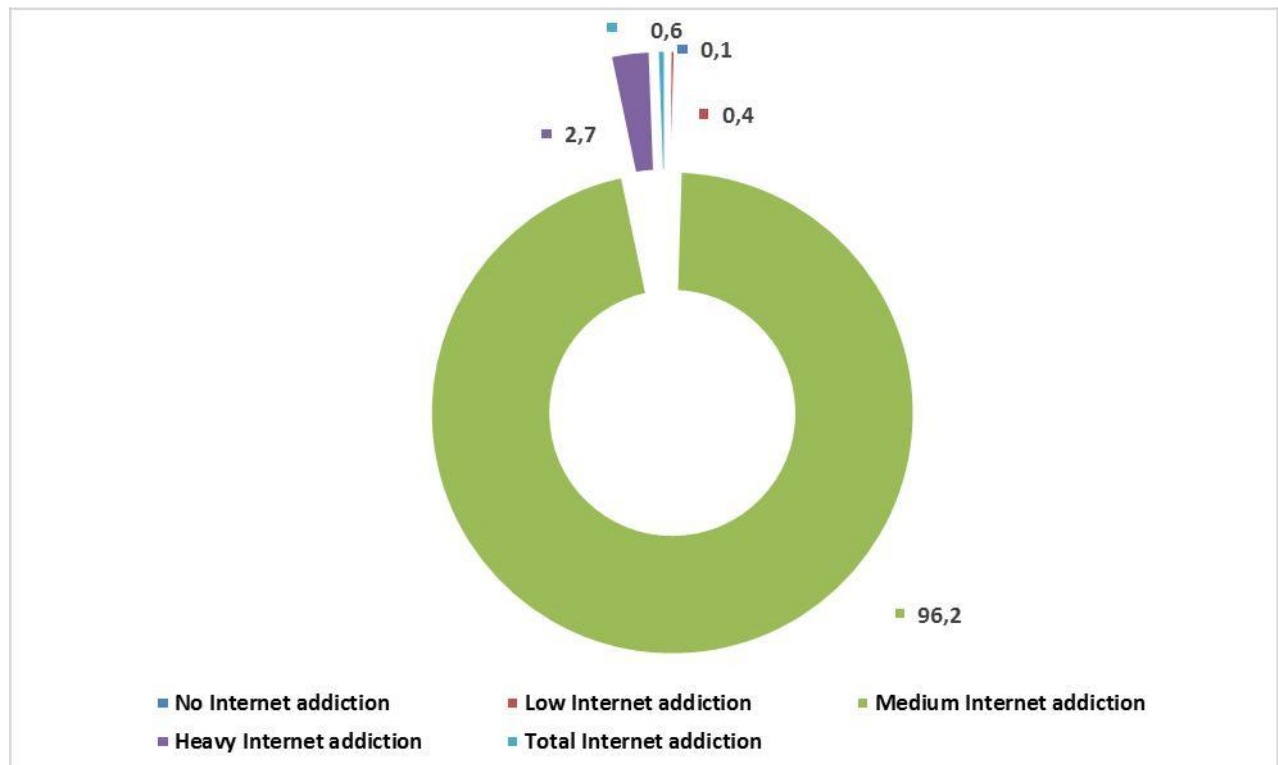


Figure 3. The Breakdown of Different Types of Internet Addiction Among Youth in the Megacities Worldwide (% of total respondents) (Varlamova, Goncharova, Sokolova, 2015)

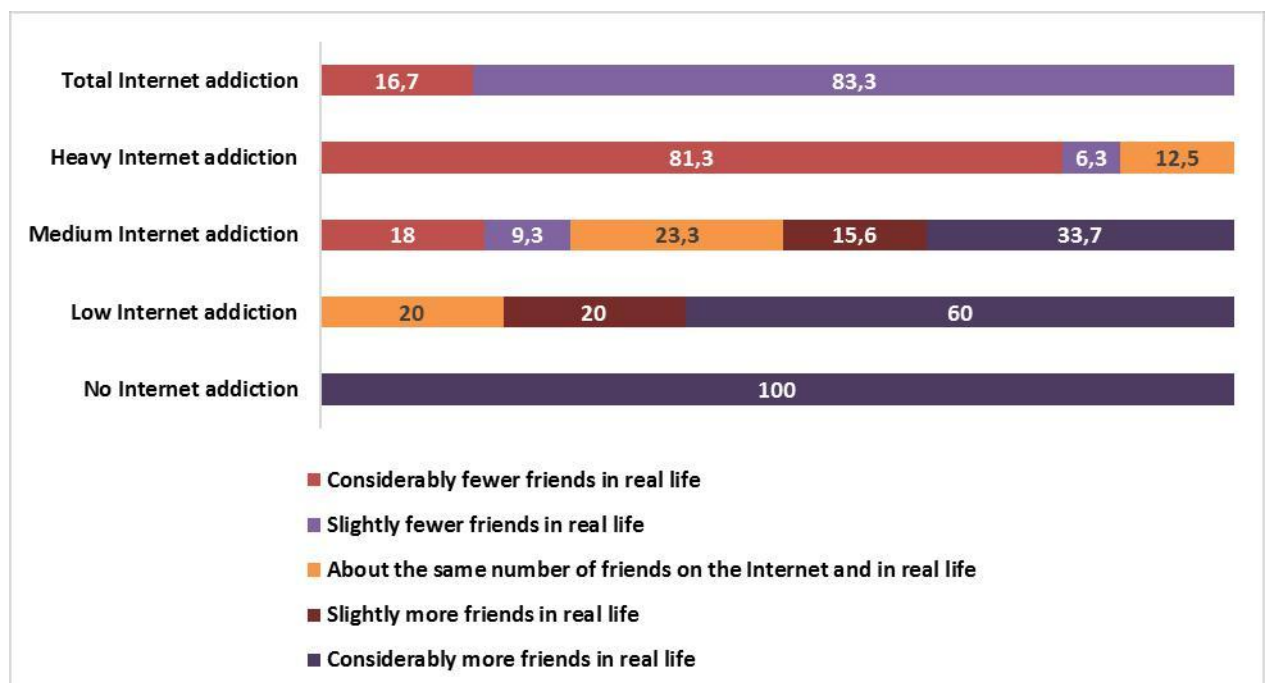


Figure 5. The Correlation of the Number of Friends in Real Life and on the Internet Among Youth in Megacities (% of respondents in each group) (Ibid)

IMPACT OF ICT CAPITAL SERVICES ON PRODUCTIVITY GROWTH ACROSS CENTRAL AND EASTERN EUROPEAN COUNTRIES – WHERE HAVE ALL DIGITAL BENEFITS GONE?

Tinatini Akhvlediani

*University of Warsaw, Faculty of Economic Sciences
takhvlediani@wne.uw.edu.pl*

ABSTRACT

*The paper aims to examine the contribution of ICT capital services on productivity growth in the Central and Eastern European (CEE) countries relatively to the old EU member states (EU10: Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Spain, and the United Kingdom). Statistical analysis based on the EU KLEMS database clearly demonstrates that while in the EU10 ICT capital services bring the largest contribution to the labour productivity, in CEE economies non-ICT services contribute productivity growth. However, regression results of quasi-Maximum Likelihood (QML) estimator indicate that in CEE economies positive effects of ICT capital services could be hidden in the TFP contribution. **Keywords:** Central and Eastern Europe, ICT, total factor productivity.*

1. INTRODUCTION

“You can see the computer age everywhere but in the productivity statistics” – Robert Solow, 1987

Already in the nineties, Porter (1990) in his hypothesis stated that economic prosperity of a nation in the twenty-first century might not be necessarily inherited due to the access to natural resources and labour but rather due to the innovative activities. In our century, in the era of information technology revolution and Internet, to track the phenomenon of economic growth there is indeed the necessity to put the research focus on technological progress and innovation. This idea comes already from the introduction of neoclassical Solow growth model (1956), which implied that due to the decreasing marginal product of capital, the output growth in the long run should be achieved by inventing new technologies that could lead to the higher capital or labor productivity (LP). In other words, the Solow framework suggests that to forecast the growth rate of aggregate output, it is essential to forecast the rate of technological change, which in turn determines the rate of capital deepening and hence the growth rate of labor productivity. While the impact of technological progress on labour productivity may seem clearly positive and easy to be observed, the literature reveals that the technology effects are in fact very puzzling for economists. As Robert Solow stated, computers were visible everywhere but in the productivity statistics (Solow, 1987). Most considerably, the literature reveals that compared to the USA, the growth of total factor productivity (TFP) and the ICT contribution in the services sector in the EU are clearly lower. Additionally, while, most of the studies compare the EU founder countries to the US economy, the performance of the new EU member states is not studied systematically.

Following the most recent advancement in the literature, the paper aims to fill the gap in the literature by extending analysis for the Central and Eastern European (CEE) economies. Statistical analysis based on the EU KLEMS database demonstrates that while in the old EU member states (EU10: Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Spain, and the United Kingdom) ICT capital services bring the largest contribution to the labour productivity, in CEE economies non-ICT services contribute productivity growth. However, regression results of quasi-Maximum Likelihood (QML) estimator indicate that in CEE economies positive effects of ICT capital services could be hidden in the TFP contribution.

The remainder of the paper is organized as follows: second section reviews literature; third section describes data and provides statistical analysis; fourth section reports estimation results and finally fifth section concludes the findings of the paper.

2. LITERATURE REVIEW

The basic theoretical framework for the analysis of ICT contribution in the output growth, LP or TFP is the growth accounting, that describes the economy by an aggregate Cobb-Douglas production function:

$$Y = AK^{\alpha} L^{1-\alpha} \quad (1)$$

where Y is output, K is capital input, L is labour input and α and $(1 - \alpha)$ are, respectively, the elasticities of output with respect to capital and to labour. For empirical purposes this expression can be given as follows:

$$\Delta \ln(Y/L) = \alpha[\Delta \ln(K/L)] + \Delta \ln A \quad (2)$$

where $\Delta \ln(Y/L)$ is the rate of growth of labour productivity, $\Delta \ln(K/L)$ stands for capital deepening, and $\Delta \ln A$ for improvements in TFP. From these equations we can also easily get the measures for TFP growth in the following way:

$$\Delta \ln A = \Delta \ln Y - \alpha \Delta \ln K - (1 - \alpha) \Delta \ln L \quad (3)$$

In other words, as the equation (3) indicates TFP stands for all the gains in output, that can not attributed to the other quantified inputs of production. It is remarkable, that given the particular research interests, the basic equation of the production function given by the equation (1), can be easily extended by inclusion of the additional inputs, for instance ICT capital, labor quality, etc. Equation (4) illustrates the extension of the simple growth accounting equation:

$$\Delta \ln(Y) = \alpha \Delta \ln(nICTk) + \beta \Delta \ln(ICTk) + \gamma \Delta \ln(L) + \delta \Delta \ln(H) + \Delta \ln A \quad (4)$$

where $nICTk$ indicates non ICT capital, $ICTk$ indicates ICT capital, L stands for the labor, H presents the labor quality and $\Delta \ln A$ again describes the TFP growth. In other words, equation (4) disaggregates capital into ICT and non ICT capital and labor into the unskilled labor and human capital. Therefore the measures of TFP, calculated by taking into account these additional inputs for production, becomes more precise to indicate purely technological effects. The early studies in the 1970s and 1980s elaborating the impact of ICTs on productivity yielded quite counterintuitive results. Namely, there was found either negative or zero impacts of ICT investment on productivity. Later number of studies employing the firm level data for a single country (due to the limited data availability) showed the positive correlation between ICT investments and productivity growth (Baldwin, et al. 2004, Sabourin, 2002), although there was little evidence on the positive impacts of ICT at the industry level. Moreover the cross country analyses indicate that the ICT contribution vary considerably across countries and does not allow to derive the clear conclusions about the effects of ICT. For instance, Stiroh (2002) compares the methods, data and results of around 20 studies and finds that estimates of ICT elasticity depend on the application of the different econometric method, the sample period and the level of aggregation. The paper also underlines that studies which report excess returns to ICT investments do not account for the quality of the workforce, or other improvements in the knowledge accumulation related to ICT usage. Besides, the author states that once studies control for unobserved heterogeneity by introducing fixed effects, the

ICT coefficient falls considerably. Ambiguous results are also found by O'Mahony and Vecchi (2005). Authors examine the impact of ICT capital on output growth for the US and UK non-agricultural market industries. Employing the traditional panel data analysis the study fails to find a positive contribution. However, once applying pooled estimates, the paper shows positive and significant return of ICT capital on output growth.

Other studies concerning the cross country evidence (Colecchia and Schreyer, 2001; Van Ark, et al., 2003; Schreyer, et al. 2003) show that ICT investment contributed to the output growth in most OECD countries in the 1990s, however this contribution vary considerably across countries. Studies examining ICT effects at the industry level, (for instance Van Ark, et al., 2002; Pilat, et al., 2002; Inklaar, et al., 2003) demonstrate that the ICT-producing manufacturing sector contributed substantially to TFP growth in certain OECD countries. Based on an econometric approach Spiezia (2012) estimates the contribution of three types of ICT (computer, software and communication) and non-ICT investment in 26 industries (the whole business sector) in 18 OECD countries over the period 1995-2007. Estimations show that in one-third of the countries in the sample the contribution of ICT investment was bigger or equal to the contribution of non-ICT investments and in most countries, computing equipment provided the largest contribution. Besides, the findings of the paper revealed that for number of the EU countries TFP increased in the ICT producing industries whereas it decreased for the total business sector.

Furthermore, ICT contribution in the services sector was found to be quite ambiguous. OECD study (2004) reveals that there is the little evidence that ICT use has led to stronger productivity growth in the services sector, the United States and Australia being exceptions (OECD, 2004). Moreover, Crafts (2008) finds that generally European countries experienced negative MFP growth in market services between 1995 and 2005. Ark and O'Mahony (2008) provide very informative and precise statistical analysis in this direction and show that productivity growth in the US is a combination of high levels of investment in information and communications technology in the second half of the 1990s, followed by rapid productivity growth in the market services sector of the economy in the first half of the 2000s. Authors also demonstrate that the productivity slowdown in the EU is largely the result of slower multifactor productivity growth in market services.

While questioning why contribution of ICT may take the time to show up in the EU economy and in market services sectors, Crafts (2008) states that the remarkable importance comes on the firms' own experiments and product development based on the new capabilities that ICT afford. As the author discusses, without so called "co-invention" the economic impact of ICT may be limited, although this process of "co-invention", has a slower pace than the technological invention itself and thus the contribution of ICT needs time to appear. Following the same idea, the broader approach to explain the phenomenon of ICT effects, considers ICT as a general purpose technology (GPT) (Brynjolfsson and Hitt, 2000, 2003, Basu et al. 2003, Oliner et al. 2007, cited in Wang and Pearson, 2014). These studies mainly underline that all the advantages related to gathering, processing, and transmitting information that represents a new GPT might be fully utilized through complementary investment in both tangible ICT equipment and software and intangible capital such as organizational changes in the firms. Most recently, Wang and Pearson (2014) bring valuable insights in the empirical analysis of the issue at hand. Namely, authors state that due to the complementarity between tangible ICT capital and intangible organizational capital, ICT investment and ICT capital can serve as good proxies for unobserved intangible investment and intangible capital, respectively. Their study demonstrates the investments in ICT done by the second half of the 1990 yielded the positive impacts on the TFP in the early 2000s.

To conclude, the literature reveals that the EU considerably falls behind the US in terms of ICT uptake. The reasons of the slower employment of ICT benefits could be not exactly the small

investment in ICT itself, but smaller efforts of firms to co-invent – to invest in both tangible ICT equipment and software and intangible capital such as organizational changes in the firms. Additionally, mostly market services demonstrate the slow TFP growth. While, most of the studies compare the EU founder countries to the US economy, the performance of the new EU member states is not studied systematically. One reasons of this gap in the literature is limited data availability on growth accounting of the CEE countries. This paper aims to fill the gap in the literature and to compare performance of the new and old EU member states in terms of effects of ICT capital services on TFP growth.

3. DATA DESCRIPTION AND STATISTICAL ANALYSIS

The data for the analysis is taken from the EU KLEMS Growth and Productivity Accounts (www.euklems.net). This database includes measures for ICT capital developed for 25 individual EU member states, from 1970 to 2007. It is remarkable that together with ICT capital and ICT services, the dataset also provides information about labor composition (LC, also known as “labor quality”) - cross-classified labor input by educational attainment, gender, and age into 18 labor categories. However the coverage of the new EU member states is rather limited. While the data on growth accounting covers the 10 EU countries (EU10: Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Spain, and the United Kingdom) for longer period of time, from CEE countries it only covers Czech Republic, Hungary and Slovenia from 1995 to 2004. Therefore, given the data availability, I take EU10 to stand for the average indicators across the old EU member states and Czech Republic, Hungary and Slovenia as representatives of the CEE economies.

Following Von Ark and O'Mahony (2008), I take growth rate of the real output in the economy as the sum of hours worked and the labor productivity. I also decompose labor productivity itself into contributions from labor composition, capital services (sum of contributions of ICT and non-ICT capital services) and total factor productivity. I also present the contribution of knowledge economy into labor productivity calculated as the sum of contributions of labor composition, ICT capital services and total factor productivity.

Table 1 presents the contribution of hours worked and labor productivity to the real output growth of the total economy in two periods: from 1996 to 2001 and from 2002 to 2007. As the table indicates, in the first as well is in the second periods, both Hungary and Slovenia are outstanding by the growth of the real output mainly because of substantial increase in labour productivity while hours worked bring minor or even negative contribution. Czech Republic falls behind not only the average performance of the EU10 but also Hungary and Slovenia in 1996-2001 but catches up with these two CEE countries in the second period. Additionally, in the EU10 mainly ICT capital services contribute labor productivity, while in Slovenia and Czech Republic non-ICT capital services are more contributive. As for Hungary, in the first period, labor productivity is explained by considerably large total factor productivity contribution. In 2002-2007, TFP contribution decreases in Hungary relatively to the first period, but again in all of the three countries the biggest contribution comes on non-ICT capital services. In the EU10, similarly to the first period, in 2002-2007 again ICT capital services contribute the most to labour productivity.

Table following on the next page

Table 1. Contributions to Growth of Real Output in the Market Economy (in annual average growth rates, in percentage points), EU10 and CEE (own calculations based on EU KLEMS database)

	1996-2001				2002-2007			
	EU10	Czech Republic	Hungary	Slovenia	EU10	Czech Republic	Hungary	Slovenia
Market economy	2,51	1,07	4,32	3,96	1,92	4,47	3,54	4,19
Hours worked	0,69	-0,60	0,52	-0,29	0,46	0,41	-0,05	0,00
Labor productivity	1,83	1,67	3,80	4,26	1,46	4,06	3,59	4,19
Labor Composition	0,19	0,23	0,32	0,23	0,13	0,37	0,90	1,41
Capital Services	1,34	2,37	0,10	2,93	0,90	1,51	1,22	2,12
a. ICT capital services	0,58	0,92	0,10	0,44	0,29	0,15	0,51	0,32
b. Non-ICT capital services	0,76	1,46	0,00	2,49	0,61	1,35	0,71	1,80
Total Factor Productivity	0,30	-0,93	3,38	1,10	0,43	2,19	1,46	0,65
<i>Knowledge Economy</i>	1,06	0,21	3,80	1,77	0,85	2,71	2,88	2,39

To deliver more smooth statistics I furthermore average growth rates over the whole period of 1996-2007 in Table 2. Although the results are quite similar for the whole period of time. Again in the EU10 the largest contribution comes on ICT capital services, while in CEE on non-ICT capital services. Additionally, likewise in the previous case, TFP brings considerable contribution in labor productivity in CEE for the whole period as well.

Table 2. Contributions to Growth of Real Output in the Market Economy (in annual average growth rates, in percentage points), EU10 and CEE in 1996-2007 (own calculations based on EU KLEMS database)

	CEE	EU10
Market economy	3,59	2,22
Hours worked	0,00	0,58
Labor productivity	3,59	1,64
Labor Composition	0,58	0,16
Capital Services	1,71	1,12
a. ICT capital services	0,41	0,44
b. Non-ICT capital services	1,30	0,69
Total Factor Productivity	1,31	0,36
<i>Knowledge Economy</i>	2,29	0,96

I should notice that TFP contribution across CEE seems quite implausible. First of all, given the growth accounting framework, whatever is not assigned to the production inputs, labour quality or capital services, is assumed to be contribution of TFP. Second, we may face some measurement problems since it is very difficult to measure output in services than in goods-producing industries. As Von Ark and O'Mahony (2008) explain in their analysis, most measurement problems stem from the fact that service activities are intangible, more heterogeneous than goods, and often dependent on the actions of the consumer and the producer. Third, data collection and administration by the nineties in the CEE countries at the national level might also be questionable. Overall, if the ICT capital services are not measured well enough then contribution of TFP to productivity growth should contain effects of ICT capital services in its values. This statement could be tested by simple regressions based on the

growth accounting framework given by equation (4) in the second section of the paper. More precisely, since the TFP contribution to output growth calculated by the EU KLEMS database is free of the contributions from labor quality or ICT capital and services inputs, ICT capital and non-ICT capital services could be regressed on growth of TFP contribution in the output.

4. ESTIMATION RESULTS

To test the measurement bias stated above, I construct the panel data to account for the country specific factors that would derive more plausible results compared to the cross section analysis. Following the discussion in a number of studies, (Basu and Fernald, 1997, 2001) TFP can not be considered as an accurate measure of technology without averaging the growth rate over a number of years to account for both business cycle peaks and troughs. Therefore, I use the average growth rate of TFP as a proxy for its trend growth over the following three periods: 1990-1995; 1996-2001 and 2002-2007. As for independent variables, I take ICT capital services and non-ICT capital services measured in volume indices. Following the recent findings of the literature, stating that ICT capital may yield positive impact on productivity with some time lag that is necessary for firms to invest in their organizational changes for ICT uptake, I take both of the independent variables by the beginning of each period.

Since the panel sample contains country specific characteristics (heterogeneities) of the EU member states, ordinary least squares (OLS) will suffer from simultaneity bias due to the correlation between the joint error term (error term and country characteristics together) and explanatory variables. In this case, fixed effects or random effects estimator is an adequate methodology. Yet, since dependent variable is average growth rate of TFP, empirical equation will form dynamic model. In the dynamic panel-data model, the presence of lagged values of the dependent variable together with the individual effect, even with the assumption that the error term is the independent and identically distributed (i.i.d.) makes both fixed and random effects estimators inconsistent because of well known Nickell (1981) bias. OLS regression also produces inconsistent estimates, because of the correlation between the lagged values and the error term.

In this case I find proper to employ transformed/quasi maximum likelihood (QML) for the dynamic fixed effects model. Among several advantages of QML, Hsiao, Pesaran and Tahmiscioglu (2001) underline that compared to generalized method of moments estimator (GMM) QML uses higher number of instruments and does not require the strict condition of orthogonality to hold. Authors also conduct Monte Carlo studies to evaluate the finite sample properties of the transformed maximum likelihood, GMM, minimum distance estimator (MDE) and instrumental variable estimator (IV). Estimations show that likelihood approach appears to dominate the GMM approach both in terms of the bias and root means square error of the estimators and the size and power of the test statistics. Furthermore, to verify that individual effects are indeed not random, I apply post-estimations using Hausman test that confirms randomness of country heterogeneities.

Estimation results are reported in Table 3. The first column of the table reports estimations done for CEE (only Czech Republic, Hungary and Slovenia due to the data availability). Likewise, the second column reports estimations done for the EU10 (Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Spain, and the United Kingdom).

Table following on the next page

Table 3. Estimation results (own calculations based on EU KLEMS database)

Variables	CEE	EU10
log (ICT capital services)	0.221** (2.68)	0.191* (2.37)
log (non-ICT capital services)	0.290 (1.32)	0.317 (1.41)
Lagged_TFP	0.281*** (3.93)	0.245*** (3.44)
constant	-2.149* (-2.11)	-0.0326*** (0.0074)
Number of groups	204	216
Number of observations	511	549

As estimations indicate, while non-ICT capital services do not yield statistically significant coefficients, ICT capital services indeed have positive and statistically significant impact on the contribution of TFP in output growth for both groups of countries. Although, the magnitude of coefficients are higher for the CEE countries that only underlines that considerably large values of TFP contribution could contain positive effects of ICT capital services. More precisely, regression results show that in ceteris paribus condition, ICT capital services explain 22% and 19% of growth of TFP contribution in the output growth in CEE and the EU10 respectively.

5. CONCLUSION

The literature on ICT contribution based on growth accounting framework reports different findings given the data, sample or econometric techniques of analysis. While, most of the studies examine the core 10 EU founder countries to the US economy, the performance of the new EU member states is not studied systematically. To fill this gap in the literature, the paper aimed to examine the effects of ICT capital services on productivity in CEE relatively to the old EU member states.

Statistical analysis based on the EU KLEMS database demonstrated that unlike to the EU10 where mainly ICT capital services bring the largest contribution to the labor productivity, in CEE economies, non-ICT services contribute productivity growth. Additionally, data reported considerably large values of TFP contribution in labor productivity across CEE. To explain these remarkable values of TFP contribution, the paper discussed the possible inclusion of positive effects of ICT capital services in TFP contribution. To test this suggestion, based on the growth accounting framework, I regressed ICT and non-ICT capital services on TFP contribution in the productivity growth. Regression results of QML estimator indicated that ICT capital services yield indeed positive and statistically significant impact on TFP contribution. In other words, while contribution of the non-ICT capital services to labour productivity in CEE countries could be reported by the statistical analysis, impact of ICT capital services in CEE economies could be hidden in TFP contribution.

LITERATURE:

1. Arellano, M. and Bond, S.R. 1991. Some tests of specification for panel data: Monte Carlo evidence and application to employment equations, *Review of Economic Studies* 58, 227-297.
2. Baldwin, J.R., Sabourin, D. (2002), "Impact of the Adoption of Advanced Information

- and Communication Technologies on Firm Performance in the Canadian Manufacturing Sector”, *STI Working Paper 2002/1*, OECD, Paris.
3. Baldwin, J.R., Sabourin, D., Smith, D. (2004), “Firm Performance in the Canadian Food Processing Sector: the Interaction between ICT Advanced Technology Use and Human Resource Competencies”, in OECD (2004), *The Economic Impact of ICT – Measurement, Evidence and Implications*, OECD, Paris: 153-181.
 4. Basu, S., Fernald, J., Oulton, N., Srinivasan, S. (2003), “The Case of the Missing Productivity Growth, or Does Information Technology Explain Why Productivity Accelerated in the United States but Not in the United Kingdom?” *NBER Macroeconomics Annual*, 18: 9–63.
 5. Brynjolfsson, E., Hitt, L., M. (2003), “Computing Productivity: Firm-Level Evidence.” *Review of Economics and Statistics*, 85(4): 793–808.
 6. Brynjolfsson, E., Hitt, L., M. (2000), “Beyond Computation: Information Technology, Organizational Transformation and Business Performance.” *Journal of Economic Perspectives*, 14: 23-48.
 7. Colecchia, A., Schreyer, P. (2001). “The Impact of Information Communications Technology on Output Growth”, *STI working paper 2001/7*, OECD, Paris.
 8. Corrado, C., Hulten, C., Sichel, D. (2006), “Intangible Capital and Economic Growth”, *NBER Working Paper 11948*.
 9. Crafts, N. (2008). “What Creates Multi-factor Productivity”, *ECB, Banque de France and The Conference Board conference "The Creation of Economic and Corporate Wealth in a Dynamic Economy"*, Frankfurt, January 2008.
 10. Hausman, J.A. (1978), “Specification tests in econometrica”, *Econometrica* 46: 1251-1271.
 11. Hsiao, Ch., Pesaran, M. H. and Tahmiscioglu, K. A. (2002), “Maximum likelihood estimation of fixed effects dynamic panel data models covering short time periods”, *Journal of Econometrics* 109, 107-150.
 12. Inklaar, R., O’Mahony, M., Timmer, M. (2003), “ICT and Europe’s Productivity Performance – Industry-level Growth Account Comparisons with the United States”, *Research Memorandum GD-68*, University of Groningen, December.
 13. Marrano, M. G., Haskel, J., Wallis, G. (2007), “What Happened to the Knowledge Economy? ICT, Intangible Investment and Britain's Productivity Record Revisited”, *Queen Mary Department of Economics Working Paper No. 603*.
 14. Nickel, S. (1981), “Biases in dynamic models with fixed effects”, *Econometrica* 49: 1399-1416.
 15. O’Mahony, M., Vecchi, M. (2005). “Quantifying the Impacts of ICT Capital on Output Growth: a Heterogenous Dynamic Panel Approach”, *Economica*, 72: 615-633.
 16. OECD (2004), “The Economic Impact of ICT – Measurement, Evidence and Implications”, OECD, Paris.
 17. Oliner, S. Sichel, D., Stiroh, K. (2007), “Explaining a Productive Decade.” *Brookings Papers on Economic Activity* 2007, 1: 81–137.
 18. Pilat, D., Lee, F., van Ark, B. (2002), “Production and Use of ICT: A Sectoral Perspective on Productivity Growth in the OECD area”, *OECD Economic Studies*, 35, Paris: 47-78.
 19. Pilat, D. (2004), “The ICT Productivity Paradox: Insights from micro Data”, *OECD Economic Studies*, 38, 2004/1.
 20. Porter, M.E. (1990), “The Competitive Advantage of Nations”, Free Press, New York, NY.
 21. Schreyer, P., BIGNON, E., DUPONT, J. (2003), “OECD Capital Services Estimates: Methodology and A First Set of Results”, *OECD Statistics Working Papers 2003/6*,

- OECD, Paris.
22. Solow, R. (1987), “We’d better watch out”. New York Times, Book Review (July 12): 36.
 23. Spiezia, V. (2012), “ICT Investments and Productivity: Measuring the Contribution of ICTS to Growth”, *OECD Journal: Economic Studies*, 2012/1.
 24. Stiroh, K. (2002) “Reassessing the Impacts of IT in the Production Function: A Meta-analysis”, *Federal Reserve Bank of New York*.
 25. Van Ark, B., Melka, J., Mulder, N., Timmer, M., Ypma, G. (2003), “ICT Investments and Growth Accounts for the European Union, 1980-2000”, *Research Memorandum GD-56*, Groningen Growth and Development Centre, Groningen.
 26. Van Ark, B., Inklaar, R., McGuckin, R.H. (2002), “Changing Gear - Productivity, ICT and Service Industries: Europe and the United States”, *Research Memorandum GD-60*, University of Groningen, December.
 27. Van Welsum, D., Willem, O., Van Ark, B. (2013) “Unlocking the ICT Growth Potential in Europe: Enabling People and Business. Using Scenario to Build a New Narrative for the Role of ICT in Growth in Europe”, *the conference board report for DG Connect*, Brussels: European Commission.
 28. Wang, C., J., Pearson, A. (2014), “Productivity in the Slow Lane? The Role of Information and Communications Technology”, *Federal Reserve Bank of Boston*, Current Policy Perspectives, 14-10.

RELATIONSHIP BETWEEN PROPERTY RIGHTS ENFORCEMENT AND CORRUPTION – PANEL ANALYSIS OF EU COUNTRIES

Davor Mance

*University of Rijeka, Faculty of Economics, Croatia
davor.mance@efri.hr*

Mario Pecaric

*University of Split, Faculty of Economics, Croatia
mpecaric@efst.hr*

ABSTRACT

We investigate the relationship between property rights enforcement and corruption in EU countries. Property rights are the basic economic institution enabling commerce as a form of exchange of titles. Property rights enable the building of rational expectations about the results of future actions. Therefore, by reducing insecurity, property rights provide incentives for investment, wealth formation, specialization, production, and trade. Corruption is an institutional dysfunction caused by the relationship between private and governmental sector consisting of an act of abuse of power by governmental employees for the purpose of private gain. Corruption was, until recently, mainly analysed as an independent variable. We permit for endogeneity of both variables when regressing the composite index of perception of freedom from corruption against the composite index of property rights enforcement. The choice of variables and the model follows from the theoretical background of the Economic analysis of law and property rights literature. The study is conducted as a panel data analysis of the EU28+2 countries over 21 years. The analysis suggests that corruption is a consequence of the embodiment and enforcement of a formal institution of “property rights”.

Keywords: *corruption, institutions, property rights, public policy.*

1. INTRODUCTION

Institutions are the basic fabric of society. Institutions shape human behaviour. The function of institutions is to provide incentives that shape trustworthy human behaviour creating mutual expectations about the results of human interactions (North, 1990). Formal institutions are embodied in governmental organisations and bureaucratic institutional mechanism designs declaring status functions (Searle, 2005). By corruption, we usually mean corruption of institutions up to the point of their dysfunction by some form of dishonest, fraudulent or outright illegal behaviour of government officials, involving abuse of public office for personal gain. There is no universally accepted definition of corruption.

For the purposes of this analysis, we propose a working definition of corruption as being a social fact denoting an institutional dysfunction occurring in a social environment of interaction of the public sector with the private one in the allocation of assets under government control. It is proximately caused by desire dependent behaviour of governmental officials in the allocation of property rights and ultimately by misaligned property rights allocation mechanism designs.

We claim the role of property rights is crucial in explaining corruption. Scarcity is the main problem of economics, and property rights are the necessary institution to mitigate the problem (Demsetz, 2008). Economic progress is based on specialization and trade.

Specialization without recoverability of irreversible costs is impossible (Mance et al., 2015). Irreversible investments necessary for specialisation are protected by property rights. All commercial activities involve transfers of property rights. If transfer of property rights is subject to clear, unambiguous, and publicly accepted rules, property rights constitute a functional institutional mechanism design (Hurwitz, 2006). Corruption adversely affects these commercial activities as it poses a threat to clear, unambiguous, and impartial rules, impairing mutual trust and expectations about the results of human interactions.

We start with a short theoretical insight and literature review of factors deemed to cause, i.e. to be correlated with corruption where corruption is a dependent variable. We continue with the explanation of the dataset, appropriate methodology, empirical results with the discussion, and at the end a short conclusion with some policy recommendations.

2. THEORETICAL INSIGHT AND LITERATURE REVIEW

Although property rights and corruption are complex and multidisciplinary phenomena, their interaction may be conceptualised as a framework of New Institutional Economics: a combination of the Theory of property rights and Economic Analysis of Law. According to the methodological individualism, property rights are an essential institution of the market economy. The discussion about the role of property rights was best dealt by Ronald Coase in his famous article on the Federal Communications Committee (Coase, 1959). Coase argues that:

“A private-enterprise system cannot function properly unless property rights are created in resources, and, when this is done, someone wishing to use a resource has to pay the owner to obtain it. Chaos disappears; and so does the government except that a legal system to define property rights and to arbitrate disputes is, of course, necessary.”
(Coase, 1959, p.14).

The bundle of property rights is a circumstance relative institution giving its holder an exclusive power (right, duty, obligation, authorization, permission, etc.) over access, withdrawal, management, exclusion, and alienation (Ostrom and Schlager, 1996, p.136) of assets in the sense it excludes others from acting in a same or similar way where the problem of rivalry exists (Samuelson, 1954). Property rights are contextual rules of exclusion. Rational agents exchange their bundles of property rights further enhancing their efficiency and welfare and trying to decrease transaction costs. The transaction cost is the cost of defining property rights, their demarcation, and enforcement regardless of its form (private, club, common, or public). The transaction cost is inversely proportional to the degree of how well the property rights are defined and protected: the less well defined and enforced the property rights, the higher their transaction cost, the less efficient the market mechanism, and lower the welfare. Unlike the ideal Coasean zero-transaction-costs world, the real-world transaction costs are always positive. According to the Economic Analysis of Law (Posner, 1992), property rights evolved through the evolutionary common law mechanism design as a means of imposing socially acceptable behaviour on self-interested and rational individuals increasing trust, decreasing transaction costs, and increasing economic efficiency.

The major stumbling block in the development of countries is their inability to produce capital due to the institutionally defective form of *evidence of ownership* preventing assets and liabilities to form in a clear and transparent way and to subsequently be traded in global circles (de Soto, 2000, p.16-17). So, how does the institution of property rights influence the institutional fact of corruption?

Corruption as a social fact is an informal institution internalised by the behaviour of economic agents inducing a “social cost” in form of a “moral hazard”: a behaviour incommensurate with formal institutions. At the same time it is a rational behaviour by self-interested individuals trying to lower their transaction costs. In evaluating a property right as a formal legal rule, one needs to compare it with its informal opportunity cost: corruption. As in a “black market” the *ex ante* opportunity cost of a corruptive activity might be lower for the corrupting individual (Williamson, 1979), but the overall social cost is nevertheless higher.

The most problematic issue with corruption is its definition, and currently there is no universally accepted theory of corruption (Farrales, 2005). The frequently used definition of corruption is: “*the abuse of public power for private benefit*” (Aguilera and Vadera, 2008). This definition is too broad as it may well include any kind of theft and embezzlement by public officials. For all practical purposes, corruption is always associated with the interaction of the governmental and the private sector (Rose-Ackermann, 1997, p.31).

Corruption means corruption of institutions, where institutions are regulations, rules, and procedures, by any institutional status function declaration that would put an individual or entrepreneur that is corrupting in a preferential position creating thus an exclusive economic rent.

The causes of corruption were analysed extensively by Treisman (2000). An increase in income per capita and an increase in the quality of the legal system strongly decrease corruption whereas an increase in inflation and complexity of the regulatory system have a negative relationship to corruption. The analyses were either cross-country regressions or time-series analyses with the resulting lack of control over the variables, or lack of dynamic effects, something we tried to overcome in this paper. Treisman (2000) finds the following six factors significant in the causation of corruption: protestant tradition, history of British rule, more developed economy, openness to trade, and long exposure to democracy. Current degree of democracy was not significant. Federations were more corrupt. These factors describe some 80% of corruption (Treisman, 2000).

To the authors’ knowledge, no direct causal conjecture of a relationship between property rights enforcement and corruption has been postulated.

3. EMPIRICAL ANALYSIS

3.1 Data

The empirical analysis is based on a balanced panel of property rights indices and freedom from corruption indices of 28 European Union (EU) member states plus Switzerland and Norway over a time span of 21 years ranging from 1995 to 2016. The data was acquired from the Heritage foundation and Transparency international internet sites. The analysis was performed with the E-Views 9.0 statistics software.

The property rights index consists of an assessment of the ability of the state to enforce laws protecting private property rights, the likelihood of expropriation, the independence of the judiciary concerning the enforceability of property rights, and the ability of individuals and businesses to enforce contracts (Heritage foundation, 2016). It measures the degree to which a country’s laws protect private property rights and the degree to which its government enforces those laws. The index is granted 100 points if private property is absolutely guaranteed by the government, if the court system enforces contracts efficiently and quickly, and the justice system punishes those who unlawfully confiscate private

property. (Heritage foundation, 2016)

The Freedom from Corruption index is derived from the Transparency International's Corruption Perceptions Index (CPI) and inverted. The maximum point score (100) is given to the least corrupt country, and the score of zero is given to the country deemed absolutely corrupt.

3.2 Methodology

The quantitative analysis starts with the Panel Ordinary Least Squares (OLS) analysis complemented by the Panel Granger (non-)causality test. Since Panel Granger causality tests must be performed on stationary data in level and trend, and to decrease the possibility of spurious regressions, a stationarity test of the nominal panel data series was performed with a series of Unit root tests. Current behaviour depends upon past behaviour, in lieu of cultural habit formation, slow adjustment speed, etc. The ability to estimate a dynamic model for individual effects is unique for panel data.

Because causality may run in both directions, from property rights to corruption and vice versa, these regressors may be correlated with the residuals. Time-invariant country characteristics, called fixed effects, may also be correlated with the explanatory variables. The presence of the lagged dependent variable gives rise to autocorrelation. By differencing, the fixed effect and the autocorrelation is removed, as well as any time invariant component. In this way the Dynamic General Method of Moments (GMM) First Differences (FD) controls for unobserved heterogeneity when this heterogeneity is constant over time. Finally and most importantly, FD removes the unit-root process from the data, and also control for the phenomena of momentum and inertia. Since lags of the dependent variable are necessarily correlated with the idiosyncratic error we test the residuals using the Arellano-Bond GMM estimator (Arellano and Bond, 1991).

3.3 Results

We start our analysis with Panel OLS. The results are shown in Table 1.

Table 1: Panel Least Squares of factors influencing freedom from corruption

Dependent Variable: FREEDOM_FROM_CORRUPTION

Method: Panel Least Squares

Total panel (balanced) observations: 630

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PROPERTY_RIGHTS	0.890963	0.006200	143.7123	0.0000
R-squared	0.683284	Mean dependent var		63.72540
Adjusted R-squared	0.683284	S.D. dependent var		20.46031
S.E. of regression	11.51455	Akaike info criterion		7.726685
Sum squared resid	83395.82	Schwarz criterion		7.733742
Log likelihood	-2432.906	Hannan-Quinn criter.		7.729426

After the nul hypotheses of unit root processes could not have been rejected, nominal data was differentiated. The tests on differentiated data let us reject the nul hypothesis of a Unit-Root process ($p < 0.001$) (Table 2).

Table 2: Panel unit root test of the differentiated index of property rights

Method	Statistic	Prob.	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t	-11.6847	0.0000	19	346
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-9.76257	0.0000	19	346
ADF - Fisher Chi-square	163.367	0.0000	19	346
PP - Fisher Chi-square	177.882	0.0000	19	361

Same conclusion was reached for Freedom from corruption index (Table 3).

Table 3: Panel unit root test of the differentiated index of freedom from corruption

Method	Statistic	Prob.	Cross-sections	Obs
Null: Unit root (assumes common unit root process)				
Levin, Lin & Chu t	-14.9661	0.0000	30	542
Null: Unit root (assumes individual unit root process)				
Im, Pesaran and Shin W-stat	-17.3653	0.0000	30	542
ADF - Fisher Chi-square	332.486	0.0000	30	542
PP - Fisher Chi-square	400.429	0.0000	30	570

Panel Granger causality tests have been performed on differentiated data with time lags of 2, 3, and 4 years. The results may be found in Table 4.

Table 4: Panel Granger causality tests

Null Hypothesis:	Lag	Obs	F-Stat	Prob.
D(PROPERTY_RIGHTS) does not Granger Cause D(FREEDOM_FROM_CORRUPTION)	2	540	3.6782	0.0259
D(PROPERTY_RIGHTS) does not Granger Cause D(FREEDOM_FROM_CORRUPTION)	3	510	6.7271	0.0002
D(PROPERTY_RIGHTS) does not Granger Cause D(FREEDOM_FROM_CORRUPTION)	4	480	6.4145	$5 \cdot 10^{-5}$
D(FREEDOM_FROM_CORRUPTION) does not Granger Cause D(PROPERTY_RIGHTS)	4	480	0.1517	0.9622

The results show the null hypothesis of non-causation between differenced panel data of Property rights over the Freedom from corruption index may be rejected for all measurements. The inverse null hypothesis cannot be rejected. We proceed with GMM testing.

Table 5: Panel GMM FD test of Property Rights and Freedom from Corruption

Dependent Variable: FREEDOM_FROM_CORRUPTION

Method: Panel Generalized Method of Moments

Transformation: First Differences

Total panel (balanced) observations: 570

Instrument specification: @DYN(FREEDOM_FROM_CORRUPTION,-2)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FREEDOM_FROM_CORRUPTION(-1)	0.668314	0.017835	37.47281	0.0000
PROPERTY_RIGHTS	0.164270	0.020615	7.968668	0.0000
Cross-section fixed (first differences)				
Mean dependent var	0.263158	S.D. dependent var	3.882240	
S.E. of regression	5.463995	Sum squared resid	16957.78	
J-statistic	29.85829	Prob(J-statistic)	0.370024	

The results show a strong and statistically significant effect of the lags of the dependent variable but also of the property rights variable. The J-statistic states that the instruments are uncorrelated with the error term and the Prob(J-statistic) significantly different from

zero (0.37) shows that it is far from the rejection of its null, giving us the confidence that our instrument set is appropriate. To further test for model consistency, we test the residuals for biasness, i.e. their serial correlation with the variables.

Table 6: Arellano-Bond Serial Correlation Test

Test order	m-Statistic	rho	SE(rho)	Prob.
AR(1)	-3.342831	-5450.277521	1630.437484	0.0008
AR(2)	-0.064465	-62.509098	969.652344	0.9486

The test shows the first order AR(1) statistic is statistically significant, whereas the second order AR(2) statistic is not. These results point to the residuals being serially uncorrelated in levels. The model above was chosen as the most appropriate one according to its lower standard error values and the results of the post-hoc Arellano-Bond residuals test (Arellano and Bond, 1991). This is probably due to the ability of Panel GMM FD models to use the time variation of explanatory variables.

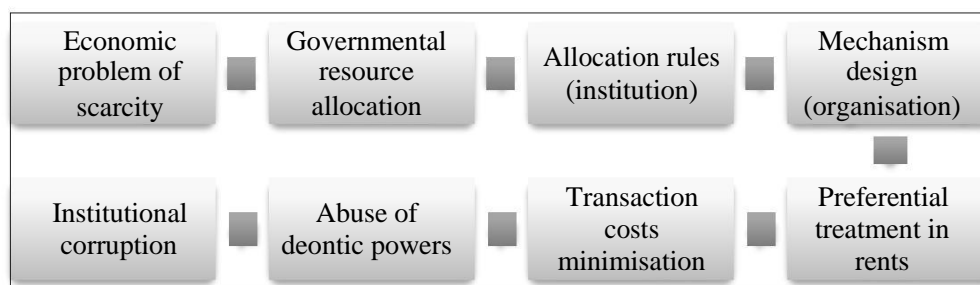
3.4 Discussion

There is a statistically significant correlation between property rights panel indices and the freedom from corruption panel indices. The function of the Panel OLS was an introductory one showing the potential for further testing. The appropriate test was the one using both the time-series and the cross-section information in the best possible way. We have given priority to Panel GMM FD test because of its use of time variation in the explanatory variables as a way of integrating Granger Causality into the overall results. In fact, the previously conducted Granger Causality tests on differenced data (to eliminate non-stationarity) could not have rejected the unidirectional relationship going from “property rights” to “freedom from corruption”. Although an endogenous relationship between corruption and property rights is unquestionable from both theory and empirical analysis, corruption is primarily a reflection of the weak definition and enforcement of property rights. Therefore, a policy clearly defining, demarcating and thus better enforcing property rights by reducing transaction costs makes corrupt activities economically unviable.

Overall, we couldn’t statistically reject our main theoretical conjecture of the importance of well defined and enforced “property rights” in explaining the “freedom from corruption” index.

Institutions are supposed to create *desire independent behaviour* by all participants in a transaction. This should especially count for public officials. They need to act professionally for the purpose of assuring institutionally acceptable behaviour by others. If the institutional and organisational *mechanism design* is misaligned with its *collective intentionality* objectives, and produces *behavioural incentives* contrary to its objective, the institutional mechanism design is corrupted and the institution is dysfunctional.

A full theoretical conjecture is shown in Figure/Chart 1 below.



Figure/Chart 3: *From Collective Intentionality to Institutional Corruption*. Source: Own representation.

The social fact of corruption is created by the interaction of the governmental and private sectors in their attempt to allocate scarce goods by an allocation rule that has been accepted by the society. Nevertheless, the governmental mechanism design is seriously flawed when it is not transparent, when it allows governmental officials to act discretionarily providing preferential treatment in exchange for benefits other than their legal remuneration.

4. CONCLUSION

The results of the analysis suggest that corruption is not only a matter of cultural heritage in general in the sense of culture being a set of informal institutions adopted by a population of a country, but a consequence of the embodiment of a formal institution of “property rights” in particular. Although we modelled by including for a strong possibility of endogeneity, it seems the “causal” relationship unequivocally goes from well defined and enforced “property rights” to “freedom from corruption”. Some policy guidelines may be derived from these results. Clearly and unambiguously defined, and enforced property rights are the single most important factor positively influencing “freedom from corruption”. Secondly, to control for corruption also means to restrict public authorities from discretionary allocation of goods and resources under government control, thus preventing the creation of discretionary preferential “rents”.

LITERATURE:

1. Aguilera, R. V., & Vadera, A. K. (2008). The dark side of authority: Antecedents, mechanisms, and outcomes of organizational corruption. *Journal of Business Ethics*, 77(4), pp. 431–449. DOI: 10.1007/s10551-007-9358-8
2. Arellano, Manuel and Bond, Stephen (1991) Some Tests of Specification for Panel Data: Monte Carlo Evidence and an Application to Employment Equations. *The Review of Economic Studies*, Vol. 58, No. 2, pp. 277-297.
3. Coase, R. H. (1959) The Federal Communication Committee. *Journal of Law and Economics*. Vol. 2 (Nov.), pp. 1-59. The University of Chicago Press.
4. Demsetz, H. (2008) *From Economic Man to Economic System: Essays on Human Behavior and the Institutions of Capitalism*. Cambridge University Press, Cambridge, UK.
5. De Soto, H. (2000) *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. Basic Books, New York.
6. Farrales, M. J. (2005). What is corruption? A history of corruption studies and the great definitions debate. San Diego: University of California. Social sciences Research Network.
7. Mance, D., Vretenar, N., Katunar, J. (2015). Opportunity Cost Classification of Goods and Markets. *International Public Administration Review*, 13(1), pp. 119–134. DOI: 10.17573/ipar.2015.1.06
8. North, D. C. (1990) *Institutions, Institutional Change, and Economic Performance*. Cambridge University Press, Cambridge.

9. Ostrom, Elinor and Edella Schlager (1996) The Formation of Property Rights, in Susan Hanna, Carl Folke, and Karl-Göran Mäler (eds) *Rights to Nature*, pp. 127-56. Washington, D.C.: IslandPress.
10. Posner, R. A. (1992) *Economic Analysis of Law*. 4th ed. Little, Brown and Company.
11. Rose-Ackerman, S. (1997) The political economy of corruption. In K. A. Elliott (Ed.), *Corruption and the global economy* (pp. 31–60). Washington, DC: Institute for International Economics.
12. Samuelson, P. A. (1954) The Pure Theory of Public Expenditure, *Review of Economics and Statistics* 36(Nov.): 387-9.
13. Searle, John R. (2005) What is an institution? *Journal of Institutional Economics*, 1: 1, pp. 1–22.
14. Treisman, D. (2000) The causes of corruption: A cross-national study. *Journal of Public Economics*, 76(3), 399–457.
15. Williamson, O. E., (1979) Transaction-Cost Economics: The Governance of Contractual Relations. *Journal of Law and Economics*, 22(2), pp. 233-261.

ASSUMPTIONS OF TRANSPORT POLICY IN POLAND IN THE SUSTAINABLE DEVELOPMENT ASPECT

Jan Kowalik

*Czestochowa University of Technology, Poland
janekowalik@yahoo.pl*

ABSTRACT

Efficiently functioning transport system is one of the key factors determining living conditions of citizens and economic development of the country and regions. It has been assumed in the programme "Transport policy of the country for the years 2006-2025", which defines the confines of the transport development in Poland, that the basic goal of the transport policy is to improve the transport system quality and its development in accordance with the sustainable development principles. Defined in this way goal can be achieved through implementation of the following tasks: improving transport accessibility and its quality, supporting competitiveness of Polish economy, improving the efficiency of transport system functioning, integrating transport system - in the branch and territorial arrangement, security improvement leading to radical reduction of the number of accidents, limiting the negative influence of transport on the environment and living conditions.

In the article the Author attempts to answer the question how the transport system changed in the years 2006-2013, which of the assumption of the transport policy for the years 2006-2025 have been carried out and to what extent they have been carried out so far.

Keywords: *management, sustainable development, Poland, transport, transport policy.*

1. INTRODUCTION

Social and economic development on the local, regional, national or international level implies development of transport needs, which are carried out by various transport branches. On the other hand, transport is one of the most important factors that determine social and economic development of the country or region. National economy that develops influenced by transport gives it bigger and bigger challenges. Thus, it is necessary that transport constitutes a vital element that contributes to economic growth through creating a functionally integrated infrastructure, implementing new transport technologies and ensuring high quality of services on the competitive transport market (Rześny-Cieplińska, 2013, s. 343).

However, the positive influence of transport on economic development of regions brings also negative effects in the form of natural environment degradation. While most sectors strive to reduce CO₂ emission, the transport share in this respect is growing. According to data by the European Environmental Agency emission of greenhouse gases in the transport sector grew in the period 1990-2008 by about 34%. In the same period the energy sector reduced its emission by about 9%. According to the same Agency, transport is responsible for about quarter of greenhouse gases emission in the EU. 12,8% of the total emission is generated by the air transport, 13,5% sea transport, 0,7% rail transport, 1,8% inland waterways and 71,3% road transport.

The importance of transport in the economic growth and quality of life and the care for the natural environment have caused that actions have been taken that aim at implementing the idea of sustainable development in the transport sector. Sustainable development, which leads to an increase in effective use of resources and supports environmentally friendly and more competitive economy (Europa 2020, 2010, p. 5). Sustainable transport in turn should be characterized by achieving such an arrangement of particular elements of the transport system that is possible to increase the efficiency of its functioning in economic, social and environmental dimension (Mesjasz-Lech, 2016, p. 625).

Directions of transport sustainable development in the EU countries were outlined in the European Union's White Paper in 2001 and 2011. With reference to Poland the documents that determine the frameworks of transport sustainable development are "The Transport Policy of the Country for the Years 2006-2025" and "The Strategy of Transport Development until 2020 (with the until 2030 perspective)".

The goal of the article is to evaluate the changes in the scope of sustainable transport in Poland. The Author attempts to answer the question how the transport system changed in the years 2006-2013, which of the assumption of the transport policy for the years 2006-2025 have been carried out and to what extent they have been carried out so far.

2. MAIN ASSUMPTIONS OF TRANSPORT POLICY IN POLAND

The transport policy in Poland has been based on the postulates and guidelines included in document the issued in 2005 - The Transport Policy of the Country for the Years 2006-2025. The basic goal of the transport policy in Poland for the years 2006-2025 was to improve the quality of the transport system and develop it in accordance with the sustainable development principles, because the transport system quality is one of the key factors determining the living conditions of the citizens and the economic development of the country and regions. The application of sustainable development principles will ensure the balance between social, economic, spatial and environmental care aspects in the conditions of developing market economy (Polityka Transportowa Państwa na lata 2006-2025, 2005, p. 9). Defined in this way goal can be achieved through implementation of the following six detailed tasks (Polityka Transportowa Państwa na lata 2006-2025, 2005, p. 9):

- improving the transport accessibility and transport quality as a factor of living conditions improvement and removing the barriers of economy development,
- supporting competitiveness of Polish economy as a key instrument of economic development,
- improving efficiency of transport system functioning,
- transport system integration- in the branch and territorial arrangement,
- security improvement that leads to a radical reduction of the number of accidents and reducing their effects (fatalities, injuries) and - in the social grasp - to improvement in the personal security of transport users and cargo protection,
- limiting the negative influence of transport on natural environment and living conditions. The diagnosis of the transport sector condition in Poland in that period, forecasts of road transport increase, and also guidelines of the European Union with regard to the directions of the transport policy led to accepting the following ten priorities of the national transport policy:
 - a radical improvement of the conditions of all categories of roads, developing the network of motorways and express roads of most burdened directions,
 - modernizing rail through a radical improvement of the infrastructure condition at a simultaneous reduction of cost to access it,
 - improving transport security, in this a radical decrease of number of fatalities in accidents,
 - improving transport quality in cities, in this through improved competitiveness of public transport against the individual one,
 - improving the quality and competitiveness of public transport in metropolitan areas and regions,
 - intermodal system development,
 - development of air services market,
 - strengthening the role of sea and air ports and improving the access to them in the region and country scale,
 - supporting carriers in widening their offer of passenger and cargo transport services in trans-

European and intercontinental relationships,

- improving the conditions of inland water transport through modernization of selected parts of the infrastructure and supporting entrepreneurs in fleet renewal.

3. THE ANALYSIS OF TRANSPORT CONDITION IN POLAND

While analyzing the development of the transport sector in Poland in the sustainable development context one should notice its branch structure. It should be remembered that particular transport branches have differentiated, degrading influence on the environment. The highest burden constitutes road transport while the lowest influence on environment pollution have rail transport and inland waterway transport. Table 1 and Chart 1 present the structure of passenger and cargo transport in Poland in the years 2006-2013.

Table 1: Dynamism and structures of cargo transport in Poland in the years 2006-2013 (Transport – wyniki działalności w 2008 r., 2009, s. 46; Transport – wyniki działalności w 2010 r., 2011, s. 46; Transport – wyniki działalności w 2013r., 2014, s. 48)

Transport type	2006	2007	2008	2009	2010	2011	2012	2013
Dynamism (previous year=100%)								
Total	104,1	107,4	108,0	102,1	108,7	106,5	96,4	103,3
Rail transport	108,1	103,0	101,4	80,7	108,0	106,0	92,9	100,7
Car transport	103,2	108,9	110,4	106,4	108,9	107,0	97,0	104,0
Air transport	106,6	125,9	103,0	78,1	111,1	110,3	90,7	90,1
Pipeline transport	102,5	95,0	92,7	102,5	111,9	96,9	97,3	95,6
Inland waterway	96,5	105,6	82,8	69,7	90,9	99,1	89,9	110,2
Shipping	107,0	114,1	91,4	89,8	89,2	92,5	96,6	93,2
Structure in %								
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Rail transport	19,7	16,0	15,0	11,9	11,8	13,0	12,9	12,6
Car transport	75,2	79,2	80,9	84,3	84,4	83,5	83,4	84,0
Air transport	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Pipeline transport	3,8	3,4	3,0	3,0	3,1	2,8	3,0	2,7
Inland waterway	0,6	0,6	0,5	0,3	0,3	0,3	0,3	0,3
Shipping	0,7	0,8	0,6	0,5	0,4	0,4	0,4	0,4

In Poland a significant part of cargo transport is carried out by means of land transport, with a growing domination of road transport over the rail. The influence of such a negative in the environmental aspect of transport structure in Poland should be sought for in lack of proper implementation of transport policy, and first of all in unequal treatment of particular transport branches in the scope of charges incurred for accessing the transport infrastructure. There is a lack of consequence in the scope of introducing the principles of charging so called external costs for particular transport branches, e.g. a large increase of cost of maintaining rail infrastructure caused that many of the plants that possessed side track decided to liquidate them (Antonowicz, Zielaskiewicz, 2008, p. 177).



Chart 1: Passenger transport according to transport type in Poland in the years 2006-2013
(Own elaboration on the basis of Transport – wyniki działalności w 2013r, 2013, p. 48)

While analyzing the passenger transport in the examined period, it should be noticed that the number of passengers carried by public transport decreased. In 2006 there were slightly over a billion of passengers carried, but in 2013 the number dropped to 740 million. With reference to the transport structure, similarly to the transport of cargo, car transport has an advantage over rail transport. Car transport handled slightly over 60% of all passengers in 2013, while rail transport 36% of them. A relatively constant level of rail transport can be observed while road transport recorded a significant loss in the analyzed period as the number of carried passengers dropped by as far as 291 million. This does not mean that Polish citizens travel less, this is a signal they use individual (private) road transport, which is undoubtedly unfavourable from the ecological point of view.

In the context of passenger transport with reference to sustainable transport, the Central Statistics Office (GUS) uses the indexes of passenger transport per one urban area citizen (Chart 2).

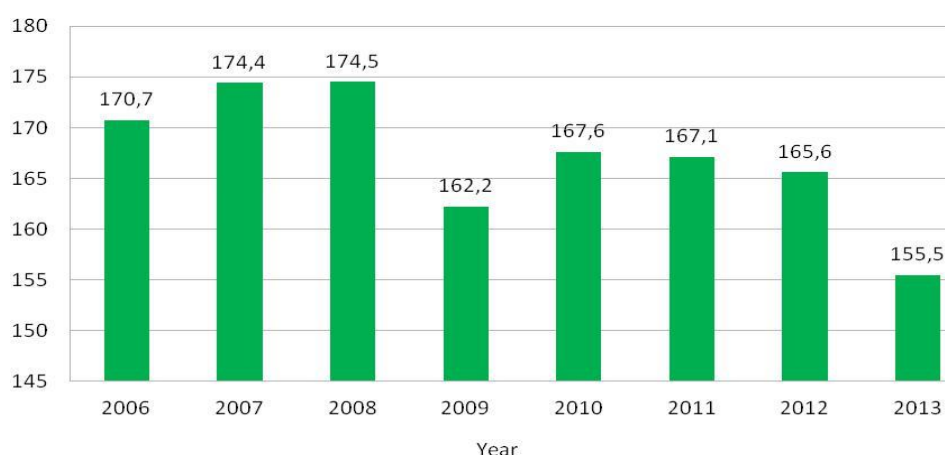
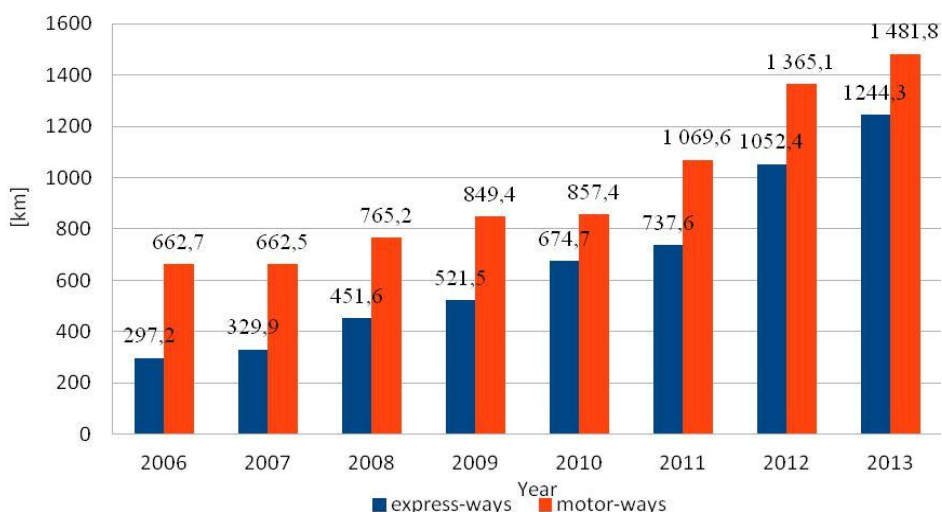


Chart 2: Number of passenger services per 1 urban area citizen (Own elaboration on the basis of GUS database (b), 2016)

From the environment protection point of view it is desirable that the number of passenger services in agglomerations is growing, which means that the public transport wins with individual passenger transport. Such tendencies can be observed in other EU countries, where in the years 2007-2010 an increase in collective transport services in cities was recorded (Wojewódzka – Król, 2014, p. 381)

A large influence on road transport development in Poland has a relatively well developed road infrastructure, both the point and linear ones. In the recent years, at the expense of other transport branches, among others rail, their number and quality have improved. It was largely influenced by the fact the EURO 2012 was organized in Poland. An evidence of road transport being treated in a better way can be the fact that in February 2011 the Government moved a part of the EU resources from rail to roads, which also shows insufficient abilities of administrative bodies in the scope of preparing and implementing projects in transport infrastructure area.

In the years 2006-2013 the number of express roads and motorways in Poland grew significantly (Chart 3), which should be understood as proper step to carry out the assumptions of the transport policy.



*Chart 3: Length of express roads and motorways in Poland in the years 2006-2013
(Own elaboration on the basis of GUS database (a), 2016)*

The length of express roads in the analyzed period grew by almost 1000 km, and motorways by 800 km. Despite such a meaningful growth not all projects connected with road infrastructure were carried out. The construction of A1 motorway joining the north and the south of the country has not been finished until the present moment and only in 2016 the first motorway - A4 - joining the two borders of Poland, that is the east and the west of the country, was put into operation, although initially it was supposed to be finished in 2012.

The improvement of the road infrastructure quality contributed to the improvement in security on Polish roads (Chart 4 and Chart 5).

The number of road accidents in Poland in the examined period decreased greatly. The record number of road accidents was recorded in 2008, where there were 49 054 accidents recorded in total. The smallest number of accidents - 35 847 - was recorded in 2013. Certainly, the significant drop in the number of accidents should be associated with the improved road infrastructure, but it was also influenced by legislative changes in the form of higher fines for traffic offences and setting up at the end of 2002 Road Transport Inspection, the aim of which is to control carriers in passenger and cargo transport.

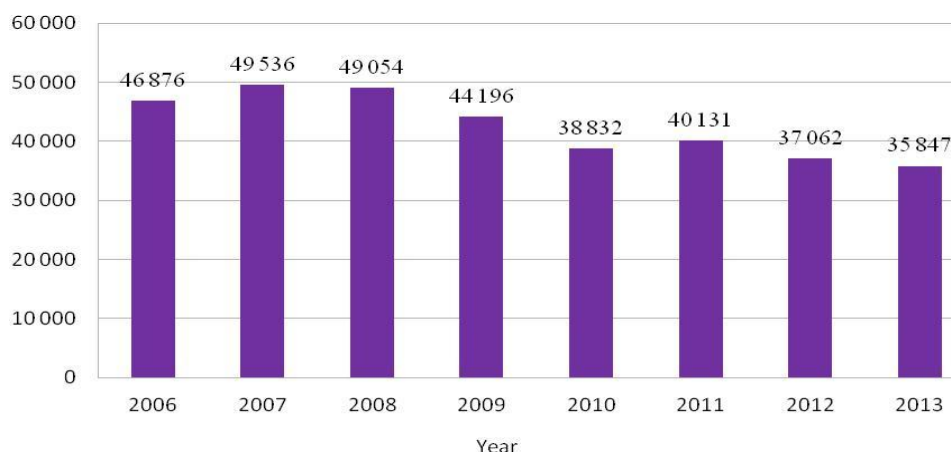


Chart 4: Road accidents in Poland in the years 2006-2013 (Own elaboration on the basis of GUS database (a), 2016)

Together with the drop in the number of accidents a smaller number of fatalities in them was recorded. In the years 2006-2013 a significant decrease in the number of fatalities in road accidents was recorded. The number dropped to 3357 persons in 2013, while in 2007 5583 people died as a result of car accidents. Such positive changes are caused on the one hand by the development of road infrastructure and the decrease in total number of accidents, and on the other hand by the improvement in the culture of driving of road users and the increased number of solutions in the scope of vehicle security.

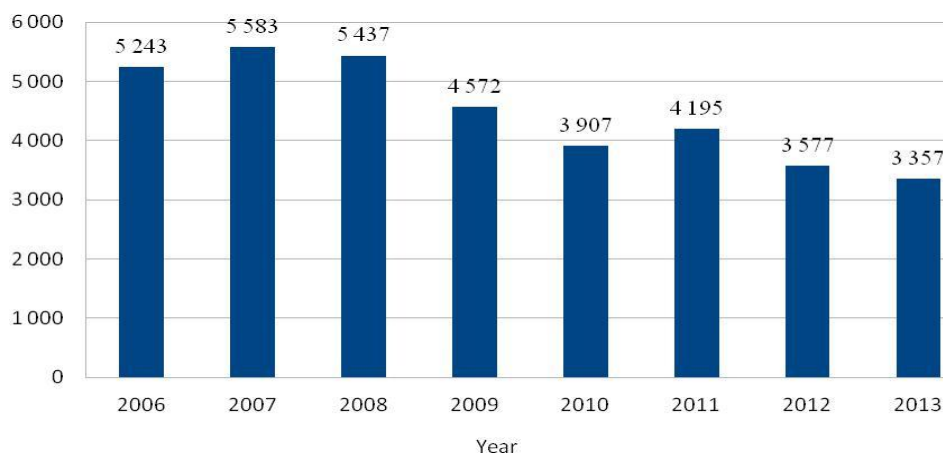


Chart 5: Number of fatalities in road accidents in Poland in the years 2006-2013 (Own elaboration on the basis of GUS database (a), 2016)

The second most important branch of transport after car transport in the Polish transport system is rail transport. The impact of this branch on the environment is significantly lower than in case of road transport and consists in emission of noise, vibrations and limited emission of pollution. In case of Polish economy rail transport suffered most in the course of social and economic transformations and its role in the economy became weaker. It is enough to quote the data from the years 1990-2009, which shows that the overall size of Polish rail network decreased by over 25%. What is worse, liquidation of rail networks is frequently done without a clear plan (Fajczak-Kowalska, 2012, p. 242). The change in the length of railway lines has been presented in chart 6.

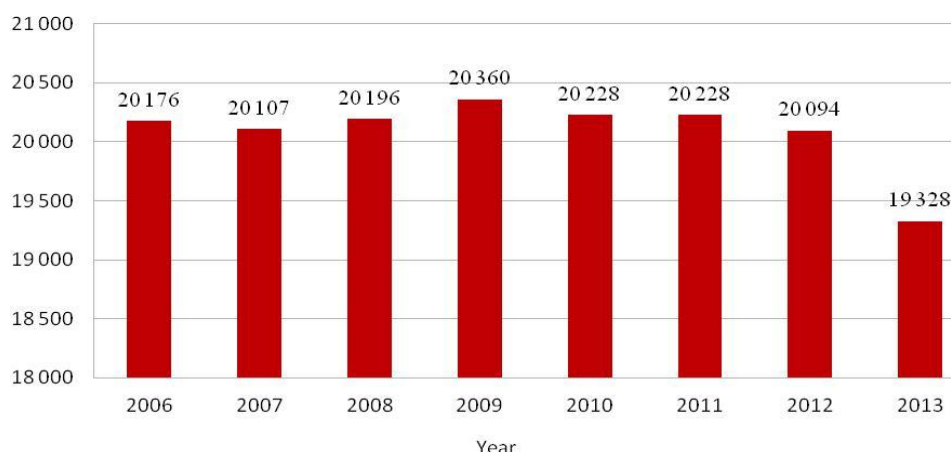


Chart 6: Length of railway lines operated in Poland in the years 2006-2013 (Own analysis based on the GUS database (a), 2016)

Chart 6 shows that in the analyzed period the length of railway lines operated in Poland decreased from 20 176 km to 19 328 km. In this period the share of rail transport in cargo services decreased as well, from 19,7% in 2006 to 12,6% in 2013. The number of passengers carried by rail also dropped in the analyze period by 15 million. In case of passenger transport the reason of the decrease in the number of carried passengers is undoubtedly low quality of these services, failures, delays. Railway infrastructure could not expect such investments and connected with them financial expenditures at it was the case with the road infrastructure. Poland still does not have real high-speed railway lines (speeds of over 250 km/h), and the percentage of those adjusted to speeds of over 160 km/h is not too large either (Chart 7).

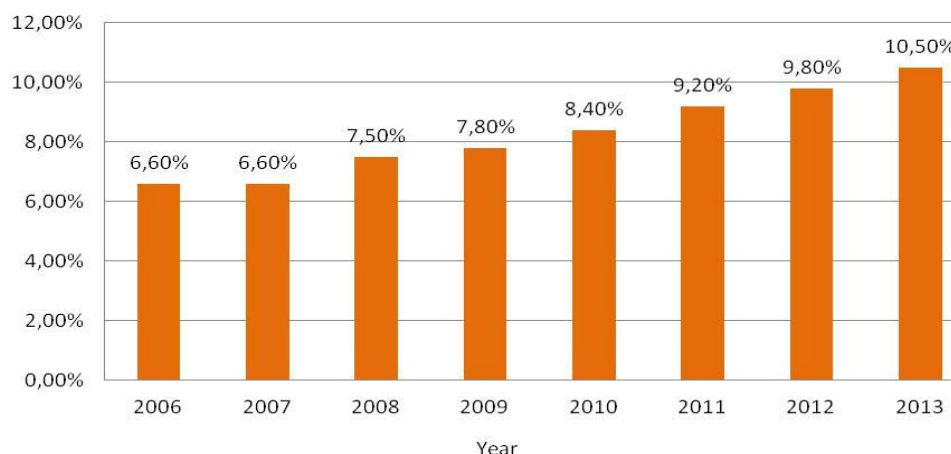


Chart 7: The share of railway lines adjusted to the speed of 160 km/h and more in the total length of railway lines operated in Poland in the years 2006-2013 (Own elaboration on the basis of GUS database (b), 2016)

The index of the share of railway lines adjusted to the speeds of 160 km/h and more in the length of operated railway lines according to the Central Statistics Office is included into the indicators of sustainable transport. In the analyzed period the value of this indicator grows

substantially, but it is still at a relatively low level. Another index that illustrates sustainable transport development is the share of intermodal services in the carrying cargo by rail transport. Fairly poor condition of rail infrastructure and lack of incentives from the Government causes that the share of intermodal services constitutes about 3% (Chart 8) in Polish rail services, while in other EU countries the average value is as high as 25%.

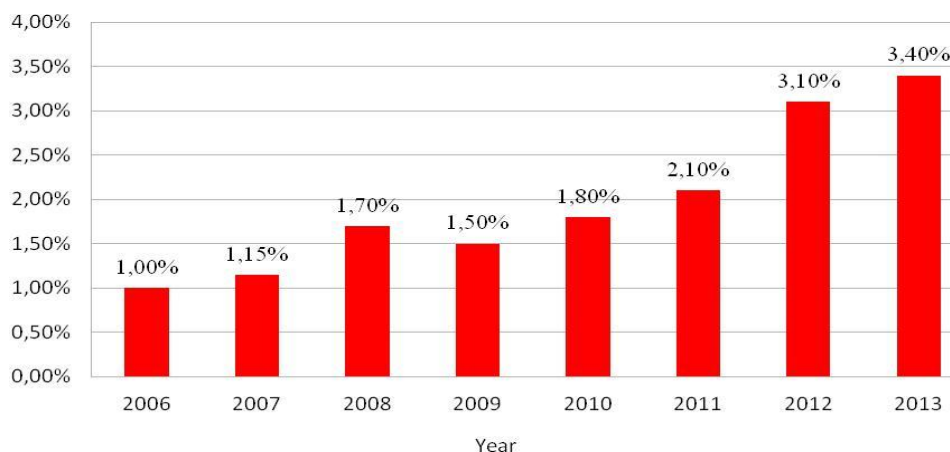


Chart 8: Intermodal cargo services in standard gauge transport in Poland in the years 2006-2013 (Own analysis on the basis of GUS database (b), 2016)

Despite a growing tendency the percentage of intermodal services carried out by rail transport in Poland largely differs from the average level for the EU countries. This is caused by the fact that in other countries intermodal services are strongly supported by administrative bodies as well as within the initiatives that combine the nature of public and private partnership. Unfortunately, in Poland the state does not provide enough economic incentives for transport operators that want to provide services of this type (Wiktorowska-Jasik, 2014, p. 6694). With reference to sustainable transport, the most desirable branch of transport is inland waterway transport. In Poland this branch of transport does not have an adequate place in the transport policy. The share of inland waterways in cargo transport in Poland has not changed for a long time and it has reached the level of 0,3%, which compared with other EU countries constitutes actually a marginal value. For example, in Belgium its share in 2013 was 20,4%, in Germany 12,6%, in Bulgaria 15% and in Hungary 4,1% (GUS database (b), 2016). Having been neglected by a long time and due to lack of investments in this scope in Poland there are just 214 km of waterways that comply with the international standards of inland waterways.

This situation is supposed to change in the years to come. According to the plans of the current Government, the following are the priorities with reference to waterways:

- restoring the use of Odra inland navigation on the whole length and making it a part of the European transport corridor Danube-Odra-Elbe,
- restoring the use of Vistula inland navigation between Warsaw and Gdansk within the European corridor E40,
- construction of the Silesia Canal, joining the two biggest Polish rivers Vistula and Odra.

These projects are supposed to be financed from the EU resources, as being in line with the Community Transport Policy.

3. CONCLUSION

The important role of transport in the economic growth and quality of life and on the other hand the care for the environment have caused that actions meant to implement the idea of sustainable development in transport have been taken. The Transport Policy of the Country for the years

2006-2025 defined the development framework of this important branch of economy in Poland. Not all of the assumptions included in the program of transport sector development have been implemented so far. Poland still has a lot to do, particularly in these transport areas of pro - environmental nature, and thus concern its sustainable development. However, it should be remembered that implementing the principles of sustainable transport development is a long-term process of improving the applied solutions and actions taken. It is difficult to implement in economies such as the Polish one, that is developing ones and trying to catch up with the countries of Western Europe.

A dominant branch of transport in Poland in the years 2006-2013 was the car transport, both in relation to cargo as well as passenger services. Also biggest expenditures for transport development were destined for road infrastructure. Thus, in our economy the most energy-intensive and burdensome to environment branch of transport is still the dominant one. It does not seem probable that this situation is going to change in the near future. It is assumed that until 2030 car transport will carry 83% of cargo, rail transport 10,6%, sea transport 3,3% and inland waterways transport only 0,5% (*Strategia Rozwoju Transportu do 2020 roku (z perspektywą do 2030 roku)*, 2013, s. 35).

The branch of transport in the Polish economy that has most lost in its importance is rail transport. Both in case of cargo and passenger services is visibly second to car transport. The length of operated railway lines is decreasing, there are no new innovative solutions implemented and the expenditures on infrastructure are insufficient for the sector to develop. In order to make this branch of transport develop it is necessary to increase the expenditures on infrastructure, improve the quality of offered services, particularly with reference to passenger services and establish rational tariffs for the services. Also managing the railway enterprises has to improve. Currently most of them are the State Treasury companies and managerial posts in them are occupied by politicians, not specialists in the given domain.

The bad situation in transport is also reflected in low level of intermodal services. It is still a lot to be done in this aspect. It can be stated that this goal of transport policy has not been achieved. Actions connected with promoting collective transport are ineffective either, the proof of which are decreasing indexes of passenger services in total and passenger services per one urban area citizen.

The actions in the scope of supporting inland waterways transport have not been taken yet. It is a pity as it is the most environmentally friendly transport solution.

The goals of the transport policy that have been achieved are definitely improved road safety and modernization of roads and building express roads and motorways. Although, a lot can be done in this scope as well. The thing that must improve in the future is management in the scope of preparing and implementing projects, so that investment in the transport infrastructure can be made faster and in a cheaper way.

LITERATURE:

1. Antonowicz, M., Zielaskiewicz, H. (2008). *Logistyka w kształtowaniu rozwoju kolejowego transportu towarowego*. In L.A. Bukowski, *Wybrane zagadnienia logistyki stosowanej* (pp.177-189). Kraków: Oficyna Wydawnicza TEXT.
2. *Europa 2020*. (2010). Retrieved 04.07.2016 from http://ec.europa.eu/eu2020/pdf/1_PL_ACT_part1_v1.pdf
3. Fajczak-Kowalska, A. (2012). Zrównoważony rozwój transportu i jego implikacje dla kolejnictwa. *Studia Prawno-Ekonomiczne*, no. LXXXV, pp.239 – 254.
4. GUS database (b). (2016). Retrieved 14.07.2016 from <http://wskaznikizrp.stat.gov.pl/index.jsf>
5. GUS database (a). (2016). Retrieved 14.07.2016 from

- <https://bdl.stat.gov.pl/BDL/dane/podgrup/temat>,
6. Mesjasz-Lech, A. (2016). Directions of Changes in the Sustainable Development of Transport in Poland in the Context of European Integration. In *3rd International Conference on European Integration 2016 (ICEI 2016)* (p.623-630). Ostrava: VSB - Technical University of Ostrava.
 7. *Polityka Transportowa Państwa na lata 2006-2025*. (2005). Retrieved 15.07.2016 from <http://www.chronmyklimat.pl/download.php?id=109>
 8. Rześny-Cieplińska, J. (2013). Kierunki rozwoju systemów transportowych ze szczególnym uwzględnieniem przewozów drogowych. In M. Michałowska, *Współczesne uwarunkowania rozwoju transportu w regionie* (pp.343-352). Katowice: Zeszyty Naukowe Wydziałowe Uniwersytetu Ekonomicznego w Katowicach.
 9. *Strategia Rozwoju Transportu do 2020 roku (z perspektywą do 2030 roku)*. (2013). Retrieved 16.07.2016 from http://mib.gov.pl/media/3511/Strategia_Rozwoju_Transportu_do_2020_roku.pdf
 10. *Transport – wyniki działalności w 2008 r.* (2009). Warszawa: Główny Urząd Statystyczny.
 11. *Transport – wyniki działalności w 2010 r.* (2011). Warszawa: Główny Urząd Statystyczny.
 12. *Transport – wyniki działalności w 2013r.* (2014). Warszawa: Główny Urząd Statystyczny.
 13. Wiktorowska-Jasik, A. (2014). Założenia europejskiej polityki transportowej a potrzeby i dylematy transportu zintegrowanego. *Logistyka*, nr 3/2014, pp. 6690 – 6696.
 14. Wojewódzka-Król, K. (2014). Problemy zrównoważonego transportu w Polsce. *Logistyka*, nr 2/2014, pp. 381 – 388.

RESERVE OPTION MECHANISM: THE NEW MONETARY POLICY TOOL OF CBRT AND ITS EFFECT ON FX RATE VOLATILITY

Ibrahim Yasar Gok

*Suleyman Demirel University, Faculty of Economics and Administrative Sciences,
Department of Banking and Finance, Isparta/ Turkey*

ABSTRACT

In this study, Reserve Option Mechanism (ROM) a new policy tool of Central Bank of the Republic of Turkey (CBRT) is explained and its effectiveness to decrease FX rate volatility is empirically examined. The effects of the ROM and the direct foreign exchange interventions and auctions of CBRT on the USD/TL exchange rate volatility is analysed by applying GARCH (1,1) model and using the data for the period 09.30.2011-06.03.2016. It is found that ROM decreases the FX rate volatility significantly, which indicates the effectiveness of ROM to contribute to the financial stability.

Keywords: *Central Bank of the Republic of Turkey, FX Rate, Monetary Policy.*

1. INTRODUCTION

After the last global crisis in financial markets, the term of financial stability come forward prominently and although the price stability is the main concern of the CBRT, the financial stability have also became a major goal. CBRT publish financial stability reports two times in a year and also in its many bulletins and reports it mentions to the importance of the financial stability, contributions to the financial stability, and the risks to the financial stability. In the 2014-2018 strategic plan of CBRT, the strategic goals seperated into three area as public, global, and institutional. The aims of the public area are explained; i) providing price stability and ii) contribution to the financial stability (CBRT, 2016a). Taken into account both the price stability and the financial stability as the new political compound, CBRT started a flexible monetary policy starting from the fourth quarter of 2010 (Oduncu et al., 2013a).

Reserve option mechanism (ROM) is a new tool of monetary policy designed by CBRT. CBRT developed ROM to limit the effects of the volatility of capital flows on the financial stability. According to Alper et al. (2012), ROM is developed to enhance the strength of the financial markets against the liquidity shocks of foreign currencies and by achieving this to reduce the FX volatility to a degree. This mechanism provides an option to the commercial and participation banks to hold required reserves for the liabilities of Turkish Lira (TL) in form of USD or gold in a determined level. Hence, mechanism enables banks to use their USD assets in exchange for TL for the TL required reserves. Benefits of the mechanism are; i) to reduce the volatility created by short term capital flows, ii) to strengthen the gross foreign currency reserve of CBRT, iii) to provide flexibility to the banks to manage liquidity, iv) to reduce the credit level sensitivity regarding the capital flows, and v) to reduce the need to the other policy tools (CBRT, 2012).

The mechanism started in September 2011 and initially the option for foreign currency was just limited up to the 10% of TL required reserves, then it was gradually increased to 20% and 40%. In May 2012, the option was increased to 45% and the mechanism seperated into two tranches as up to the 40% the first tranche and between 40-45% the second tranche. Increased coefficients assigned to each of tranches as “1” to the first tranche and “1,4” to the second tranche. These coefficients means that if the banks want to benefit more in the mechanism, they need to hold more USD in exchange for TL. In time, the option has increased and also more tranches with different coefficients added into mechanism. Today, the option can be used up to the 60% of TL required reserves. Table 1. shows the mechanism after the last regulation in 2016.

Table 1. Tranches and Coefficients in ROM

Optional Tranches (%)	Coefficients
0-30	1.0
30-35	1.5
35-40	1.9
40-45	2.3
45-50	2.7
50-55	3.1
55-56	3.9
56-57	4.1
57-58	4.3
58-59	4.5
59-60	4.7

Source: (CBRT, 2016b)

Within the first tranche, because the reserve option coefficient (ROC) is “1”, banks can hold up to the 30% of TL required reserves in form of USD, 1 to 1, calculating the amount via FX rate. In the second tranche, to hold %30-35 of the TL required reserves in form of foreign currency, banks need to multiply the TL required reserves with the ROC “1,5”, then convert the TL sum of the first two tranches into USD. Table 2 gives an example that how a bank can use the mechanism. In the example, the bank needs to hold 100 TL required reserves. Using upper limit of the first tranche means that it holds \$10 in exchange for 30 TL. If it wants to use %40 of the option that means it holds \$15,666 (\$10+\$2,5+\$3,166) rather than 40 TL. Using the mechanism completely means that bank holds \$36,33 in exchange for 60TL. Consequently, bank holds 40TL + \$36,33 in exchange for 100 TL required reserves.

Table 2. An Example Explaining the ROM

Optional Tranches (1)	Reserve Option Coefficients (2)	TL Required Reserves (3)	TL Required Reserves by Multiplying the Coefficient (2*3)	USD Value of Tranches (1 USD = 3 TL)
0-30	1.0	30	30	10
30-35	1.5	5	7.5	2.5
35-40	1.9	5	9.5	3.166
40-45	2.3	5	11.5	3.833
45-50	2.7	5	13.5	4.5
50-55	3.1	5	15.5	5.166
55-56	3.9	1	3.9	1.3
56-57	4.1	1	4.1	1.366
57-58	4.3	1	4.3	1.433
58-59	4.5	1	4.5	1.5
59-60	4.7	1	4.7	1.566
TOTAL			109	36.33

The usage of the option is sensitive to the cost of the TL and foreign currencies. If the costs of the foreign currencies decrease (in the speeding period of capital inflow), banks may intend to use the option at the higher levels (the effects of the higher ROC reduce) by holding a bigger fraction of their foreign currency asset in exchange for TL required reserves. The increasing usage of the option reduce the transformation of the capital inflow of the foreign currency into credit and also reduce the appreciation pressure on TL (Küçüksaraç ve Özel, 2012a). It is also expected that when the costs of foreign currencies increase (in the speeding period of capital outflow), the usage of the option can be affected negatively because the banks withdraw their

foreign currency reserves from CBRT. This withdrawing reduce the depreciation pressure on TL. Also, in case of CBRT buy foreign currency in the speeding period of capital inflow, then it needs to be sterilized, but ROM decreases the need to sterilization (Demirhan, 2013).

In the speeding period of capital inflow the dollar depreciates, then if the banks are more willing to use the option, this situation diminishes the dollar liquidity, which also cause appreciation in dollar. Hence, this flexible structure enables the mechanism to work as an automatic balancing¹, which may limit the volatility of FX rates. Also, depending on the market conditions (the speeding periods of the capital inflow or outflow), CBRT can revise the mechanism via upper limit of the usage rate or coefficients. By reducing the coefficients it can supply liquidity to the markets or increasing the coefficients it demands more foreign currency from banks. The mechanism either works automatically in a passive situation or works in an active situation under the intervention of CBRT by changing the coefficients or upper limits of usage rate (Alper et al., 2012).

Coefficients and required reserve ratios are same for all the banks, but because the costs of TL and foreign currency differ among banks, the usage of the option differs between them (Küçüksaraç ve Özel, 2012b). Aslaner et al. (2015) explained the differentiation of the usage of the ROM in i) cost related factors (including ROC) and ii) other factors such as foreign currency liquidity conditions, global risk appetite, and exchange rate movements. They defined the breakeven coefficient leaving banks indifferent to use or not to use the ROM. The breakeven coefficient value is calculated as the ratio of the cost of TL to the cost of foreign currency. If the cost of TL is 3 TL and the cost of the foreign currency including the expected exchange rate change is 2 TL for a bank, the breakeven coefficient is equal to 1.5. If the ROC is equal to 1 and 1.3 in the first two tranches respectively, the bank is expected to use the mechanism at the highest limit of the second tranche.

Figure 1 shows the highest limits of the usage rates and the usage rates of the banks starting from September, 2010. It is seen that the mechanism used on a large scale since the beginning.

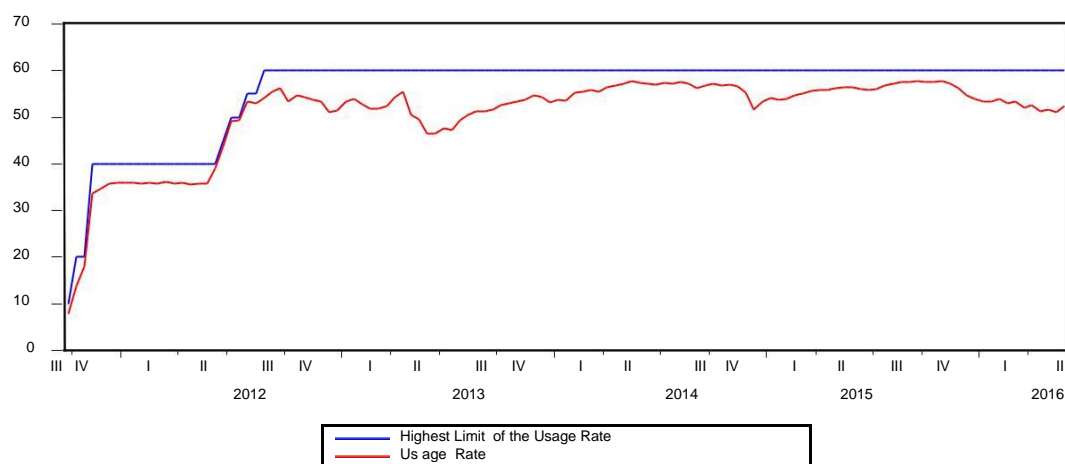


Figure 1. The Usage of the ROM

Figure 2 shows the usage rate on the basis of 100% (highest rate / usage rate). The last usage in June 3, 2016 is 87%.

¹ Automatic balancing works if the ROM is not used completely, so the ROC needs to be determined big enough in upper tranches (Alper et al., 2012).

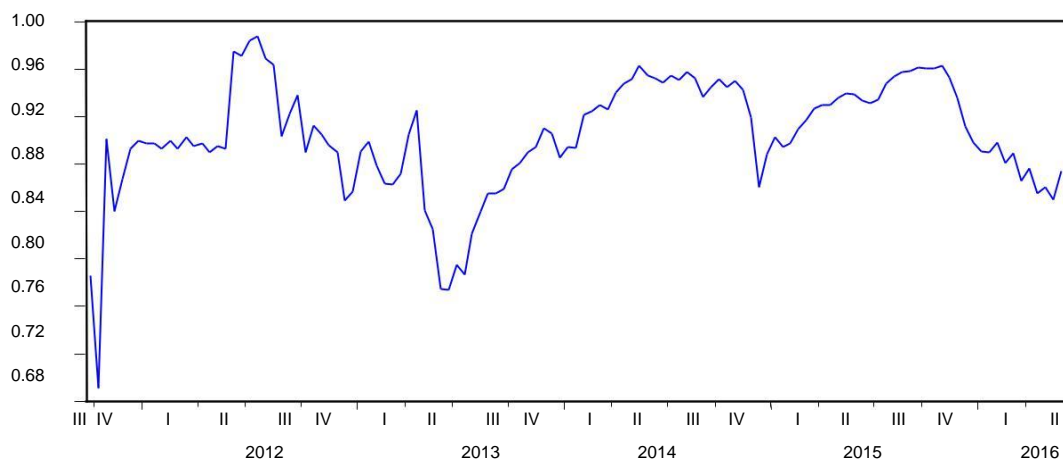


Figure 2. The Percentage of Usage the ROM

Figure 3 shows the timeline graph of the amount of USD holding in exchange for TL in the mechanism. It is seen that the amount declines since the fourth quarter of 2015. The last amount in June 3, 2016 is \$26.2 billion.

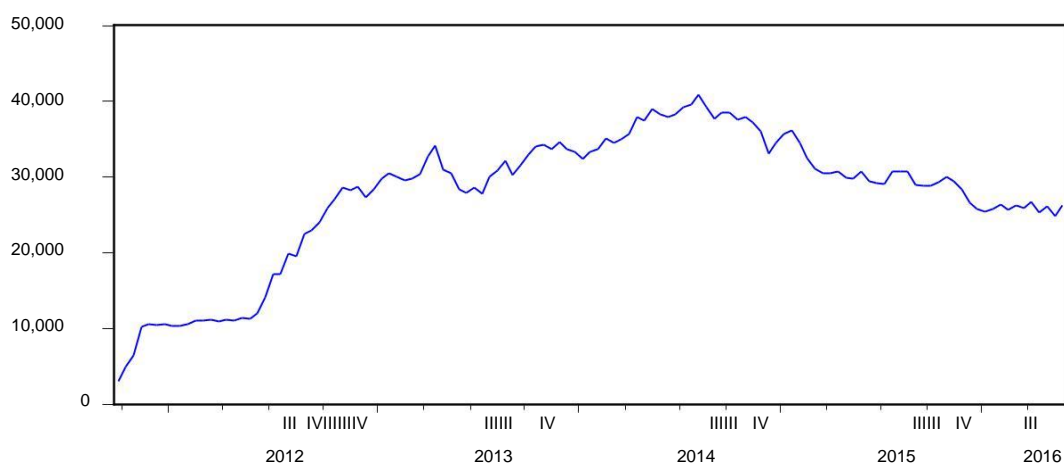


Figure 3. The Amounts of USD Holding in ROM

Because ROM is a new policy tool, there are a few empirical studies examining the effects of ROM on FX rate volatility. Oduncu et al. (2013a) analyze the effects of the amount of foreign currency in the context of ROM, FX interventions of CBRT, and additional monetary tightening on FX volatility. They used the data for the period from 10.15.2010 to 10.15.2012 and applied GARCH (1,1) model. They evidenced that ROM is efficient in decreasing the FX rate volatility. In another study, Oduncu et al. (2013b) used dummy variable alone in GARCH (1,1) model to analyze the effect of ROM on FX volatility by giving “0” before the ROM between 10.15.2010-09.29.2011 and “1” after the ROM between 09.30.2011-09.28.2012. They found that after the ROM, FX volatility decreases significantly. Also, Değerli and Fendoğlu (2013) examined the expectations of USD/TL rate’s volatility, kurtosis, and skewness using option prices and calculating the risk-neutral FX rate probability density functions. They compared developing countries which give current account deficit including Brazil, Chile, Colombia, Czech Republic, Indonesia, Mexico, Poland, Hungary, Romania, South Africa, and Turkey. They

found that USD/TL rate's skewness and especially volatility and kurtosis values decrease comparing to other FX rates after November 2011, which indicates that the policy tools such as asymmetric interest rate corridor and ROM are efficient.

This study aims to examine the effect of the holding USD amount in the ROM on the USD/TL rate volatility. Also, the effect of the direct foreign exchange interventions and auctions of CBRT on the FX rate volatility is examined. The data for the period from 09.30.2011 to 06.03.2016 is used and GARCH (1,1) model is applied. It is evidenced that the ROM is an efficient policy tool to contribute to the financial stability.

2. DATA AND METHODOLOGY

To examine the effect of the ROM on the FX rate volatility, the ratio of the holding USD amount in the ROM to gross foreign currency reserves of CBRT is used as variance regressor in the GARCH (1,1) model. Return of the USD/TL rate level as the depending variable is the indicative foreign exchange ask rates announced at 03.30 pm by CBRT in every business days. Because TL required reserves of banks are calculated² in a two-weeks period on fridays, the amount of USD in exchange for TL in the ROM is a two-weekly time series. The two-weekly exchange rate return is calculated as the log difference of the exchange rate. The data is used for the period 09.30.2011-06.03.2016.

In the model, the ratio of net foreign currency interventions (NFCI) of CBRT to gross foreign currency reserves of CBRT is also used as variance regressor. NFCI of CBRT includes the direct foreign exchange purchase and sale interventions and purchase and sale auctions of CBRT. NFCI is derived in two-weeks periods as sum of the all of the transactions in each of the two weeks. NFCI takes negative sign if the sum of the transactions are resulted as net sale and positive sign vice versa.

Mean and variance equations of GARCH (1,1) model shown in equations 1. and 2. respectively. In variance equation, $\frac{USD}{GFCR}$ represents the ratio of the holding amount of the USD in the ROM to gross foreign currency reserves of CBRT and $\frac{NFCI}{GFCR}$ represents the ratio of net foreign currency interventions of CBRT to gross foreign currency reserves of CBRT.

$$\begin{aligned} \mu_{t+1} &= \mu_t + \alpha_1 (r_t - \mu_t) + \alpha_2 (r_t - \mu_t)^2 \\ \sigma_t^2 &= \omega + \alpha_1 r_{t-1}^2 + \alpha_2 \sigma_{t-1}^2 + \beta_1 \sigma_{t-1}^2 + \beta_2 \left(\frac{USD}{GFCR} \right)^2 + \beta_3 \left(\frac{NFCI}{GFCR} \right)^2 \end{aligned} \quad \begin{aligned} 1. \\ 2. \end{aligned}$$

3. EMPIRICAL FINDINGS

Descriptive statistics of series are reported in Table 3. In panel B, it is seen that while return and NETINTR/GFCR series are stationary in level, ROM/GFCR series is not stationary.

² Required reserves are calculated in two-weeks period on Fridays and maintenance period starts two weeks after the calculation day on Friday and lasts 14 day. In this study, starting day of the maintenance period is taken into account for two-weeks periods.

Table 3. Descriptive Statistics of Series

	Return of USD/TL Rate	NETINTR/GFCR	ROM/GFCR
Panel A			
Mean	0.001643	-0.005983	0.269252
Median	0.001767	-0.003374	0.287468
Maximum	0.025049	0.000000	0.357903
Minimum	-0.021963	-0.061359	0.057216
Std. Dev.	0.008728	0.010610	0.067175
Skewness	-0.071978	-3.225057	-1.303782
Kurtosis	3.161386	13.49041	3.855116
Jarque-Bera	0.237742	770.9008**	38.28062**
Panel B			
ADF Test (Level)	-10.06302**	-6.783032**	-2.637202

Note: ** indicates significance at the 1% level and * indicates at the 5% level. Critical values for ADF test are -2.584214, -4.035648, -4.034997 for 1% level, respectively.

Since the ROM/GFCR series is not level stationary, first difference³ of this series is included in GARCH model. The results of GARCH (1,1) model are reported in Table 4. It is found that reserve option mechanism decreases the return of the USD/TL rate volatility significantly. On the other hand, the net foreign exchange interventions of CBRT do not play a significant role to decrease volatility. As a consequence, it is evidenced that the ROM is an efficient policy tool and contributes to the financial stability. This finding is in line with the findings of Oduncu et al. (2013a,b) and Değerli and Fendoğlu (2013).

Table 4. Results of GARCH (1,1) Model

	Return of USD/TL Rate	NETINTR/GFCR	ROM/GFCR	NETINTR/GFCR
4.46E-06*	-0.068288	1.001613**	-0.000886**	-0.000253
(2.281180)	(-1.370743)	(13.95968)	(-4.758964)	(-1.008535)
LB-Q (10)	12.701	[0,241]		
ARCH LM (10)	7.795	[0,649]		
	0.819	[0,610]		

** indicates significance at the 5% level and * indicates significance at the 1% level. z-statistics are given in the parantheses. p- values are given in brackets.

LB-Q and LB-Q² tests results indicate that the null hypothesis of no autocorrelation for standardized residuals and squared standardized residuals cannot be rejected. Also, ARCH-LM test result indicates that the null hypothesis of no ARCH effect cannot be rejected. Hence, diagnostic tests indicate that the model is specified correctly.

4. CONCLUSION

Reserve Option Mechanism (ROM) is introduced in September, 2011 in the context of the CBRT's new policy mix which takes into account both price and financial stability. ROM is an option for commercial and participation banks to hold USD or gold in CBRT in exchange for the Turkish Lira required reserves in a determined level. It aims to reduce the adverse effects of the volatility of the capital flow, which is a challenge to financial stability and also aims to increase the gross foreign currency reserves of CBRT. Generally speaking, the mechanism is adopted by banks and it is used on a large scale since the introduction.

³ First difference of the series is stationary.

This study empirically examines the effect of the ROM on the USD/TL rate volatility. In addition, the effect of the net foreign exchange interventions of CBRT is analyzed. In the study, the data for the period 09.30.2011-06.03.2016 is used and GARCH (1,1) model is applied. It is found that ROM significantly decreases the FX rate volatility. This result indicates that ROM is an efficient policy tool and it contributes to the financial stability.

LITERATURE:

1. Alper, K., Kara, H., & Yörükoğlu, M. (2012). Rezerv Opsiyon Mekanizması. *CBRT Research Note in Economics, No:2012-28, October 22, 2012*.
2. Aslaner, O., Çiplak, U., Kara, H., & Küçüksaraç, D. (2015). Reserve Options Mechanism: Does It Work as an Automatic Stabilizer? *Central Bank Review, 15*(1), 1-18.
3. CBRT. (2012). *CBRT Bulletin, Issue:28, December 2012*. Retrieved July 11, 2016, from <http://www.tcmb.gov.tr/wps/wcm/connect/14cdae5a-4898-42c7-a7dc-4087642253e4/Bulten28.pdf?MOD=AJPERES&CACHEID=ROOTWORKSPACE14cdae5a-4898-42c7-a7dc-4087642253e4>
4. CBRT. (2016a). CBRT 2015 Annual Report. Retrieved July 13, 2016, from <http://www3.tcmb.gov.tr/yillikrapor/2015/en/>
5. CBRT. (2016b). *Zorunlu Karşılıklar Hakkında Tebliğ*. Retrieved July 13, 2016 from [http://www.tcmb.gov.tr/wps/wcm/connect/077c0044-76d0-4388-883a-c55194041bfc/zk-teblig\(2013-15\).pdf?MOD=AJPERES](http://www.tcmb.gov.tr/wps/wcm/connect/077c0044-76d0-4388-883a-c55194041bfc/zk-teblig(2013-15).pdf?MOD=AJPERES)
6. Değerli, A., & Fendoğlu, S. (2013). Döviz Kuru Beklentileri ve TCMB Para Politikası. *CBRT Research Note in Economics, No:2013-02, January 28, 2013*.
7. Demirhan, B. (2013). Türkiye’de Yeni Yaklaşım Çerçevesinde Para Politikalarının Finansal İstikrari Sağlama Yönünde Uygulanması. *Afyon Kocatepe Üniversitesi İİBF Dergisi, 15*(2), 567-589.
8. Küçüksaraç, D., & Özel, Ö. (2012a). Rezerv Opsiyonu Mekanizması ve Optimal Rezerv Opsiyonu Katsayılarının Hesaplanması. *CBRT Working Paper, No:12/32*.
9. Küçüksaraç, D., & Özel, Ö. (2012b). Reserve Options Mechanism and Computation of Reserve Options Coefficients. *CBRT Research Notes In Economics, No:2012/33, December 7, 2012*.
10. Oduncu, A., Ermişoğlu, E., & Akçelik, Y. (2013a). Merkez Bankasının Yeni Enstrümanı Rezerv Opsiyonu Mekanizması ve Kur Oynaklığı. *Bankacılar Dergisi*(86), 43-52.
11. Oduncu, A., Akçelik, Y., & Ermişoğlu, E. (2013b). Reserve Options Mechanism: A New Macroprudential Tool to Limit the Adverse Effects of Capital Flow Volatility on Exchange Rates. *Central Bank Review, 13*(3), 45-60.
12. Watanabe, T., & Harada, K. (2006). Effects of the Bank of Japan’s Intervention on Yen/Dollar Exchange Rate Volatility. *Journal of Japanese and International Economies, 20*(1), 99-111.

CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE: THE CASE OF CROATIAN COMPANIES

Dubravka Pekanov Starcevic

*Josip Juraj Strossmayer University of Osijek, Faculty of Economics in Osijek, Republic of Croatia
dpekan@efos.hr*

Josipa Mijoc

*Josip Juraj Strossmayer University of Osijek, Faculty of Economics in Osijek, Republic of Croatia
jmijoc@efos.hr*

Matea Culjak

*Josip Juraj Strossmayer University of Osijek, Faculty of Economics in Osijek, Republic of Croatia
matea.culjak2@gmail.com*

ABSTRACT

Corporate social responsibility (CSR) refers to involving innovative ideas in everyday business that benefit society and community in which the company operates. It is a concept perceived as a great company advantage which has intrigued corporate stakeholders for many years. Reporting on corporate social responsibility involves indicators related to the environment, society and economy (triple bottom line). The main purpose of this paper is to explore corporate social responsibility disclosure in the Republic of Croatia. Although non-financial reporting in Croatia is voluntary, this will change on January 1st 2017 due to EU Directive 2014/95 by which non-financial reporting will become mandatory for Member States. With the aim of analysing how Croatian companies report on corporate social responsibility and sustainability, authors analysed the non-financial reports of Croatian companies referring to the year 2014, which were available on the official websites of the companies. Authors analysed the content, form and the extent of the reports and gave an overview of the most common used indicators, as well as variations across industry sectors. Some of the analysed companies used indicators suggested by the Global Reporting Initiative (GRI), and therefore the way and the extent of that use was also analysed.

Keywords: *corporate social responsibility, content analysis, Global Reporting Initiative, indicators, Croatia.*

1. INTRODUCTION

Throughout the years, success of the company was measured only by bottom-line profitability. Over time, good operating results cease to be the only criterion for evaluating the success of the company. Rapid technological development, increased competition and the influence that stakeholders have on the future business opportunities are the main reasons why most companies want to be perceived as socially responsible. In July 2001 European Commission recognized the importance of corporate social responsibility and issued a Green Paper –

Promoting a European framework for Corporate Social Responsibility which emphasized that „[...] although the prime responsibility of a company is generating profits, companies can at the same time contribute to social and environmental objectives, through integrating corporate social responsibility as a strategic investment into their core business strategy, their management instruments and their operations.“ (European Commission, 2001, p. 4). Corporate social responsibility (CSR) focuses on the environment, society and economy, also known as triple bottom line, as main indicators. However, reporting on corporate social responsibility is still the subject of many discussions. Several reporting guidelines have been published over the years, among them the UN Global Compact and the Global Reporting Initiative, which provide

a comprehensive system for measuring and reporting on sustainability that is, despite its extensiveness, easy to implement. „Generally, the published guidelines emphasize that corporate sustainability reports should contain a description of the organization, its sustainability vision, its objectives towards sustainability, and a series of indicators illustrating the performance of the organization, among other issues.“ (Roca and Searcy, 2012, p. 103). Despite the published guidelines, reporting on corporate social responsibility in European countries still remains voluntary. However, that will change on January 1st 2017 due to EU Directive 2014/95 by which non-financial reporting becomes mandatory for Member States. The focus of this paper is to determine the indicators disclosed in the non-financial reports. The Republic of Croatia is used as a case study, and activities related to the corporate social responsibility of the 79 Croatian companies in 2014 were analysed. After the Introduction given is Section 1, Section 2 provides a literature review on the corporate social responsibility. Results are presented in Section 3, and the paper finishes with conclusions given in Section 4.

2. LITERATURE REVIEW

The last decade was marked by the financial crisis that has affected a significant part of the global economy. Because of the crisis, which has left consequences in all segments of the society, corporate social responsibility has become one of the most talked about topics in the business world. Although corporate social responsibility is perceived as something easy and self-explanatory, defining it is not an easy task. Hopkins (2005, p. 214) points out that „CSR is concerned with treating the stakeholders of the firm ethically or in a socially responsible manner. Stakeholders exist both within a firm and outside. The aim of social responsibility is to create higher and higher standards of living, while preserving the profitability of the corporation, for its stakeholders both within and outside the corporation.“ This definition is backed up by Frederick (2006; referenced by Smith, 2011, p. 1) who says that business' have obligation „to conduct the affairs of the enterprise to maintain an equitable and workable balance among the claims of the various directly interested groups, a harmonious balance among stockholders, employees, customers, and the public at large“. Numerous political and economic institutions have their own definitions of corporate social responsibility, including the World Business Council for Sustainable Development (WBCSD) according to which „Corporate social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.“ (WBCSD, 1999, p. 3). According to Zadek (2006), learning process about corporate social responsibility for the company can be divided into several stages which are shown in Table 1.

Table 1: Stages of corporate social responsibility (Zadek, 2006, p. 339)

<i>Stage</i>	<i>What organisations do</i>
Defensive	Deny practices, outcomes, or responsibilities
Compliance	Adopt a policy-based compliance approach as a cost of doing business
Managerial	Embed the societal issue into their core management processes
Strategic	Integrate the societal issue into their core business strategies
Civil	Promote broad industry participation in corporate responsibility

Also, many authors emphasize that socially responsible behaviour of the companies is affected by the national business system, and among those authors are Matten and Moon (2008) who think that there are explicit and implicit approaches to CSR. „The explicit approach to CSR indicates the deliberate disclosure of CSR actions and a strategic choice by the company to communicate its decision to engage with stakeholders, and even if the CSR is linked to strategy the main aim is to highlight the corporate strategy in order to gain a competitive advantage in marketing communication. In contrast, the implicit approach to CSR indicates rare and poor

communication about CSR, and consequently, CSR actions are not the result of a strategic decision.“ (Matten and Moon, 2008, referenced by Romolini, Fissi and Gori, 2012, p. 67). Croatian Business Council for Sustainable Development (HR BCSD) was founded in 1997 by 18 Croatian companies, who were united in taking the public obligation of the implementation and promotion of sustainable business practices, aiming at the sustainable development of the Republic of Croatia. Today, organization counts 36 members. Ten years ago, Agreement on Cooperation between Croatian Business Council for Sustainable Development and Croatian Chamber of Economy was signed and in April 2007 project “CSR Index” started. Croatian Chamber of Economy (2016) alleges that the aim of the project was to popularize corporate social responsibility in Croatia, in terms of strengthening the market position of enterprises and building a good reputation, through all business segments. The methodology defines a set of criteria to evaluate voluntary practices of Croatian companies in six areas: economic sustainability, inclusion of CSR in business strategy, working environment, environmental protection, market relations and relations with the community. That methodology was transformed into a questionnaire which contains 119 questions for large and medium sized companies and 61 question for small companies. In August 2013, report „Draft national review report: CSR for all Croatia“ was published within the EU-funded project „Corporate Social Responsibility for All“, and in that report was stated that „[...] in Croatia the government has almost no measures for CSR promotion [...]. There are also no regulations, policies or laws that would explicitly support CSR but there is legislation in the area of environmental protection, human and labour rights which set minimum standards in these areas but there are no mechanisms that would support the voluntary practice.“ (Croatian Employers' Association, 2013, p. 2). The same report states that one of the most important recent researches on CSR practices in Croatia is comparative research *Accelerating CSR practices in the new EU member states and candidate countries as a vehicle for harmonization, competitiveness, and social cohesion in the EU* carried out by UNDP in 2007. This research has estimated that there are about 200 companies in Croatia which apply at least some form of CSR practices in one of the key areas (environmental protection, labour rights, community development, strategic or value orientation). In 2013, analysis of the results of the CSR Index was conducted and it showed that there is a lower interest from the companies in CSR. This trend can be attributed to the recession that has affected Croatia in the years between the two studies. For the companies that operate on the territory of Croatia, reporting on CSR is still a matter of choice, but on January 1st 2017 that will change due to EU Directive 2014/95. The Croatian Institute for Corporate Social Responsibility (2016) states that the Directive applies to more than 6,000 large enterprises of public interest in the EU with a minimum of 500 employees, determines the extent of non-financial reporting, but also leaves the door open for the use of framework concerning existing data on sustainability, human rights and frameworks for reporting the employees and the conditions of their work. This Directive is part of a wider EU initiative on corporate social responsibility, which includes a consistent approach to reporting and supporting sustainable and inclusive growth in achieving the objectives of the European Union by 2020, which was preceded by a new accounting directive, EU Directive 2013/34. Globalisation and market liberalization have invaded the whole world, including Croatia. Such processes are inevitable and seek an open and competitive economy and one of the preconditions of competitiveness has become corporate social responsibility to which all Croatian companies must strive for if they want to take a satisfactory market position.

3. RESULTS

Based on the research by Roca and Searcy (2012), authors conducted a content analysis of non-financial statements for 79 Croatian companies. In the present research, sample from Pekanov Starčević, Mijoč and Mijoč (2016) was used. These authors conducted a primary research

through a questionnaire in the period from January to March 2015 (for the year 2014). In this paper, all of the reports were also from 2014 and available on official websites of the companies. Furthermore, all of the companies were listed on the Zagreb Stock Exchange. National Classification of Activities, 2007 (NKD 2007) was used in order to determine in which industry sectors analysed companies operate. Sections in NKD 2007 are identified by an alphabetical code (A-U) and for the purpose of an easier companies' sorting, classification was made based on those sections. Table 2 shows number of companies by industry sectors.

Table 2: Number of companies by industry sectors (prepared by authors)

Industry sector	No. of companies
Accommodation and food service activities	12
Financial and insurance activities	13
Construction	2
Information and communication	2
Electricity, gas, steam and air conditioning supply	1
Agriculture, forestry and fishing	8
Manufacturing	26
Transportation and storage	2
Professional, scientific and technical activities	4
Wholesale and retail trade, repair of motor vehicles and motorcycles	8
Arts, entertainment and recreation	1
TOTAL	79

It is evident that the largest number of observed companies operate in the manufacturing industry, 33% of the them to be precise, while only 1 company operates in the industry of arts, entertainment and recreation and in the industry of electricity, gas, steam and air conditioning supply.

3.1. Types and length of the reports

Corporate social responsibility reports were the focus of this paper, but it has been found that companies in the sample use a variety of different report titles, and those differences are shown in Table 3. As shown below, 88% of the reports are named „Annual report“, while 5% can be found under the name of „Sustainability report“. It is important to note that the vast majority of „Annual reports“ are actually classic financial reports in which CSR is not mentioned at all. In most cases, companies highlight their CSR activities on the official websites in a few paragraphs without publishing a report related to CSR. Only one company in the sample published a report titled „Corporate social responsibility report“. In addition, the maximum, minimum and average length of the reports was analysed and, as expected, it was determined that „Annual reports“ count the most pages. Among 79 reports, the longest one had 245 pages and the shortest one 5 pages. Also, it is apparent that type of report has a significant impact on the length.

Table 3: Type and length of the reports (prepared by authors)

Type of report	Number of reports	Maximum length	Minimum length	Average length
Annual report	70	245	5	73
Communication on progress	2	18	13	15,5
Corporate social responsibility report	1	30	30	30
Report on environmental protection	1	5	5	5
Social report	1	21	21	21
Sustainability report	4	193	62	103

3.2. The most commonly used indicators

In order to identify which indicators were used in the published reports, content and the first few pages were read and indicators used in those sections were recorded. Secondly, charts, tables, figures and bold characters were checked and indicators that appear in one of the mentioned components were also recorded.

Table 4: Most commonly used indicators (prepared by authors)

Indicators	No. of reports	Indicators	No. of reports
Total no. of employees	77	Employee turnover	11
Financial result	77	Donations and sponsorships	11
Structure of expenditures	76	Education and employee training	10
Risk exposure and risk management	76	Economic environment / business environment	10
Revenue structure	76	Quality policy	9
Organisational structure	76	History of the company	9
Company activities/industry	76	Employee benefits/prizes	9
Assets	75	Stakeholders	8
Operational costs	72	Sales by market and by type of product	8
Company profile/General information	72	Market price of the shares / Croatian capital market	8
Responsibility for the report	70	Water consumption	7
Cost of salaries	68	Corporate governance	7
Number of shares	66	Work environment/Working conditions	7
Ownership structure	65	Natural gas consumption	6
Legislation	62	Hazardous waste	6
Nominal value of the share	58	Effluents/Total water discharge by quality and destination	6
Earnings/loss per share	50	Code of Ethics and Integrity	6
Adoption of new and revised IFRS	48	CO ₂ emissions (direct/indirect/total)	6
Development plan	35	Certificate	6
Expenditure, investments and information on environmental protection/Environmental Management	29	Waste management	5
Statement by the Chairman of the Board/Management report	26	Prevention of corruption and other conflicts of interest	5
Research and Development	24	Relationship with customers	5
Number of employees by qualification	20	No. of hours of training per employee	5
Litigation	19	Non-hazardous waste	5
Contribution to the community	16	NO ₂ emissions	5
Investment	15	Memberships	5
Electricity consumption (direct and indirect)	15	Manufacturing / by products / by markets	5
No. of employees by gender	13	Macroeconomic developments in Croatia	5
No. of employees by age	13	Greenhouse gas emissions	5
Financial indicators	12	Emissions of air pollutants / PM10 air quality / air protection	5
Occupational health and safety	12	Corporate social responsibility	5
Supply chain/suppliers	11	TOTAL	63

The conducted analysis showed that 338 different indicators were mentioned in 79 reports from 2014, and in the table above are shown only those indicators that appear in 5 or more reports. Number of indicators per report ranged from 10 to 122, with an average number of 27 indicators per report. Out of 338 indicators, 193 were used only once, 42 twice, 22 thrice, and 18 were mentioned by four companies. On the other hand, only 17 indicators can be found in more than 50 reports, and 11 of them appear in more than 70 reports. It is noticeable that all indicators

which are highlighted in more than 70 reports are related to the financial performance of the company as well as the general information about the company. This can be explained by the fact that most of the analysed companies, in their annual reports, present only financial data, while CSR related activities are noted on their websites, without the existence of a separate report.

3.3. Types of indicators by categories

There are several different ways in which indicators can be organized. In this paper, indicators are divided into four categories: economic, environmental, social (triple bottom line) and general standard disclosure. Out of 338 indicators, 22% were classified as economic indicators, 30% as environmental and social, and 18% as general standard disclosure indicators. Although 70 reports are highlighted as annual reports in which financial data and general information about the company dominate, companies that publish separate reports on CSR activities have contributed to this 60% dominance in favour of environmental and social indicators because in those reports a larger number of indicators is presented.

Figure 1 shows the indicators in the selected categories per type of report. As mentioned above, majority of reports (70) are annual reports, while only 9 reports are classified as a different type of report. An analysis of Figure 1 shows that economic and GSD indicators dominate in annual reports, while other reports give a greater emphasis on social and environmental indicators as well, with the exception of the Report on environmental protection in which only environmental indicators are present, which is self-explanatory. It is interesting to note that Social report and Sustainability report are the only two types of report that present a relatively balanced distribution of indicators.

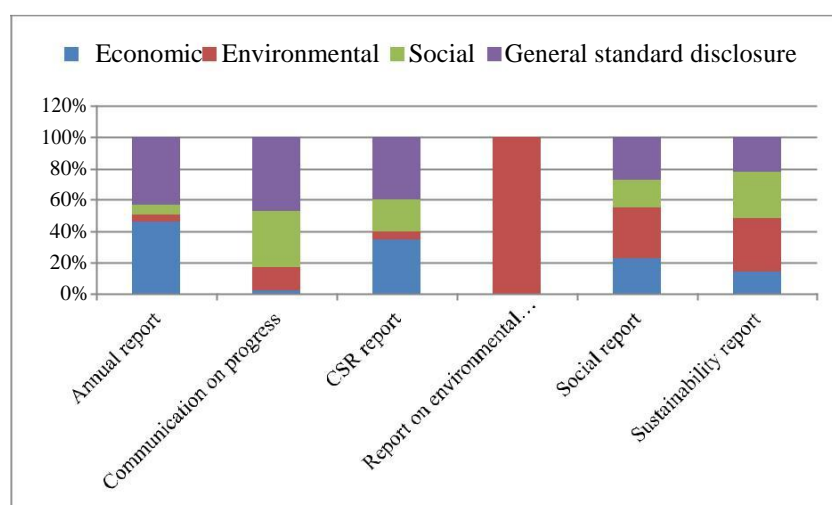


Figure 1: Display of the indicators in the selected categories by type of reports (prepared by authors)

In Figure 2, indicators in the selected categories by industry sectors are presented. It is visible that in every industry, with the exception of industries of information and communication, electricity, gas, steam and air conditioning supply and professional, scientific and technical activities, economic indicators are the most frequent. In those mentioned exceptions, the highest diversity of indicators is presented. The reason for that can be found in the fact that 3 out of 7 companies which operate in those industries published Sustainability report which, as shown in Figure 1, has the most balanced display of indicators.

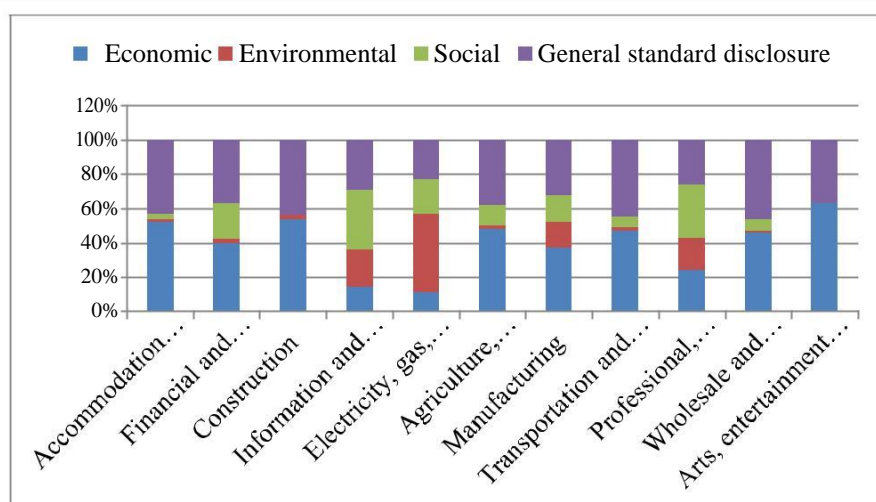


Figure 2: Display of the indicators in the selected categories by industry sectors (prepared by authors)

3.4. GRI indicators

If a company's management wants to present its work and achievements through the year in a quality manner, it is very important that published reports contain all aspects of the business, CSR included. For that purpose, the Global Reporting Initiative was released in 2006. Since then, GRI guidelines have been updated several times, last time in May 2013, when the fourth generation of the Guidelines was launched. „G4 provides guidance on how to present sustainability disclosures in different report formats: be they standalone sustainability reports, integrated reports, annual reports, reports that address particular international norms, or online reporting. [...] Sustainability reporting helps organizations to set goals, measure performance, and manage change in order to make their operations more sustainable. A sustainability report conveys disclosures on an organization's impacts – be they positive or negative – on the environment, society and the economy. (G4, Sustainability Reporting Guidelines, 2011, p. 3). Conducted analysis showed that, out of 79 analysed companies in Croatia, only 6 (8%) of them use GRI guidelines, and that is a surprisingly small number. 50% of those 6 companies that use GRI guidelines operate in a manufacturing industry, while the industries of professional, scientific and technical activities, electricity, gas, steam and air conditioning supply and information and communication are represented by one company each. Due to the small number of companies using GRI guidelines, detailed analysis could not be conducted, thereby Table 5 shows only the use of general standard disclosure (GSD), economic (EC), environmental (EN) and social (LA) GRI indicators among 6 companies.

Table following on the next page

Table 5: Use of the GRI indicators by categories (prepared by authors)

Category	No. of	Category	No. of	Category	No. of	Category	No. of
GSD	mentions	EC	mentions	EN	mentions	LA	mentions
G4-1	5	EC1	6	EN1	4	LA1	6
G4-2	4	EC2	4	EN2	2	LA2	4
G4-3	6	EC3	3	EN3	6	LA3	4
G4-4	5	EC4	2	EN4	2	LA4	3
G4-5	5	EC5	2	EN5	3	LA5	4
G4-6	5	EC6	2	EN6	4	LA6	5
G4-7	5	EC7	2	EN7	2	LA7	4
G4-8	5	EC8	1	EN8	4	LA8	4
G4-9	6	EC9	2	EN9	2	LA9	5
G4-10	6			EN10	2	LA10	4
G4-11	4			EN11	3	LA11	4
G4-12	6			EN12	3	LA12	3
G4-13	4			EN13	2	LA13	4
G4-14	4			EN14	2	LA14	2
G4-15	4			EN15	2	LA15	1
G4-16	4			EN16	3	LA16	1
G4-17	4			EN17	3		
G4-18	4			EN18	3		
G4-19	4			EN19	2		
G4-20	4			EN20	3		
G4-21	4			EN21	3		
G4-22	3			EN22	3		
G4-23	3			EN23	5		
G4-24	5			EN24	2		
G4-25	5			EN25	2		
G4-26	5			EN26	3		
G4-27	5			EN27	3		
G4-28	5			EN28	2		
G4-29	5			EN29	3		
G4-30	5			EN30	1		
G4-31	5			EN31	2		
G4-32	4			EN32	1		
G4-33	4			EN33	1		
G4-34	5						
G4-35	2						
G4-36	2						
G4-37	2						
G4-38	2						
G4-39	2						
G4-40	2						
G4-41	3						
G4-42	2						
G4-47	1						
G4-51	2						
G4-52	2						
G4-56	4						
G4-58	2						

4. CONCLUSION

As mentioned earlier, today's business world, its speed and variability, requires fast and efficient adjustment. Different stakeholders want companies to contribute to the community in which they operate. For many, social responsibility is no longer a matter of choice, but one of the ways companies can stand out and contribute to the development of the society in whole.

Since corporate social responsibility (CSR) has become one of the most talked about topics in the last several years, this paper examined the situation in the Republic of Croatia. Analysis included 79 Croatian companies, precisely, 79 published reports from 2014. Aim of the conducted analysis was to determine how Croatian companies report on corporate social responsibility. It was found that 33% of the companies operate in the manufacturing industry. 70 out of 79 reports were „Annual reports“, but it is interesting that most of those reports are classic financial reports. Results of the analysis showed that 338 different indicators were used in the reports from 2014 with an average number of 27 indicators per report. All indicators which appear in more than 70 reports are related to the financial performance and general information about the company. Out of 338 indicators, 22% were classified as economic indicators, 30% as environmental and social, and 18% as general standard disclosure indicators. Environmental and social indicators dominate the reports regarding CSR. The most balanced breakdown of indicators can be found in 3 industries: information and communication, electricity, gas, steam and air conditioning supply and professional, scientific and technical activities. The reason can be found in the fact that 43% of companies, operating in the mentioned industries, published Sustainability report which, as analysis showed, has balanced distribution of indicators. The use of GRI guidelines was also part of the analysis, and it was found that only 8% of the companies in the sample use them.

To sum up, this analysis showed that Croatian companies have a lot of room for improvement when it comes to CSR reporting. Mainly, Croatian companies, with several exceptions, do not publish separate reports related to corporate social responsibility. They mostly issue financial reports, and CSR activities are mentioned in a paragraph or two on the official websites of the companies. On January 1st 2017 that will change because non-financial reporting becomes mandatory for Member States of the European Union due to EU Directive 2014/95.

LITERATURE:

1. Croatian Institute for Corporate Social Responsibility. (2016). Retrieved 30.7.2016. from <http://www.idop.hr/hr/izvjestavanje/izvjestavanje/nefinancijsko-izvjestavanje-izvjestavanje-o-odrzivosti/direktiva-201495eu/>.
2. European Commission. (2001). *Green paper. Promoting a European framework for Corporate Social Responsibility*. Brussels:European Commission. Retrieved 28.7.2016. from http://ew.eea.europa.eu/Industry/Reporting/cec__corporate_responsibility/com2001_0366en01.pdf.
3. European union. (2013). *Corporate socail responsibility for all*. Brussels. European union. Retrieved 29.7.2016. from <http://csrforall.eu/sr/icerik/reports/Croatia-National-Review-Report.pdf>.
4. Global reporting initiative. (2013). Retrieved 30.7.2016. from <https://www.globalreporting.org/resourcelibrary/Croatian-G4-Part-One.pdf>
5. Hopkins, M. (2005). Measurement of corporate social responsibility. *International Journal of Management and Decision Making*, 6(3-4), 213-231.
6. Indeks DOP-a. (2016). Retrieved 30.7.2016. from <https://dop.hgk.hr/povijest-projekta/>.
7. Matten, D., & Moon, J. (2008). “Implicit” and “explicit” CSR: a conceptual framework for a comparative understanding of corporate social responsibility. *Academy of management Review*, 33(2), 404-424. Retrieved 29.7.2016. from <http://carleton.ca/ces/wp-content/uploads/MattenMoon-in-AMR-2008.pdf>.

8. National Classification of Activities. (2007). Retrieved 20.7.2016. from https://e-obrt.minpo.hr/dokumenti/nkd2007_s_objasnjenjima.pdf.
9. Pekanov Starčević, D., Mijoč, I. & Mijoč, J. (2016) Does it Pay Off to Be Socially Responsible? Empirical Evidence from Listed Companies. *Ekonomski pregled*, 67(4), in press.
10. Roca, L. C., & Searcy, C. (2012). An analysis of indicators disclosed in corporate sustainability reports. *Journal of Cleaner Production*, 20(1), 103-118.
11. Romolini, A., Fissi, S., & Gori, E. (2014). Scoring CSR reporting in listed companies—Evidence from Italian best practices. *Corporate Social Responsibility and Environmental Management*, 21(2), 65-81.
12. Smith, R. E. (2011). *Defining corporate social responsibility: a systems approach for socially responsible capitalism*. (Master thesis). University of Pennsylvania. Retrieved 28.7.2016. from http://repository.upenn.edu/cgi/viewcontent.cgi?article=1009&context=od_theses_mp
13. Vrdoljak Raguž, I., & Hazdovac, K. (2014). Društveno odgovorno poslovanje i hrvatska gospodarska praksa. *Oeconomica Jadertina*, 4(1), 40-58.
14. World Business Council for Sustainable Development. (1999). *Corporate Social Responsibility: Meeting Changing Expectations*. World Business Council for Sustainable Development. Retrieved 28.7.2016. from <http://oldwww.wbcsd.org/plugins/DocSearch/details.asp?type=DocDet&ObjectId=Mjg2>.
15. Zadek, S. (2006). Responsible competitiveness: Reshaping global markets through responsible business practices. *Corporate Governance: The international journal of business in society*, 6(4), 334-348. Retrieved 29.7.2016. from <http://www.emeraldinsight.com/doi/abs/10.1108/14720700610689469>.

TRADE CREDIT FINANCING: SUBSTITUTION AND MATCHING EFFECT FOR ITALIAN SMEs

Candida Bussoli

University LUM Jean Monnet
bussoli@lum.it

ABSTRACT

The paper focuses on the relevance of financial motivation in the use of trade credit. The analysis considers Italian SMEs over the years 2005-2012. Using GMM models, the study aims to test whether accounts payable may follow a model of partial adjustment, and aims to find empirical evidence that supports the financial function of trade credit.

Results support the hypothesis of the existence of a model of partial adjustment, since accounts payable of the previous year affect accounts payable of the following year. Results also support the matching hypotheses, since firms that grant extended payment terms to their customers tend to demand delayed accounts payable from their suppliers. The empirical evidence reveals the existence of a substitution function between accounts payable and debts to banks and suggests that SMEs increase their accounts payable terms when short or medium and long bank credit is less available.

Keywords: trade credit, SMEs, accounts payable.

Full paper was not published upon the author's request

LITERATURE:

1. Arellano, M., Bond, S. (1991). Some tests of specification for panel data: Monte Carlo evidence and an application to employment equations. *Review of Economic Studies*, No. 58, 277–297.
2. Arellano, M., Bover, O. (1995). Another look at the instrumental variable estimation of error-components models. *Journal of Econometrics*, No. 68, 29–51.
3. Bastos, R., Pindado, J. (2007). An agency model to explain trade credit policy and empirical evidence, *Applied Economics*, No. 39, 2631–2642.
4. Bastos, R. Pindado, J. (2013). Trade credit during a financial crisis: A panel data analysis, *Journal of Business Research*, No. 66, 614–620.
5. Berger, A.N. Udell, G.F. (1998). The Economics of Small Business Finance: The Role of Private Equity and Debt Markets in the Financial Growth Cycle, *Journal of Banking and Finance* No. 22, 613–673.
6. Biais, B. Gollier, C. (1997). Trade Credit and Credit Rationing, *Review of Financial Studies*, vol. 10, No. 4, 903–937.
7. Blundell, R., Bond, S. (1998). Initial conditions and moment restrictions in dynamic panel data models, *Journal of Econometrics*, No. 87, 115–144.
8. Burkart, M. Ellingsen, T. (2004). In-Kind Finance: A Theory of Trade Credit, *American Economic Review*, Vol. 94(3), 569–590.
9. Burkart, M. Ellingsen, T. Giannetti, M. (2011). What you sell is what you lend? Explaining trade credit contracts, *Review of Financial Studies*, Vol. 24 (4), 1261–1298.

10. Casey, E. O'Toole, C.M. (2014). Bank lending constraints, trade credit and alternative financing during the financial crisis: Evidence from European SMEs, *Journal of Corporate Finance*, No. 27, 173-193.
11. Cuñat, V. (2007). Trade Credit: Suppliers as Debt Collectors and Insurance Providers, *The Review of Financial Studies*, Vol. 20(2), 491-527.
12. Danielson, M.G. Scott, J.A. (2004). Bank loan availability and trade credit demand, *Financial Review* No. 39, 579-600.
13. Deloof, M. Jegers, M. (1996). Trade Credit, Product Quality, and Intragroup Trade: Some European Evidence, *Financial Management*, Vol. 25(3), 33-43.
14. Demircug-Kunt, A. Maksimovic, V. (2001). Firms as Financial Intermediaries: evidence from trade credit data, *World Bank Policy Research Working Paper* No. 2696, World Bank Development Research Group (DECRG) and University of Maryland.
15. Duca, J. (1986). *Trade credit and credit rationing: a theoretical model*, Board of Governors of the Federal Reserve System, Research Papers in Banking and Financial Economics, No. 94.
16. Emery, G.W. (1987). An optimal financial response to variable demand, *Journal of Financial and Quantitative Analysis*, Vol. 22, 209-225.
17. Emery, G.W. (1984). A pure financial explanation for trade credit, *Journal of Financial and Quantitative analysis*, Vol. 19, 271-285.
18. Engemann, M. Eck, K. Schnitzer, M. (2014). Trade Credits and Bank Credits in International Trade: Substitutes or Complements?, *The World Economy*.
19. Fabbri, D. Klapper, L. (2008). Market power and the matching of trade credit terms, *World Bank Policy research working paper*, no. 4754.
20. Ferris, J.S. (1981). A transactions theory of trade credit use, *Quarterly journal of Economics*, vol. 96, No. 2, 243-270.
21. Fisman, R.J., Love, I. (2003). Trade Credit, Financial Intermediary Development and Industry Growth. *Journal of Finance*, No. 58(1), 353-374.
22. Garcia-Appendini, E. Montoriol-Garriga, J. (2013). Firms as liquidity providers: Evidence from the 2007–2008 financial crisis, *Journal of Financial Economics*, No.109, 272–291.
23. Garcia-Teruel, P.J. Martinez-Solano, P. (2010). A dynamic perspective on the determinants of accounts payable, *Review of Quantitative Finance & Accounting*, No. 34, 439–457.
24. Huyghebaert, N. (2006). On the Determinants and Dynamics of Trade Credit: Empirical Evidence from Business Start-ups, *Journal of Business Finance & Accounting*, Vol. 33, 305-328.
25. Jaffe, D.M. Stiglitz, J.E. (1990). *Credit rationing*, in Friedman B.M. e Hahn F.H., (Ed.), *Handbook of Monetary Economics*, Amsterdam, North Holland.
26. Lee, Y.W. Stowe, J.D. (1993). Product risk, asymmetric information, and trade credit, *Journal of Financial and Quantitative Analysis*, Vol. 28, No. 2, 88-96.
27. Long, M.S. Malitz, I.B. Ravid, S.A. (1993). Trade Credit, Quality guarantees, and Product Marketability, *Financial Management*, Vol. 22, No. 4, 117-127.
28. Mian, S.L. Smith, C.W. (1992). Accounts receivable policy management: theory and evidence, *Journal of Finance*, vol. 47, 169-200.

29. Nadiri, M.I. (1969). The determinants of trade credit in the US total manufacturing sector, *Econometrica*, No.37(3), 408–423.
30. Nilsen, J. (2002). Trade credit and the bank lending channel. *Journal of Money, Credit, and Banking*, No. 34, 226–253.
31. Niskanen, J. Niskanen, M. (2006). The determinants of corporate trade credit policies in a bank- dominated financial environment: the case of Finnish small firms, *European Financial Management*, No. 12, 81–102.
32. Petersen, M.A. Rajan, R.G. (1997). Trade credit: theories and evidence, *The Review of Financial Studies*, Vol. 10, 661–691.
33. Pike R., Cheng N. S. Cravens, K. (2005). Trade Credit Terms: Asymmetric Information and Price Discrimination Evidence From Three Continents, *Journal of Business Finance & Accounting*, Vol. 32, 1197-1236.
34. Schwartz, R.A. (1974). An economic model of trade credit, *Journal of Financial and Quantitative Analysis*, Vol. 9, 643-657.
35. Schwartz, R.A. Whitcomb, D.K. (1978). Implicit transfers in the extension of trade credit, in K.E. Boulding e T.F. Wilson (Ed.), *Redistribution through the Financial System*, New York.
36. Schwartz, R.A. Whitcomb, D.K. (1979). The trade credit decision, in Bicksler J. (Ed.), *Handbook of financial economics*, Amsterdam.

ANTIBIOTIC CONSUMPTION IN A TURBULENT ENVIRONMENT

Arianit Jakupi

A2 – Pharmaceutical Consulting, Kosovo
arianiti@gmail.com

Hasan Jakupi

ORL private ordinance, Kosovo
hjakupi@gmail.com

Indrit Baholli

European University Tirana, Albania
indrit.baholli@uet.edu.al

ABSTRACT

Drug consumption in Kosovo is now for few year being analyzed in Kosovo with a comparison also with other countries with the results showing many differences in between. Antibiotics as a particular group of drugs also in Kosovo is defined as a group of drugs that should be dispensed in pharmacies as a prescription only medicines. The legal aspect of this particular issue is defined in the Law 04/L-190 for medicinal products and devices (previously Law 03/L-188) while the details about the prescription are set in the sublegal act 01/2010. The analysis period of the antibiotic consumption is 2011-2013 or after the entry into force of these legal aspects that defined this issue. The Ministry of Health according to the law has supplied all the health institutions with the prescription form but in the absence of the adequate supervision from the inspectorates in order that this particular aspect of the law finds the complete fulfillment has made possible that the dispensing from the pharmacists to be done also with the simple request from the patients.

Analysis of the antibiotic consumption is chosen with the aim of documenting that doing business in a turbulent environment surpasses the ethics, law or public health protection and in this case this is done with the complete consciousness in many levels including pharmacists that are a category of people with superior qualification.

Keywords: Drug Consumption, Antibiotics, Turbulent environment business.

1. INTRODUCTION

Drug consumption in Kosovo has produced results which show that the need for change in some aspects is not only necessary but essential. In many groups of drugs by comparing the results is seen that the change it is not only quantitative but also qualitative since the ranking of the use of subgroups of drugs is different from those of compared countries or countries that have very regulated health systems – or “nearly perfect” with the legislation in place for many years. In this context we must not forget the fact that Kosovo is a new country (the independence in 2008) and emerged from the war not long ago, passing even now after 2008 through many changes trying to build a stable health system, but with so many changes within years that caused surprises but also contradictions that have led to a situation with the impression of turbulent changes which then cause many difficulties for the creation of a proper health system. These turbulences are also as a result of a many changes in the leading managerial structures in this case health structures starting from Ministers, General Secretary of the Ministry or the CEO of the Drug Agency (only in last 5-6 years with changes in 4 ministers, 4 general secretaries or 5 Drug Agency CEO's). All these changes in managerial terms are accompanied by changes in health strategy building concepts and of the health legislative regulation which in reality change the basics of the system functioning.

Drug Consumption

Issues that are related to drug regulation are defined in the Health Law, or specified in the Law on medical products and devices and the law on narcotics and other sublegal acts that have defined the details, the way of regulation and function of the pharmaceutical system. Pharmaceutical system functions as public hospital system and the private system in pharmacies, warehouses, manufacturers and representatives or importers of foreign manufacturers. In the public system in recent years has been seen a tendency of supporting the development of hospital pharmacy starting with the distribution of pharmacists into various clinics in the hospital system (starting from University Clinical Center) with an aim for continuing this trend in regional hospitals thus the "advancement" or giving the pharmacist real responsibilities which belong to them and not only those which are related to the management of the hospital pharmacy in the technical point of view or just the distribution part without being related to the professional aspects of the drug dispensing for the patient. While the private system that is more developed it has a structure which is built in this form after the war in 1999. This built structure operated for these years with changes all the time having frequent changes in requirements and legal and administrative causing in this way their own system problems or dysfunction of some important parts of the system. Legal regulation of the issues related to the supply chain of drugs has also gone through turbulences but despite regulation or legal determination never until now could not be implemented in this case in last chain thus giving drugs to patients without the prescription by the family doctor. In this case is created the possibility of supply of any medicinal product in pharmacies even only at the request of the patient and including psychotropic substances and precursors although there are reports of last year's that however for these categories is a better control but not an absolute control. The same situation applies to the use of antibiotics which is failing to be applied, enabling patients supply with any antibiotic with or without need, without any prior consultation with the family doctor but only upon request at pharmacies. Antibiotic analysis of consumption in Kosovo is made also from WHO now for some years having some publications which are made with a comparative analysis with other European countries. Administrative Instruction 01/2010 has regulated the issue of the use of prescription in the health system legally but that this is not implemented, so lacking supervision even that the Ministry of Health has made the supply with the prescription forms for all the health institutions, but in this case patients often neglecting control, directly address in pharmacies. The pharmacists in pharmacies do not fulfill this legal act and dispense the drugs or antibiotics to the patients even without the prescription. Article 8 of the Administrative Instruction 01/2010 stipulates that the pharmacist must provide only drugs that are with the prescription (except drugs that are given without prescription or OTC drugs).

2. METHODOLOGY

Methodology used is based on ATC classification of drugs. According to WHO in the Anatomical Therapeutic Chemical (ATC) classification system, the active substances are divided into different groups according to the organ or system on which they act and their therapeutic, pharmacological and chemical properties, furthermore explaining that drugs are divided into fourteen main groups (1st level), with pharmacological/therapeutic subgroups (2nd level), the 3rd and 4th levels are chemical/pharmacological/therapeutic subgroups and the 5th level is the chemical substance. Furthermore WHO introduced DDD (Defined Daily Dose – as the average maintenance daily dose of a product) and DID (Defined Daily Dose of a product per Inhabitant per Day) which are used for drug utilization studies and also that are used in the analysis for this paper. Drug consumption data were collected from wholesalers in the time period 2011-2013. As this was the first official publication by Kosovo Medicines Agency (KMA) this was the reason of analyzing it for three year period in order to get also the

perception of the trend of drug use (KMA. 2014). From this publication were analyzed the antibiotic group and this is compared to other countries antibiotic consumption. The detailed analysis of data included also different indicators needed for final results. These including the total quantity in mg of substance, defined daily dose of the product, time period of the consumption that has been made and population in total.

3. RESULTS

The consumption of drugs results show the consumption in monetary values but also in DID (The defined daily dose per inhabitant per day). From the table below we see monetary values of consumption of drugs and see how the group J or group to which they are set antibiotics is a group which has the second largest monetary value of the fourteen groups of drugs being very close to the first group in terms of the monetary consumption. This shows the commercial importance of this group of drugs despite health importance which is another indicator for the developed drug marketing. In the table 1 is shown the comparison between the monetary drug consumption based on level one of the ATC codes within three years in Kosovo:

Table 6 Drug Consumption in monetary values in Kosovo 2011-2013 (Source: KMA, 2014)

ATC 1	2011	2012	2013	Grand Total
A	€ 3,814,821.44	€ 4,057,549.47	€ 5,227,757.38	€ 13,100,128.29
B	€ 3,214,534.82	€ 3,633,039.42	€ 5,366,609.68	€ 12,214,183.93
C	€ 4,985,072.59	€ 6,140,228.63	€ 7,511,511.14	€ 18,636,812.37
D	€ 722,834.33	€ 779,633.49	€ 935,654.26	€ 2,438,122.08
G	€ 1,189,018.61	€ 909,913.07	€ 1,231,227.71	€ 3,330,159.38
H	€ 582,215.91	€ 1,114,013.49	€ 852,195.44	€ 2,548,424.84
J	€ 5,919,427.99	€ 6,620,593.72	€ 5,834,674.59	€ 18,374,696.30
L	€ 3,496,065.07	€ 7,058,046.99	€ 5,595,446.98	€ 16,149,559.04
M	€ 2,794,497.02	€ 3,162,747.31	€ 3,237,373.78	€ 9,194,618.11
N	€ 3,400,936.67	€ 4,635,876.88	€ 3,998,372.38	€ 12,035,185.92
P	€ 16,552.32	€ 10,480.32	€ 4,958.20	€ 31,990.84
R	€ 1,806,894.99	€ 1,553,303.06	€ 2,196,083.31	€ 5,556,281.36
S	€ 822,393.54	€ 440,432.81	€ 500,348.09	€ 1,763,174.44
V	€ 112,763.04	€ 85,006.08	€ 263,899.35	€ 461,668.47
Grand Total	€ 32,878,028.35	€ 40,200,864.73	€ 42,756,112.29	€ 115,835,005.37

From table one we also can see the consumption of other drug groups in monetary value and the commercial importance of drug groups in Kosovo with the most consumed the group C –

cardiovascular drugs, then antibiotics, after it with oncology products etc. This is an indicator of the monetary values and is not related to the dose. Regarding the consumption of antibiotics in the DID or the mg of substance that is consumed as defined daily dose per inhabitant per day the results are presented in the table number 2 below:

Table 7 Drug Consumption in DID in Kosovo 2011-2013 (Source: KMA, 2014)

Row Labels	2011	2012	2013	Grand Total
C	86.36	97.13	110.06	293.55
B	32.04	51.91	57.23	141.18
A	41.73	41.44	50.14	133.30
M	25.33	35.92	30.06	91.30
N	26.41	22.42	25.50	74.33
J	24.45	26.81	19.62	70.88
R	23.21	14.43	17.32	54.96
H	7.58	5.94	7.03	20.54
G	4.81	3.34	6.85	15.00
L	0.96	0.48	0.40	1.84
S	0.58	0.00		0.58
D	0.32	0.01	0.04	0.38
P	0.04	0.03	0.01	0.08
V	0.00	0.00	0.02	0.03
Grand Total	273.81	299.86	324.28	897.95

From this table we see that there is a big change as regards the consumption between groups of drugs as antibiotics in 2011-2013 in monetary value compared to DID value rankings. In the drug consumption with monetary values the antibiotics were ranked first (figure 1) while with the DID values the antibiotic consumption is ranked the sixth with 70.88 DID showing that the "mg" of antibiotics are worth in monetary terms much higher than those of many types of other drugs. From the both tables number one and two we see that cardiovascular drugs are first even in monetary values and in DID showing its importance for Kosovo. In this is also related the morbidity and mortality analysis that show that diseases of blood circulation including the cardiovascular diseases are those that cause the most number of deaths in Kosovo and in this context this is compatible with the drug consumption for this drug group (ASK 2012). The consumption of drugs including the antibiotic in Kosovo is made also without prescription (despite that many patients undergo in to adequate medical examination procedures hence adequate drug prescription) and these procedures are clear in the Law 04 / L-190 but also in administrative instruction 01/2010 which is on medical prescription in the health system which determines the details that regulate this issue. In table three is presented the consumption of antibiotics according to the third level of the ATC classification with the ranking of the most used subgroups. In this table we see that the most used subgroup is the one of penicillin's followed by cephalosporin's etc however the ranking of the individual members is of particular importance as well.

Table 8 Drug consumption of J01 group (III level of ATC) (Source: KMA, 2014)

ATC - J	Antibiotics – level III of ATC	2011	2012	2013	Total
J01	Subgroup name	24.45	26.81	19.62	70.88
J01C	Betalactam antib. Penicillins	11.51	13.76	10.18	35.45
J01D	Other beta lactams Cephalosporins	4.31	4.90	4.10	13.30
J01M	Quinolones	3.49	4.48	1.93	9.90
J01F	Macrolides	1.88	1.53	1.35	4.76
J01E	Sulphonamides	1.30	0.54	0.66	2.50
J01A	Tetracyclines	0.73	0.24	0.47	1.44
J01G	Aminoglycosides	0.25	0.85	0.20	1.30
J01X	Other	0.75	0.17	0.05	0.97

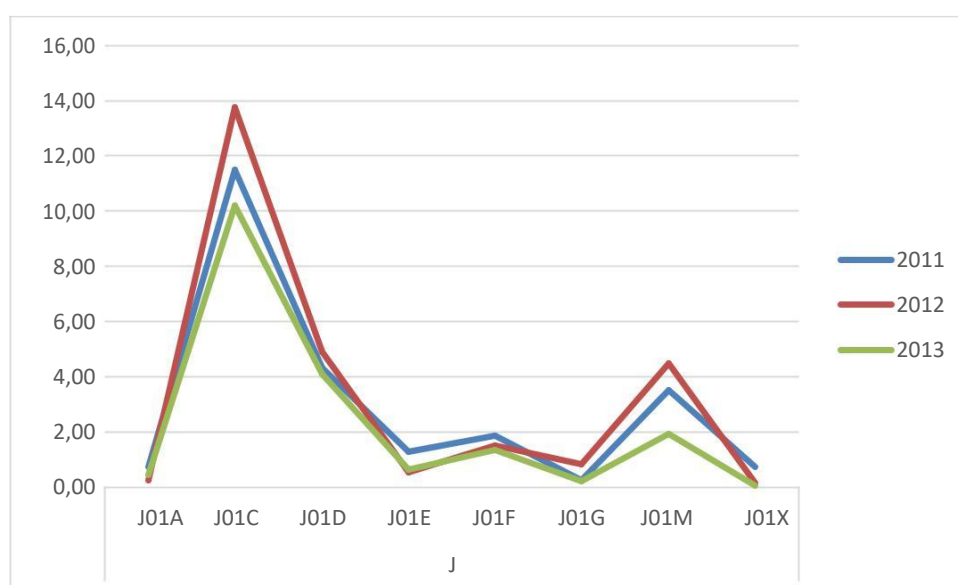


Figure 4 Drug consumption of J01 group (III level of ATC) (Source: KMA, 2014)

Table following on the next page

Table 9 Drug consumption of J01 group – 20 most used (V level of ATC) (Source: KMA, 2014)

Row Labels	2011	2012	2013	Total
J	24.45	26.81	19.62	70.88
Amoxicilline	5.47	5.61	3.72	14.80
Amoxicilline + Clavulanic acid	3.19	3.31	3.50	9.99
Ciprofloxacin	2.99	2.36	1.33	6.68
Amoxicillin	0.94	2.14	1.50	4.58
Cefaclor	1.30	1.00	1.27	3.57
Cefalexine	1.40	1.17	0.59	3.17
Ceftriaxone	0.58	1.01	1.06	2.65
Ampicilline	1.07	1.02	0.48	2.56
Levofloxacin	0.02	1.68	0.36	2.07
Phenoxy Methyl Penicilin	0.53	0.46	0.56	1.55
Sulfam + Trimet	0.80	0.15	0.51	1.46
Doxycycline	0.73	0.24	0.47	1.44
Clarithromycine	0.50	0.68	0.19	1.36
Cefuroxime	0.15	0.70	0.44	1.29
Cefalexin	0.35	0.43	0.39	1.17
Gentamicine	0.14	0.82	0.19	1.15
Azithromycine	0.24	0.34	0.39	0.98
Sulphamethoxazole + trimet	0.49	0.31	0.15	0.95
Cefixime	0.27	0.44	0.22	0.93
Ampicillin sulbactam	0.08	0.76	0.09	0.93

From table 4 we see each individual member of the antibiotic group (this is according to the fifth level of the ATC) with the most used drugs Amoxicillin and Amoxicillin with clavulanic acid which in the first view is according to the literature but if we analyze the list of 20 most used antibiotics we see that there are three cephalosporin's before ampicillin or fenoxymetylpencillin and with values compared to Norway consumption in 2012 for ceftriaxone with 0.03 DID compared to Kosovo with 1.06 DID, or 0.54 DID total subgroup J01D (cephalosporin's) in 2012 in Norway compared to 4.9 DID in 2012 in Kosovo while J01C (penicillin's) in 2012 in Norway with 8.58 DID compared to Kosovo in 2012 with 10.18 DID. This is typical case showing that not only the total consumption matters but also the type of the antibiotics for treating infections in order not to cause other problems like antimicrobial resistance etc.

Figure following on the next page

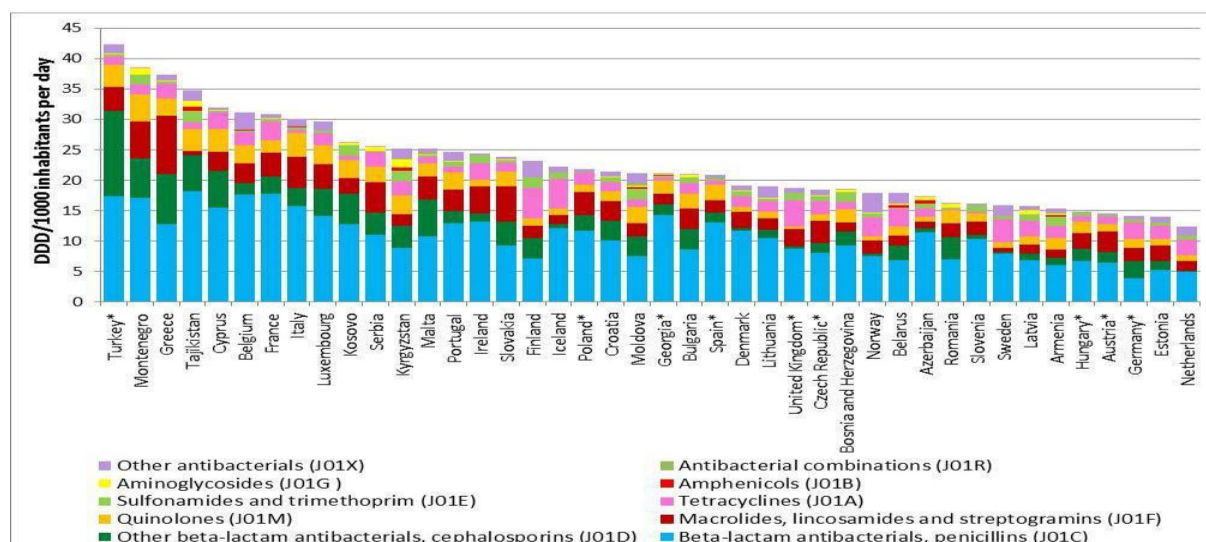


Figure 5 Total antibiotic use in 2011, expressed in number of DDD per 1000 inhabitants per day in 12 European countries and Kosovo as compared to 29 ESAC-Net countries. Ref: Versporten A, Bolokhovets G, Ghazaryan L, Abilova V, Pyshnik G, Spasojevic T, et al. Ant

The chart above shows that Kosovo is on the top of the countries with high antibiotic consumption although there are surprisingly nine European countries with higher consumption including some EU countries such as Belgium, France, Italy and Luxembourg.

4. DISCUSSION AND CONCLUSION

From the analyzed results we see that Kosovo has a relatively high consumption of antibiotics, ranking it among the states with the highest consumption. This result is even more important because consumed subgroups of certain types of antibiotics are very high and different when compared to other countries in a way that some of the members of these subgroups should have been with much lower consumption or being treated as a reserve antibiotics and not routine ones. In this case is the cephalosporin group with its members especially the ceftriaxone with the use that should be the concern of the policy makers. Taking into account the level of control of the health system in Kosovo and the lack of law enforcement and administrative instructions for the prescription and starting from the fact that the dispensing of the medicines is made also without prescription makes these results to be in this level. The absence of the Law on health insurance, lack of implementation of the administrative instruction for prescription in the health system, numerous changes of management structures make the environment turbulent and thus give big space to issues that develop in the opposite direction from the right ore legislative health and pharmaceutical system despite that turbulent environment enables doing business without any criterion in this case also damaging the public health of the population as demonstrated by the use of antibiotics in Kosovo as the second used group's with the monetary value. In this case it is seen that making business in a turbulent environment can be seen as opportunity for making particular turnover without thinking about legislation and other requirements that are related to the regulation of the sector and to the public health. In this environment it seems that everyone is linked in the spiral of the drug abuse starting from distributors, pharmacists, doctors and patients as well.

LITERATURE:

1. Jakupi, A. (2014) Drug Consumption in Kosovo 2011-2013, Kosovo Medicines Agency. Prishtina Kosovo.
2. Ministry of Health (2016) Law 04/L-125 for Health. Available from <http://msh-ks.org/legjislacioni/ligjet/>. Accessed online on July 2016. Prishtina. Kosovo. Prishtina. Kosovo.
3. Ministry of Health (2016) Law 03/L-188 for medicinal products and devices. Available from <http://msh-ks.org/legjislacioni/ligjet/>. Accessed online on July 2016. Prishtina. Kosovo. Prishtina. Kosovo.
4. Ministry of Health (2016) Law 04/L-190 for medicinal products and devices. Available from <http://msh-ks.org/legjislacioni/ligjet/>. Accessed online on July 2016. Prishtina. Kosovo. Prishtina. Kosovo.
5. Ministry of Health (2016) Administrative Instruction 01/2010 the prescription in the health system. Available from <http://msh-ks.org/legjislacioni/udhezimet-administrative/>. Accessed online on July 2016. Prishtina. Kosovo.
6. National Institute of Public Health Norway (2013) Drug Consumption in Norway. Oslo Norway.
7. Statistical Agency of Kosovo (2012) Causes of Death in Kosovo 2010-2011. Prishtina. Kosovo.
8. Versporten A, Bolokhovets G, Ghazaryan L, Abilova V, Pyshnik G, Spasojevic T, et al. Antibiotic use in eastern Europe: a cross-national database study in coordination with the WHO Regional Office for Europe. *Lancet Infect Dis* 2014 May;14(5):381-7.
9. WHO (2003) Introduction to Drug Utilization Research. Oslo Norway.
10. WHO (2014) Structure and Principles of ATC classification. Available from http://www.whocc.no/atc/structure_and_principles/, accessed online on 5.5.2016.

THE VALIDITY OF THE FEATURES OF THE OFFER FOR CLIENTS IN THE SPHERE OF SALES MARKETING – THE ASSESSMENT OF DAIRY COOPERATIVES FROM ŚWIĘTOKRZYSKIE PROVINCE

Izabela Konieczna

The Jan Kochanowski University in Kielce, Poland

izabela.konieczna@ujk.edu.pl

ABSTRACT

The features of the offer are important for customers, and the knowledge of their validity is extremely important for every kind of enterprise, including cooperatives, especially in the turbulent environment. Every decision before it will be implemented must be adapted to the environment, also to turbulent one, taking into account features of the offer, which clients consider to be important. Therefore, the aim of the article is an analysis of the features of the offer in the sphere of sales marketing, which according to managers of dairy cooperatives from Świętokrzyskie Province are for clients important, and have an influence on clients' value. The research of the validity of the features of the offer in the sphere of sales marketing was conducted on the sample of 50% of dairy cooperatives from Świętokrzyskie Province in Poland by using an interview questionnaire. Cooperatives' representatives were asked to indicate features of the offer that, in their opinion, have an influence on value of such clients as: consumers, companies-users (gastronomy), wholesalers, independent retail grocery stores, large retail chains, local retail chains, intermediary agents in food trade, other dairies, and other institutional purchasers. The features that the representatives had to indicate include: the individualization of the offer, the price of the product, the range of pre-, peri-, and after-sales services, the price of pre-, peri-, and after-sales services, the payment terms, the crediting of purchases, the special sales conditions (discounts), the promotional prices, the novelty prices, advertisement, the loyalty programs, the consumer promotion (e.g. samples, coupons, contests, lotteries, gifts, etc.), public relations, publicity, and the availability of information about the offer / product.

Keywords: *Features of the offer, Sales marketing, Cooperatives.*

1. INTRODUCTION

Businesses do not undertake marketing activities alone. They face threats from competitors, and changes in the political, economic, social and technological aspects of the macro-environment. All of which have to be taken into account as a business tries to match its capabilities with the needs and wants of its target customers. An organization that adopts the marketing concept accepts the needs of potential customers as the basis for its operations, and thus its success is dependent on satisfying those customer needs (Whalley, 2010, p. 14). Through good economic times and bad, marketing remains the pivotal function in any business. Determining and satisfying the needs of customers through products that have value and accessibility and whose features are clearly communicated is the general purpose of any business. It is also a fundamental definition of marketing (Burnett, 2008, p. V). The body of literature suggests that implementing marketing as a strategic concept in all parts of the company increases customer satisfaction which in turn leads to corporate success (Webster 1988, pp. 31 and 39; referenced by Rehme, Rennhak, 2011, p. 2).

There was conducted the research aiming to show how future managers i.e. management and economics students from Poland and Ukraine, perceive actions in the sphere of sales marketing, realized by their potential future places of work, i.e. cooperatives. The research results showed that the respondents considered that cooperatives, in the average extent, pursue activities in the sphere of sales marketing. Analysis of the research results also showed, that students from

Ukraine, better assessed the implementation of activities of cooperatives in this area than students from Poland. However, respondents from both countries agreed that in the greatest extent cooperatives implement the following actions: offering products on favorable terms of payment / financing, offering products with a competitive scope of warranty coverage, and the usage of special conditions of sales (discounts). Respondents from Poland considered that, in the least extend, cooperatives use public relations, whereas students from Ukraine considered that, in the least extend, cooperatives use publicity, and target advertisement to final customers (Konieczna, Garasym, 2014a, p. 92). Another research that was narrowed to dairy cooperatives showed that dairy cooperatives both in Poland, and in the Ukraine in the sphere of sales marketing are being averagely assessed. Considering the data analysis, it occurred that students from Poland better assessed nationwide dairy cooperatives than regional ones in such activities as: the use of promotional prices, targeting advertisement to final customers, the use of loyalty programs, the use of public relations, the use of publicity, extensive sharing of information about the offer. In the same time respondents from Poland better assessed regional dairy cooperatives in the use of consumer promotion (samples, coupons, contests, raffles, gifts, etc.). The research results also showed that the respondents from Ukraine considered that regional dairy cooperatives better than nationwide ones pursue such activities in the sphere of sales marketing as: targeting advertisement to final customers, the use of loyalty programs, the use of consumer promotion (samples, coupons, contests, raffles, gifts, etc.), the use of public relations, extensive sharing of information about the offer. In the same time the use of publicity was better assessed in case of nationwide dairy cooperatives. Moreover, respondents agreed that the use of promotional prices is on the same level realized by both nationwide and regional cooperatives. Comparing with each other the responses of Polish and Ukrainian respondents regarding nationwide dairy cooperatives, it appeared that respondents from Poland better assess than Ukrainian ones such activities as: the use of promotional prices, targeting advertisement to final customers, and extensive sharing of information about the offer. On the other hand Ukrainian respondents better assess than respondents from Poland such activities as: the use of loyalty programs, the use of consumer promotion (samples, coupons, contests, raffles, gifts, etc.), the use of public relations, and the use of publicity. Making a comparison of the responses of Polish and Ukrainian respondents regarding regional dairy cooperatives, it appeared that respondents from Ukraine better assess than respondents from Poland all indicated activities in the sphere of sales marketing (Konieczna, Garasym, 2014, pp. 69-70).

The purpose of this article is an analysis of the features of the offer in the sphere of sales marketing, which according to managers of dairy cooperatives from Świętokrzyskie Province are important for clients, and have an influence on clients' value.

2. MARKETING – THE ESSENCE OF THE CONCEPT IN DELIVERING VALUE FOR CUSTOMERS/CLIENTS

Marketing is the answer to how to compete on bases other than price. Because of overcapacity, marketing has become more important than ever. Marketing is the company's customer manufacturing department (Kotler, 2003, p. xi). Basically, the marketing function is responsible for the management of the marketing mix which, at its simplest, is summarized by the four Ps of product, price, place and promotion (Baker, Hart, 2008, p. 8). The specific role of marketing is to provide assistance in identifying, satisfying, and retaining customers (Burnett, 2008, p. 3). Marketing is the set of planned activities designed to positively influence the perceptions and purchase choices of individuals and organizations. Marketing is not the art of finding clever ways to dispose of what the company makes (Berry, Wilson, 2000, p. 28). Marketing is the art of creating genuine customer value. It is the art of helping the customers become better off. The marketer's watchwords are quality, service, and value (Kotler, 2003, p. xii). Marketing in the meaning of activities performed by an individual organization is the performance of activities

that seek to accomplish an organization's objectives by anticipating customer or client needs and directing a flow of need-satisfying goods and services from producer to customer or client (Perreault, McCarthy, 2002, p. 8).

Marketing is the business function that identifies unfulfilled needs and wants, defines and measures their magnitude and potential profitability, determines which target markets the organization can best serve, decides on appropriate products, services, and programs to serve these chosen markets, and calls upon everyone in the organization to think and serve the customer (Kotler, 2003, p. xiii). As companies make decisions about products and marketing strategies, they focus not only on markets they currently serve, but also on markets they want to serve. Including potential future customers allows a company to predict how well the company can meet the needs of these customers, and how the company can manage them in the manner most profitable to the company over the long term (Epstein, Yuthas, 2007, p. 11).

The marketing concept affects all areas of the business, from production (where the engineers and designers have to produce items that meet customers' needs) through to after-sales services (where customer complaints need to be taken seriously) (Blythe, 2005, p. 4). Marketing is the homework the company does to figure out what people need and what the company should offer. Marketing determines how to launch, price, distribute, and promote the product/service offerings to the marketplace. Marketing then monitors the results and improves the offering over time. Marketing also decides if and when to end an offering (Kotler, 2003, p. xii). There's a strong case for splitting marketing into upstream (strategic) and downstream (tactical) groups. Downstream marketers develop advertising and promotion campaigns, collateral material, case histories, and sales tools. They help salespeople develop and qualify leads. The downstream team uses market research and feedback from the sales reps to help sell existing products in new market segments, to create new messages, and to design better sales tools. Upstream marketers engage in customer sensing. That is, they monitor the voice of the customer and develop a long view of the company's business opportunities and threats. The upstream team shares its insights with senior managers and product developers – and it participates in product development (Kotler, 2006, p. 12).

Table 1: Traditional customer categories (Epstein, Yuthas, 2007, p. 12)

Current customers receiving insufficient value	Category 1 INVEST improve value proposition
Current customers receiving high value	Category 2 RETAIN continue high service
Potential target customers that could receive high value	Category 3 ACQUIRE target these customers

Marketing provides time, place, and possession utility. It should also guide decisions about what goods and services should be produced to provide form utility and task utility, where utility means the power to satisfy human needs. They all are needed to provide consumer satisfaction. Form utility is provided when someone produces something tangible. Task utility is provided when someone performs a task for someone else. Time utility means having the product available when the customer wants it. And place utility means having the product available where the customer wants it. Possession utility means obtaining a good or service and having the right to use or consume it (Perreault, McCarthy, 2002, pp. 5-6).

Table 1 categorizes customers based on the value they receive from the company. Following this categorization, the firm would likely take actions similar to those described in the matrix that might be very effective in delivering increased value to customers. For categories such as Category 1 that the company is not currently serving effectively, the company could make investments to enhance the value provided to these customers. For example, for this category,

the company could invest in desired product or service enhancements, it could invest in brand-based advertising, or it could invest in loyalty programs to increase the value received by these customers. For customers currently receiving high value, as in Category 2, the company would continue investing resources (a) to maintain and enhance the high levels of value currently provided, and (b) to sustain the company's relationship with these customers. For categories like Category 3, which include non-customers that the company could potentially serve well, the company is likely to target these categories by developing products and services and engaging in marketing activities to attract these customers (Epstein, Yuthas, 2007, pp. 12-13).

3. THE VALIDITY OF THE FEATURES OF THE OFFER FOR CLIENTS IN THE SPHERE OF SALES MARKETING - RESEARCH RESULTS

Cooperatives' executives were asked to indicate the features of the offer in the sphere of sales marketing, which are for clients important, and have an influence on clients' value. The research of the validity of the features of the offer in the sphere of sales marketing was conducted on the sample of 50% of dairy cooperatives from Świętokrzyskie Province in Poland by using an interview questionnaire. Cooperatives' representatives were asked to indicate features of the offer that, in their opinion, have an influence on value of such clients as: consumers, companies-users (gastronomy), wholesalers, independent retail grocery stores, large retail chains, local retail chains, intermediary agents in food trade, other dairies, and other institutional purchasers. Interview results are shown in Table 2, Chart 1, and Chart 2.

Table 2: The validity of the features of the offer for customers in the area of the sales marketing in the assessment of dairy cooperatives from the Świętokrzyskie Province
(compiled by author – continues on the next page)

11.		Features / elements of the offer	Consumers	Companies - users (gastronomy)	Wholesalers	Independent retail grocery stores		Retail chains		Intermediary agents in food trade	Other dairies	Other institutional purchasers
								Large	Local			
the individualization of the offer	Mean	4.33	4.00	3.67	0	0	3.67	0	0	0	0	0
	Standard deviation	0.471	0.000	0.471	0	0	0.471	0	0	0	0	0
	Median	4	4	4	0	0	4	0	0	0	0	0
the price of the product	Mean	3.67	4.00	4.67	0	0	4.33	0	0	0	0	0
	Standard deviation	0.577	0.000	0.577	0	0	0.577	0	0	0	0	0
	Median	4	4	5	0	0	4	0	0	0	0	0
the range of pre-, peri-, and after-sales services	Mean	4.33	4.00	3.67	0	0	4.67	0	0	0	0	0
	Standard deviation	0.577	0.000	0.577	0	0	0.577	0	0	0	0	0
	Median	4	4	4	0	0	5	0	0	0	0	0
the price of pre-, peri-, and after-sales services	Mean	4.00	4.50	4.00	0	0	4.33	0	0	0	0	0
	Standard deviation	1.000	0.707	1.000	0	0	1.155	0	0	0	0	0
	Median	4	5	4	0	0	5	0	0	0	0	0
the payment terms	Mean	4.67	3.50	4.00	0	0	3.67	0	0	0	0	0
	Standard deviation	0.577	0.707	1.000	0	0	1.528	0	0	0	0	0
	Median	5	4	4	0	0	4	0	0	0	0	0

the crediting of purchases	Mean	4.00	4.50	3.67	0	0	4.33	0	0	0
	Standard deviation	0.000	0.707	0.577	0	0	0.577	0	0	0
	Median	4	5	4	0	0	4	0	0	0
the special sales conditions (discounts)	Mean	3.67	4.00	4.00	0	0	4.00	0	0	0
	Standard deviation	0.577	0.000	0.000	0	0	1.000	0	0	0
	Median	4	4	4	0	0	4	0	0	0
the promotional prices	Mean	4.33	5.00	4.00	0	0	3.67	0	0	0
	Standard deviation	0.577	0.000	0.000	0	0	0.577	0	0	0
	Median	4	5	4	0	0	4	0	0	0
the novelty prices	Mean	4.00	4.00	4.00	0	0	3.67	0	0	0
	Standard deviation	0.000	0.000	1.000	0	0	1.528	0	0	0
	Median	4	4	4	0	0	4	0	0	0
advertisement	Mean	3.67	4.00	4.00	0	0	3.67	0	0	0
	Standard deviation	0.577	0.000	0.000	0	0	0.577	0	0	0
	Median	4	4	4	0	0	4	0	0	0
the loyalty programs	Mean	4.33	3.50	4.33	0	0	4.00	0	0	0
	Standard deviation	0.577	2.121	0.577	0	0	0.000	0	0	0
	Median	4	4	4	0	0	4	0	0	0
the consumer promotion (e.g. samples, coupons, contests, lotteries, gifts, etc.)	Mean	4.33	3.00	3.67	0	0	4.00	0	0	0
	Standard deviation	0.577	0.000	0.577	0	0	1.000	0	0	0
	Median	4	3	4	0	0	4	0	0	0
public relations	Mean	2.67	3.50	3.67	0	0	3.50	0	0	0
	Standard deviation	0.577	0.707	0.577	0	0	0.707	0	0	0
	Median	3	3.5	4	0	0	3.5	0	0	0
publicity	Mean	2.00	2.50	3.67	0	0	3.67	0	0	0
	Standard deviation	0.000	0.707	0.577	0	0	0.577	0	0	0
	Median	2	3	4	0	0	4	0	0	0
the availability of information about the offer / product	Mean	3.67	4.00	4.33	0	0	4.33	0	0	0
	Standard deviation	0.577	0	0.577	0	0	0.577	0	0	0
	Median	4	4	4	0	0	4	0	0	0

Scale: 1-5, where 5 – extremely important, 4 – very important, 3 – quite important, 2 – little important, 1 – completely unimportant, 0 – not applicable.

When analyzing Table 2 and Chart 1, it is clear that:

- the individualization of the offer was considered as very important for consumers (mean rating 4.33), companies-users (gastronomy) (mean rating 4.0), wholesalers and local retail chains (mean rating 3.67).
- the price of the product was found as extremely important for wholesalers (mean rating 4.67), and as very important for local retail chains (mean rating 4.33), companies-users (gastronomy) (mean rating 4.0), and consumers (mean rating 3.67).
- the range of pre-, peri-, and after-sales services was considered as extremely important for local retail chains (mean rating 4.67), and as very important for consumers (mean rating 4.33), companies-users (gastronomy) (mean rating 4.0), and wholesalers (mean rating 3.67).
- the price of pre-, peri-, and after-sales services was found as extremely important for companies-users (gastronomy) (mean rating 4.5), and as very important for local retail chains (mean rating 4.33), consumers, and wholesalers (mean rating 4.0).
- the payment terms were considered as extremely important for consumers (mean rating 4.67), and as very important for wholesalers (mean rating 4.0), local retail chains (mean rating 3.67), and companies-users (gastronomy) (mean rating 3.5).
- the crediting of purchases was found as extremely important for companies-users (gastronomy) (mean rating 4.5), and as very important for local retail chains (mean rating 4.33), consumers (mean rating 4.0), and wholesalers (mean rating 3.67).
- the special sales conditions (discounts) were considered as very important for companies-users (gastronomy), wholesalers, local retail chains (mean rating 4.0), and consumers (mean rating 3.67).
- the promotional prices were found as extremely important for companies-users (gastronomy) (mean rating 5.0), and as very important for consumers (mean rating 4.33), wholesalers (mean rating 4.0), and local retail chains (mean rating 3.67).
- the novelty prices were considered as very important for consumers, companies-users (gastronomy), wholesalers (mean rating 4.0), and local retail chains (mean rating 3.67).
- advertisement was found as very important for companies-users (gastronomy), wholesalers (mean rating 4.0), consumers, and local retail chains (mean rating 3.67).
- the loyalty programs were considered as very important for consumers, wholesalers (mean rating 4.33), local retail chains (mean rating 4.00), and companies-users (gastronomy) (mean rating 3.5).
- the consumer promotion (e.g. samples, coupons, contests, lotteries, gifts, etc.) was found as very important for consumers (mean rating 4.33), local retail chains (mean rating 4.0), and wholesalers (mean rating 3.67), and as quite important for companies-users (gastronomy) (mean rating 3.0).
- public relations were considered as very important for wholesalers (mean rating 3.67), companies-users (gastronomy), and local retail chains (mean rating 3.5), and as quite important for consumers (mean rating 2.67).
- publicity was found as very important for wholesalers, and local retail chains (mean rating 3.67), as quite important for companies-users (gastronomy) (mean rating 2.5), and as little important for consumers (mean rating 2.0).
- the availability of information about the offer / product was considered as very important for wholesalers, local retail chains (mean rating 4.33), companies-users (gastronomy) (mean rating 4.0), and consumers (mean rating 3.67).

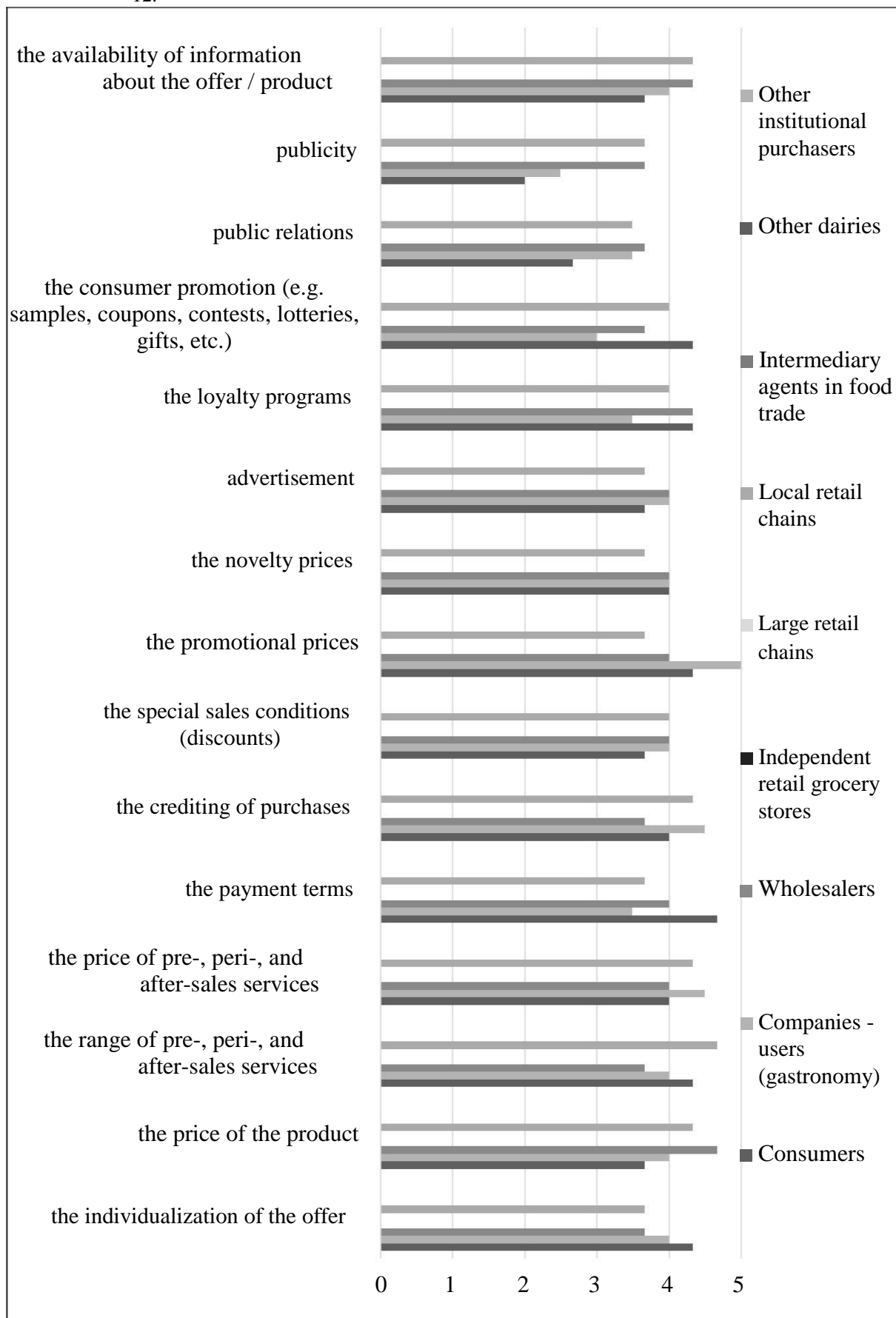


Chart 1: Chart for the data of Table 1 (compiled by author)

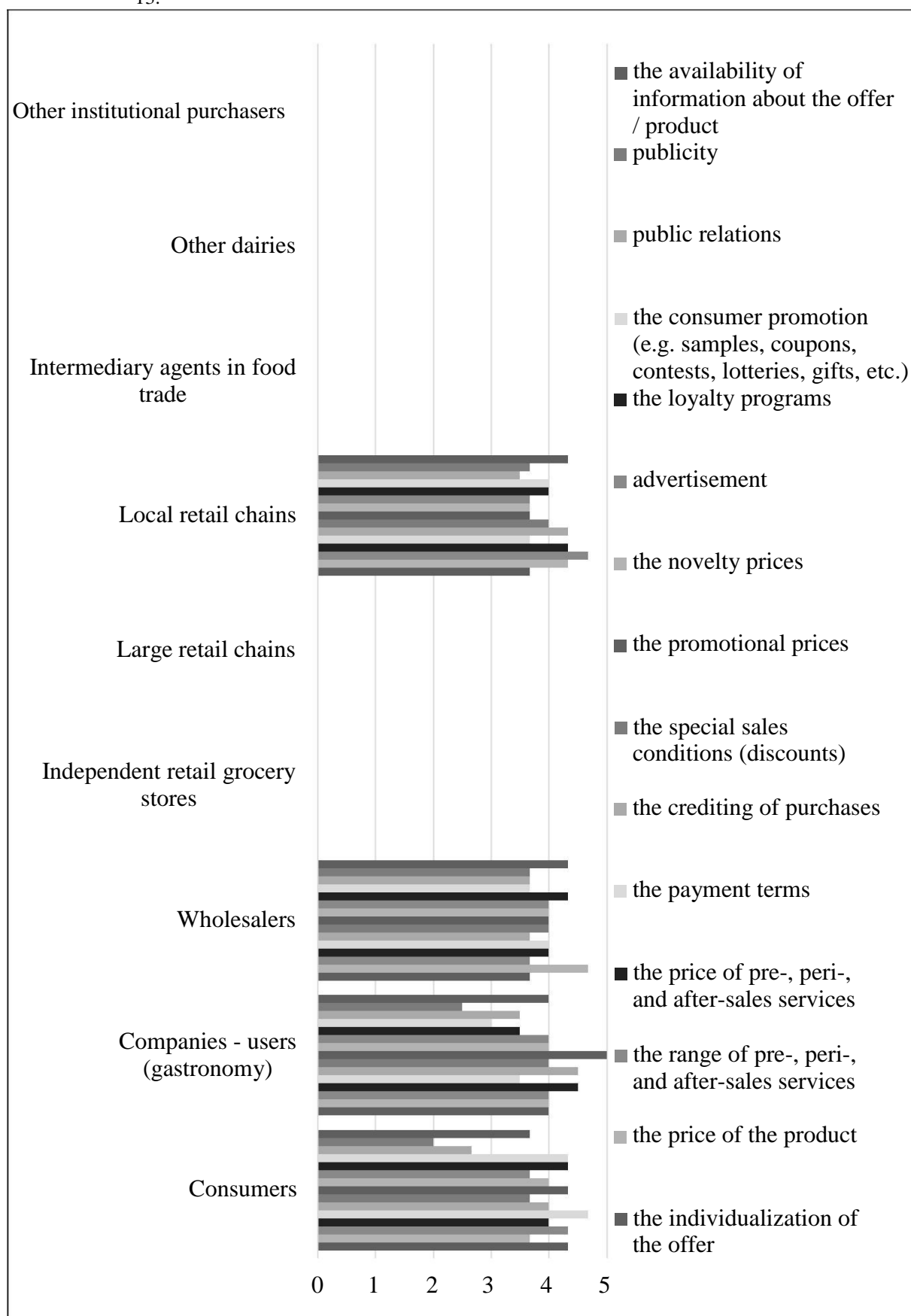


Chart 2: Chart for the data of Table 1 (compiled by author)

Analyzing the assessment of the validity of the features of the offer for particular customers (Table 2 and Chart 2), it is clear that:

- For consumers as extremely important are considered the payment terms (mean rating 4.67), while as very important are found the individualization of the offer, the range of pre-, peri-, and after-sales services, the promotional prices, the loyalty programs, the consumer promotion (e.g. samples, coupons, contests, lotteries, gifts, etc.) (mean rating 4.33), the price of pre-, peri-, and after-sales services, the crediting of purchases, the novelty prices (mean rating 4.0), the price of the product, the special sales conditions, advertisement, and the availability of information about the offer / product (mean rating 3.67). In the same time, the cooperatives' executives pointed out that public relations are considered as quite important (mean rating 2.67), and publicity as little important (mean rating 2.0).
- For companies-users (gastronomy) as extremely important are considered the promotional prices (mean rating 5.0), the price of pre-, peri-, and after-sales services, and the crediting of purchases (mean rating 4.5), while as very important are found the individualization of the offer, the price of the product, the range of pre-, peri-, and after-sales services, the special sales conditions (discounts), the novelty prices, advertisement, the availability of information about the offer / product (mean rating 4.0), the payment terms, the loyalty programs, and public relations (mean rating 3.5). On the other hand, the publicity was considered as quite important (mean rating 2.5).
- For wholesalers as extremely important is considered the price of the product (mean rating 4.67), while as very important are found the loyalty programs, the availability of information about the offer / product (mean rating 4.33), the price of pre-, peri-, and after-sales services, the payment terms, the special sales conditions (discounts), the promotional prices, the novelty prices, advertisement (mean rating 4.0), the individualization of the offer, the range of pre-, peri-, and after-sales services, the crediting of purchases, the consumer promotion (e.g. samples, coupons, contests, lotteries, gifts, etc.), public relations, and publicity (mean rating 3.67).
- For local retail chains as extremely important is considered the range of pre-, peri-, and after-sales services (mean rating 4.67), while as very important are found the price of the product, the price of pre-, peri-, and after-sales services, the crediting of purchases, the availability of information about the offer / product (mean rating 4.33), the special sales conditions (discounts), the loyalty programs, the consumer promotion (e.g. samples, coupons, contests, lotteries, gifts, etc.) (mean rating 4.0), the individualization of the offer, the payment terms, the promotional prices, the novelty prices, advertisement, publicity (mean rating 3.67), and public relations (mean rating 3.5).

4. CONCLUSION

Because of the fact that the features of the offer are important for customers, and the knowledge of their validity is extremely important for enterprises especially in the turbulent environment, there was taken the research. Taking into account the respondents' answers it is clear that cooperatives have such customers as consumers, companies-users (gastronomy), wholesalers and local retail chains. Their customers are not independent retail grocery stores, large retail chains, intermediary agents in food trade, other dairies, and other institutional purchasers. An analysis of the validity of the features of the offer for customers in the area of the sales

marketing based on the results of conducted research in dairy cooperatives from the Świętokrzyskie Province, shows that all the features of the offer are considered as extremely or very important for such customers as wholesalers, and local retail chains. Moreover, as extremely important are considered different features for each type of customers, i.e. for consumers – the payment terms, for wholesalers – the price of the product, for local retail chains – the range of pre-, peri-, and after-sales services, and for companies-users (gastronomy) – promotional prices, the price of pre-, peri-, and after-sales services, and the crediting of purchases. Taking into account the mean for all types customers in assessing the validity of the features of the offer it is seen that the highest were rated the promotional prices (4.25), then the price of pre-, peri-, and after-sales services (4.21), the price of the product, the range of pre-, peri-, and after-sales services (4.17), the crediting of purchases (4.13), the availability of information about the offer / product (4.08), the loyalty programs (4.04), lower were rated the payment terms (3.96), the individualization of the offer, the special sales conditions (discounts), the novelty prices (3.92), advertisement (3.84), the consumer promotion (e.g. samples, coupons, contests, lotteries, gifts, etc.) (3.75), public relations (3.34), and the lowest was rated publicity (2.96). Because of the fact, that cooperatives are aware of features of the offer affecting the value for the clients, they should take such actions that help them to deliver increased value to customers. And for all those clients that are not their clients nowadays, they should take such activities that will attract them.

LITERATURE:

1. Baker, M.J., Hart, S.J. (2008). *The Marketing Book* (6th edition). Oxford: Elsevier.
2. Berry, T., Wilson, D. (2000). *On Target: The Book on Marketing Plans* (1st edition). Eugene: Palo Alto Software, Inc.
3. Blythe, J. (2005). *Essentials of Marketing* (3rd edition). Harlow: Prentice Hall.
4. Burnett, J. (2008). *Core Concepts of Marketing*. Zurich: Global Text Project.
5. Epstein, M.J., Yuthas, K. (2007). *Managing Customer Value*. Mississauga: CMA Canada, AICPA and CIMA.
6. Konieczna, I., Garasym, P. (2014). Activities of Sales Marketing – Their Perception on the Example of Dairy Co-operatives in Poland and Ukraine. *Journal of Management and Marketing* (2014, 1), pp. 63-70.
7. Konieczna, I., Garasym, P. (2014a). Perception of Activities of Sales Marketing Pursued by Cooperatives in Poland and Ukraine. In M. Mokrys, S. Badura, A. Lieskovsky (eds.). *Proceedings in Conference of Informatics and Management Science (ICTIC 2014)* (pp. 88-92). Žilina: University of Žilina.
8. Kotler, P. (2003), *Marketing Insights from A to Z. 80 Concepts Every Manager Needs To Know*. Hoboken: John Wiley & Sons.
9. Kotler, P., Rackham, N., Krishnaswamy, S. (2006). Ending the War Between Sales and Marketing. *Harvard Business Review* (2006, July-August), pp. 1-13.
10. Perreault, W.D., McCarthy E.J. (2002). *Basic Marketing. A Global-Managerial Approach*. New York: McGraw-Hill/Irwin.
11. Rehme, S., Rennhak, C. (2011). Marketing and Sales – Successful Peacekeeping. *Reutlingen Working Papers on Marketing & Management* (2011, 11), pp. 1-37.
12. Whalley, A. (2010). *Strategic Marketing*. Frederiksberg: Ventus Publishing ApS.

INVESTMENTS FOR THE EFFICIENT USE OF RAW MATERIALS

Jarmila Vidova

*University of Economy, Faculty of National Economy, Department of Economic Policy,
Dolnozemska cesta 1,
851 04 Bratislava, Slovak republic
vidova@euba.sk*

ABSTRACT

The traditional economy is characterized by a direct linear process "resources - products - waste", with a focus on maximizing social wealth and profit. This line of business is over-consuming natural resources, produces uncontrollable amount of waste, which has a negative impact on natural resources and the environment. Natural resources are a prerequisite for the functioning of the European and global economy and our quality of life. Price of natural resources used in industry has increased over the last 10 years, it's doubled, which represents a historic shift compared to the 20th century, when the price of resources decreased and wages increased. Pressure on natural resources is growing. If current trends will continue, it is expected that by 2050 the population worldwide will increase by 30% to around 9 billion people. To ensure growth and jobs in Europe is vital increase resource efficiency, which is also one of the objectives of Europe 2020. Investments for the efficient use of raw materials to ensure increased productivity, reducing costs and enhancing competitiveness in Europe are necessary. Circular (closed) economy as a scientific concept model of sustainable development economically, which is a kind of green economy. This article deals with the issue of circular economy, which is characterized in saving, efficient use of scarce natural resources, waste management. At present, the company preferred and innovative entrepreneurship in innovation, the emphasis is on the fact that the ability to develop new products, processes and other innovations is becoming less and less constrained by limits of human intelligence. The problem now does not lie in our ability to develop something new, but is based on our responsibility for possible effects of the introduction of these innovations.

Keywords: *Critical raw material efficiency, Circular economy, Sustainable development.*

"The major shift towards a sustainable circular economy is to create a win-win solution and give Europe a new competitive advantage. We want to be present a comprehensive action plan for both consumers and businesses to use resources more efficiently. For this we need to get input from stakeholders in all parts of the value chain."

Jyrki Katainen, Commissioner for Employment,
growth, investment and competitiveness 2014 -
2019

1. INTRODUCTION

People in developing and emerging economies will legitimately aspire to improve their wellbeing and level of consumption, which is typical for developed countries. As we have seen in the past decades, intensive use of the world's resources puts pressure on our planet and threatens the security of supply. In the future, will be no longer possible to use natural resources in the same way as they do now. The key instrument for the protection of the environment is the efficient use of natural resources, increased employment in the waste management sector and the fight against climate change in order to reduce the amount of waste that ends up in landfills.

2. PRECIOUS NATURAL RESOURCES

Natural resources are a prerequisite for the functioning of the European and global economy and our quality of life. Price of natural resources used in the industry has increased over the last 10 years, it is doubled, which represents a historic shift compared to the 20th century, when the price of resources decreased and wages increased. These sources include raw materials, such as fuels, minerals and metals but also food, soil, water, air, biomass and ecosystems. Pressure on natural resources is growing. If current trends continue, it is expected that by 2050 the population worldwide will increase by 30% to around 9 billion people. In addition, it is necessary to streamline manufacturing processes, reduced use of primary sources and reduction of emitted substances. In 2011, in the European Union it produced more than 2.5 billion tons of waste, of which the waste from households amounted to 218.6 million tons (8.74%). Most waste is produced in the largest economies (Germany, France, UK), which was followed by the economically weakest countries (Romania, Bulgaria). In Slovakia the total to over 9.38 million tons of waste. Most waste produced per capita taxes Denmark (719 kg), Luxembourg (687 kg) and Cyprus (658 kg). At least household waste produced per capita Central European and Baltic States - Estonia (298 kg), Poland (315 kg), Czech Republic (320 kg) and Slovakia (327 kg).

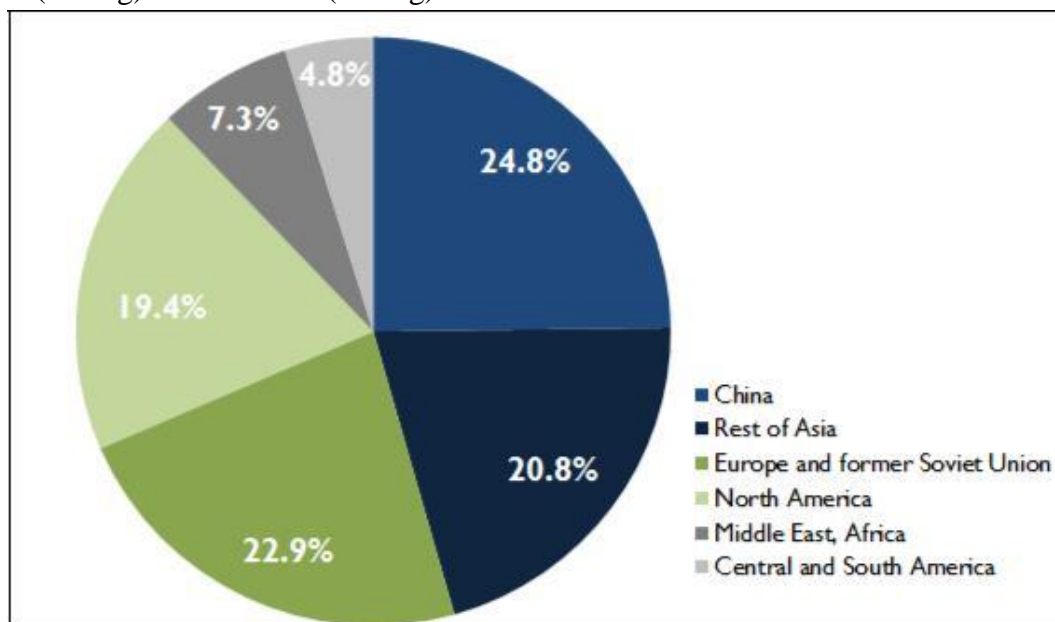


Figure 1: World production of plastics. (Source: <http://www.odpady-portal.sk/Dokument/102345/worldwatch-institute-svetova-produkcia-plastov-rastie-recyklacia-stagnuje.aspx> 2013)

A large part of the waste consists of plastic. Almost every average American or European citizen consumes annually about 100 kg of plastic, while in Asia it is only about 20 kg / person. The largest share of a consumption of plastic packaging different form. According to the United Nations Environment about 22-43% of a plastic end up as a waste in landfills. Of approximately 10 to 20,000,000 tons of the plastic waste ends up in the ocean each year. The plastic waste is causing a serious damage directly on the marine ecosystem, as well as a fishing and tourism. Environmental and social costs, however, should be considered together with technological and logistical properties of plastics: stability, durability, light weight, hygienic harmlessness. Wasting of the material from fossil resources while unnecessarily take up valuable landfill capacity and landfill fires pollutes the surrounding community. Currently selected material recycling plastic waste streams and an energy use of unsorted plastic has the potential to reduce

the amount of landfilled plastics. However, quite a lot of plastic waste which is separated in economically developed countries get for recycling to countries where labor is cheaper and lower environmental regulation and supervision. There is often burned on open fires, and produces hazardous emissions and ash, containing harmful substances. According to statistics, most of the plastic waste from the United States as well as the Europe and other environmentally advanced countries with separated collection of various plastic waste flows to China, which receives 56% of the total amount of separated plastics in the world.

3. RESOURCE-EFFICIENT EUROPE

According to the study of the German Institute for Environmental Strategies Ökopol "Climate protection - potential of recycling targets of the EU" in January 2008, if we will, till 2020, really recycle half of municipal waste, CO₂ emissions would be reduced by more than 89 million tons, which is equivalent to removing 31 million cars from the European roads. The Waste Framework Directive, adopted in November 2008, to the governments of the Member States, until 2020, provides for re-use and recycle household waste (paper, metal, plastic and glass) and possibly from other origins as far as these streams are similar to waste as household waste at least 50% by weight. Down the scope of the rest of converting construction waste and demolition waste at least 70% by weight. Recycling rate in the EU was, according to Eurostat, in 2011 at 63.6%. In Belgium, up 80.2% recycled packaging. Over 70% of packaging waste is recycled in the Netherlands, Germany and Ireland, in the last place Poland came to 41.2%. The recycling level in Slovakia was the same as in Greece - 62.4%. The European Union has a strong interest in deepening cooperation with international partners in the area of resource efficiency. Thanks incitement to shift towards cleaner production methods and energy transfer. The solution to this problem is the adoption of a number of secondary legislation. Green Paper - A European Strategy for addressing the issue of plastic waste in the environment (7. 3. 2013). The purpose of the Green Paper was to launch a broad discussion on how to resolve the public policy issues in the field of plastic waste, which is currently not explicitly addressed no EU legislation on waste. Further follow-up to the Green Paper was to review legislation on waste. In March 2013 the European Commission launched a debate on how to improve the sustainability of plastic products throughout their life cycle and how to mitigate the impact of plastic waste on the environment. In November 2013, the Commission presented a proposal to amend the directive on packaging and packaging waste in order to reduce the Union consumption of lightweight plastic bags. It is estimated that in 2010 the EU market received 98.6 billion plastic bags, which means that every EU citizen on average used 198 plastic bags per year. Slovakia accounted for 466 plastic bags per capita, opposite the house in Denmark 4. The vast majority are lightweight plastic bags that are used again much less frequently than their thicker alternatives. In December 2008, the EU adopted the climate and energy package, in order to combat climate change and is committed to reduce by 2020, overall emissions by 20% compared to 1990 levels and the European Council approved a European economic recovery, which includes three innovative public-private partnerships. Through these partnerships in the period 2010 - 2016 was allocated to research a total of 3.2 billion. €. Half of these funds were used by industry and half by the European Commission through the 7th Framework Program for Science and Research. Public-private partnerships addressed the following issues:

- Factories of the Future (1.2 bil. €) - increasing a knowledge and use of future technologies
- Energy-efficient Buildings (1 bil. €) - promote green technologies and development of energy-efficient systems and materials in buildings

- Green Cars (1 bil. €) - the development of renewable and non-polluting energy sources, safety and traffic flow. (Vidová, 2015 p. 262)

In connection with the problems of raw materials has been developed initiative “An industrial policy for "green" growth” - helping the EU's industrial base. Therefore, the flagship initiative under the Europe 2020 Resource efficient Europe, is focusing on resource efficiency, and support of the transition to an energy efficient, low-carbon economy to ensure sustainable growth. The aim of this main initiative is to create a framework for policies to support the shift towards a low carbon and resource-efficient economy. This move will help boost economic performance while reducing resource use; identify and create new opportunities for economic growth and more innovation and increase the competitiveness of the EU; ensure security of supply of essential resources; fight against climate change and limit the impacts of resource use on the environment. Forum for multinational companies trying to exploit the potential for circular economy (Vidová, 2014).

4. RECOVERY RESIDENTIAL BUILDINGS AND ENERGY SAVING IN SLOVAK REPUBLIC

Buildings represent 40% of primary energy use globally, and energy consumption in buildings is projected to rise sustainably. At the same time is increasing resource scarcity, legal risks and growing operating costs as well as different requirements from different users, are just some of the challenges that need to be taken into consideration when thinking about energy efficiency and sustainable buildings. The main question to be addressed is which policy instruments respond most effectively to housing needs in Europe, especially those households at risk of poverty and social exclusion. Alternatives to be considered are cash and in kind benefits. Since the late 1990s, a lot of research has been done on the conditions and effects of different housing policy measures in different EU countries. Some comparative studies brings together the results of European Member States. For instance Stephens et al. (2010) search for relations between welfare regimes, housing systems and housing outcomes. However, these studies do not address cost-effectiveness in particular and may not have allowed for the results to be appraised by the stakeholders. It are exactly those elements that we want to incorporate.



Figure 2: Energy efficiency – the right balance between comfort, building performance and sustainability. (Source: <http://www.buildingtechnologies.siemens.com/bt/global/en/energy->

efficiency/pages/energy-efficiency.aspx#w2gImgRC-/bt/global/en/energy-efficiency/PublishingImages/infographic-energy-efficiency-sustainable-buildings.jpg)

The requirement to develop a strategy for restoration of residential and non-residential buildings in the Slovak Republic under the Directive of the European Parliament and Council Directive 2012/27 / EU of 25th October 2012 on energy efficiency, which amends Directive 2009 / EC and 2010/30 / EU that are repealing Directives 2004/8 / EC and 2006/32 / EC (the "Directive 2012/27 / EU"), where in Art. 4 of this Directive, Member States of the European Union imposes a long term strategy for the purpose of activating the (mobilization) investment in the renovation of the national stock of residential and non-residential buildings in the private and public ownership. This strategy should include a review of the national fund of residential and commercial buildings, identify cost-effective approaches to the restoration related to the building type and climatic zone with an expression of policies and measures to encourage cost-effective (resp. depth) restoration including the progressive restoration of buildings (depth) recovery. This requires evidence based estimates of expected energy savings and other benefits of the restoration of residential and non-residential buildings in the future to guide investment decisions of individuals, the construction industry and financial institutions in Slovakia. The strategy of building renovation also includes the obligation under Article 5 of Directive 2012/27 / EU. Each Member State shall each year from 1st January 2014 to ensure recovery of 3% of the total floor area of heated and / or cooled buildings owned and used by central government bodies (hereinafter referred to as "CSAA") in order to reach at least the minimum energy performance requirements set by the Member State under Article 4 of European Parliament and Council Directive 2010/31 / EU of 19th May 2010 on the energy performance of buildings (recast) (hereinafter "Directive 2010/31 / EU"). The structure of the strategy of building renovation respects the requirements arising from Art. 4 of Directive 2012/27 / EU, taking into account the associated conditions mentioned in the "Assistance Documents for EU Member States in developing long term strategies for mobilizing investment in building energy renovation (CA EED, CA EPBD and CA RES)".

4.1 Situation in the reconstruction of residential buildings

Buildings can be characterized depending on the period of construction. From 1947 to 1992 it was carried out large-scale construction of residential houses in different types, construction systems and building systems (existing building) especially in panel technology. After 1992, it is a different non-standard solutions of buildings (new buildings). Situation in the reconstruction of residential buildings since 1992, it takes place in the Slovak Republic, mainly renewal of housing units older than 20 years, especially its insulation and removal of static defects. In 1993, it was completed construction of prefabricated blocks of flats. All of these residential buildings should be gradually restored. This is based on the knowledge that the building stock under 20 years has to be subject of periodic maintenance and fund of buildings older than 20 years must be renewed. Recovery range (insulation) building allows us to compare the results not only collectively for Slovakia, but also express the differences between regions. While the extent of recovery houses in Bratislava region (41.86%) and Žilina (33.08%) is the largest, the smallest in the Banská Bystrica region (19.55%) and Nitra region (22.97%). Similarly, even in apartment buildings, where in Žilina region it was made for recovery to 53.13%, followed by houses in Bratislava (50.25%). The minimum extent restored residential houses in Košice region (31.21%) and Nitra region (32.04%). Nearly 20% of the differences between regions indicate the regions in which the restoration of residential buildings carried out quickly and seek the support mechanisms for wiping of regional disparities.

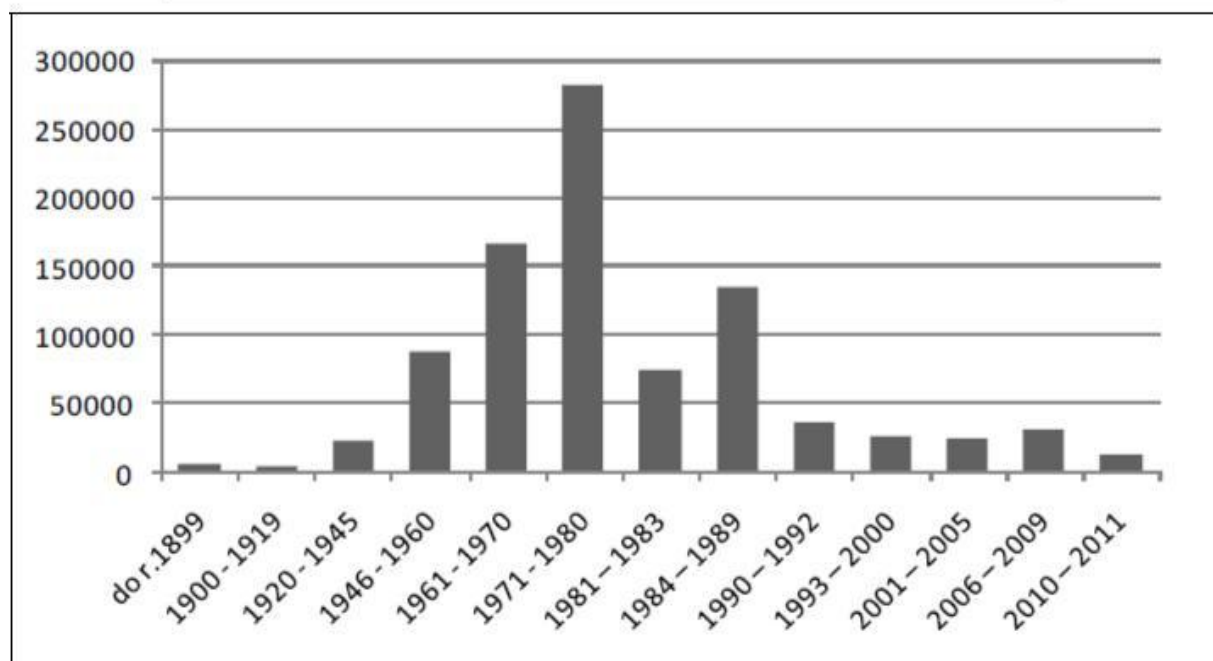


Figure 3: Number of built flats in Slovak Republic 1899 – 2011 (Source: Slovak Statistical Office, 2015)

Most apartment buildings located in the area of designed temperatures in winter period of -11°C (308 212 flats), -13°C (163 195 flats) and 15°C (186 437 flats). Only 23 apartment buildings located in areas with a temperature of -19°C (274 flats). All of the coldest regions affected residential houses are located in Prešov and Žilina territorial unit. Of the 21,723 residential houses only 1,147 are at an altitude of 600m and only 175 at an altitude of 800m. According to the latest comprehensive surveys, the average annual consumption of heat for the years 1994 - 2003 residential buildings and masonry from bricks 131.7kWh / (m².a), single-layer panel (built from 1955 to 1983) 110.3kWh / (m².a), multilayer panel 119.0kWh / (m².a) and panel built after 1983 101.9 kWh / (m².a). The results obtained for buildings constructed after 1983 to 1992 were used in 2006 for the statistical evaluation to determine the upper limit of energy Class B rate building performance. On actual heating energy consumption affect climatic conditions in Slovakia differ significantly. In terms of energy consumption is a significant proportion of openings structures (construction structures with the worst heat and technical characteristics) of the total building envelope. It ranges from about 13% to 25% of the total area of the building envelope and from 19% to 32% of the surface of the building envelope. Opening structures of the original building have a significant share of heat loss of the building. In terms of activation of investment for the reconstruction of residential and non-residential buildings are currently in use funds from the European Union initiatives JESSICA to those projects which meet the criteria of building energy level. By 2020, will be gradually tightened requirements for different energy levels of the construction not only the new but also reconstructed buildings. The desired level of construction requires the high-quality preparation of the project documentation, use of the new materials, construction products and innovative technologies, and in particular the quality execution of works. In order to increase skills, education and expertise of employees in construction it is necessary to provide dual training with the determination of the resorts share. In the field of science and technology it is necessary to support projects focusing on research and development of the new innovative materials and technologies that will be applied in the reconstruction of buildings.

5. CONCLUSION

The last 150 years of industrial evolution have been dominated by a one-way or linear model of production and consumption in which goods are manufactured from raw materials, sold, used and then discarded or incinerated as waste. In the face of sharp volatility increases across the global economy and proliferating signs of resource depletion, the call for a new economic model is getting louder. The quest for a substantial improvement in resource performance across the economy has led businesses to explore ways to reuse products or their components and restore more of their precious material, energy and labour inputs. A circular economy is an industrial system that is restorative or regenerative by intention and design. The economic benefit of transitioning to this new business model is estimated to be worth more than one trillion dollar in material savings. Scientific article was prepared with the support of the project VEGA 1/0002/16 Socio-economic aspects of housing policy in the context of labor migration. 2016 – 2018

LITERATURE:

1. Vidová, J. (2014) *Resource-efficient Europe*. In: For fin : odborný mesačník pre financie a investovanie [elektronický zdroj]. - Bratislava : Fin Star, 2014. ISSN 1339-5416, 2014, č. Júl-august, s. 1-5 online. Dostupné na : ftp://193.87.31.84/0190799/FF-2014_Jul_August_Vidova Europa efektívne využívajúca zdroje.pdf
2. Vidová, J. (2015). *Circular economy and investment in efficient use of raw materials*. Finančné trhy. Bratislava. 4/2015. ISSN: ISSN 1336 – 5711. http://www.derivat.sk/files/2015_financne_trhy/Dec_2015_FT_Vidova_Kruhova%20ekonomika.pdf
3. Vidová, J. (2015). *Economic policy of the European Union*. Bratislava. Vydavateľstvo EKONÓM. ISBN 978-80-4161-9.
4. Stephens M., Fitzpatrick S., Elsinga M., van Steen G. & Chzhen Y. (2010). Study on housing exclusion: welfare policies, housing provision and labour markets. European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities.
5. Assistance Documents for EU Member States in developing long term strategies for mobilizing investment in building energy renovation (CA EED, CA EPBD and CA RES)
6. Directive of the European Parliament and Council Directive 2012/27 / EU of 25 October 2012 on energy efficiency, which amends Directive 2009 / EC and 2010/30 / EU
7. Energy efficiency – the right balance between comfort, building performance and sustainability. <http://www.buildingtechnologies.siemens.com/bt/global/en/energy-efficiency/pages/energy-efficiency.aspx#w2gImgRC-/bt/global/en/energy-efficiency/PublishingImages/infographic-energy-efficiency-sustainable-buildings.jpg>.
8. Green Paper - A European Strategy for addressing the issue of plastic waste in the environment (7. 3. 2013).
9. *World production of plastics*. <http://www.odpady-portal.sk/Dokument/102345/worldwatch-institute-svetova-produkcia-plastov-rastie-recyklacia-stagnuje.aspx> 2013.
10. Odpady. <http://www.odpady-portal.sk/Dokument/102345/worldwatch-institute-svetova-produkcia-plastov-rastie-recyklacia-stagnuje.aspx>
11. Správa EÚ o odpadoch. 2012.

DISTINCTIVE FEATURES OF COMPANIES WITH OPTIMAL CAPITAL STRUCTURE

Jasenska Bubic

*The University Department of Professional Studies, Split, Croatia
jbubic@oss.unist.hr*

Toni Susak

*The University Department of Professional Studies, Split, Croatia
tsusak@oss.unist.hr*

ABSTRACT

Capital structure, due to its significant impact on the vitally important business activities, is often subject of economic researches. One of the most important areas which affects the daily operations of a company includes effects that capital structure can have on tax liability of a company. It is because of the differences in the tax treatment of fundamental capital structure categories as well as the creditor's perception of a company which is the groundwork for making a decision whether to approve funds allocation necessary to finance business activities. That is the reason why it is important to determine the appropriate ratio of own and borrowed funds, which is often characterised by tendency of finding optimal value that is not always easy to identify because it can be done in different ways. As the basis for determining the optimal value, dichotomous business continuity variable is used because profitability is not necessarily a reliable indicator of real value and stability of a company. Furthermore, the next question that arises is - what distinguishes companies which do not have an optimal capital structure from those companies that have an optimal capital structure? The aim of this research is to, by applying statistical methodology, determine which financial ratios represent key distinctive characteristics of the two groups of companies. Sample is comprised of small and medium enterprises based in Republic of Croatia. They are divided in two subsamples – first subsample includes companies which have had optimal capital structure and second subsample includes companies which haven't had optimal capital structure. Financial data was gathered from Croatian Financial Agency official website.

Keywords: Bankruptcy, Determinants, Optimal Capital Structure, SME.

1. INTRODUCTION

One of the most crucial issues every company, regardless of their size and industry, faces is capital structure decision. In other words, company must decide on sources of financing their assets. Decision is actually very complex. In nutshell, company usually must balance between stability of their operations and greater expansion opportunities or, in other words, choose the combination of these factors which are, seemingly, optimal at the current point of time. This choice can also have effect on company's valuation, market price of company's shares and creditworthiness of a company. Because of complex business environment that is perpetually in process of change, definition of optimal capital structure depends on various aspects (time, country, industry etc.). Capital structure of a company can change over time (for instance – management of a company can decide on additional external financing by debt because of expansion aspirations). Also, legislator in particular country has significant impact on this decision by passing a tax law (capital structure can differ due to tax preference) and industries have their specificities (for instance – more concentrated industries can have substantial entry barriers). Ultimately, in need of defining capital structure (financial structure) it can be stated that »it presents relative share of equity, long – term and short – term debt that reflects on passive side of balance sheet« (Vidučić et al., 2015., p. 223.).

Table 10. *Factors of influence on capital structure*

Characteristics of the economy	Characteristics of the industry	Characteristics of the company
<ul style="list-style-type: none"> • tempo of the business activity • state of capital market • taxation • state regulation 	<ul style="list-style-type: none"> • cyclical variations • degree of competition • stage in life cycle 	<ul style="list-style-type: none"> • size of the business • form of business organization • stability of earnings • age of company • asset structure of company • credit standing • attitude of management

Source, table created by using: Parab S.R. (2013). *A critical study of capital structure of selected industries in Gujarat*, Sardar Patel University, available at: <http://shodhganga.inflibnet.ac.in/handle/10603/7334>

As said before, capital structure of a company is very complex issue – there are numerous factors which can influence capital structure decision as presented in **Table 1**. They can be classified in three groups of factors: *characteristics of the economy*, *characteristics of the industry* and *characteristics of the company*. In this paper, focus will be directed at characteristics of company which will be analysed through financial statements that companies are obliged to provide annually.

2. RECENT LITERATURE

There are numerous scientific papers which are related to topic of capital structure and several paths which researchers can take in analysis of this issue.

Firstly, they can analyse an effect capital structure choice has on certain group of financial ratios like, for instance, Cole et al. (2015.) who founded negative relationship between profitability and capital structure which means that higher levels of debt negatively affect performance of a company. Same relations were founded by Tsuji (2013.) and Phatel and Bhatt (2013.).

Secondly, researchers can try to detect multiple determinants from various groups of financial ratios, their impact and sign of their impact on capital structure. This approach was adopted by Smith (2010.) who has founded positive relationship between debt and asset tangibility, growth, size, but also negative relationship between debt and age, liquidity, profitability. Proença et al.

(2014.) have highlighted liquidity, asset structure and profitability as crucial capital structure predictors and noticed debt ratios downward trend influenced by recent economic slowdown.

Serghiescu and Vaidean (2014.) have founded negative relationship between capital structure and liquidity ratios as well as tangibility of assets and also positive relationship between capital structure and size of a company as well as asset turnover. Handoo and Sharma (2014.) have founded that profitability, growth, asset tangibility, size, cost of debt, tax rate and debt serving capacity are determinants with significant effect on capital structure. Thippayana (2014.) has confirmed positive relationship between capital structure and size of a company, negative relationship with profitability and concluded that there is no significant relationship with tangibility, growth opportunity and business risk. Guner (2016.) has founded negative relationship between the capital structure and size, growth opportunities, profitability and liquidity, but there was positive relationship with non-debt tax shields variable which wasn't statistically significant. Sheikh (2015.) observed that liquidity, profitability and tangibility were negatively related to capital structure, while firm size and dividends are positively related to capital structure financial ratios.

Thirdly, when considering optimal capital structure, researches are not so frequent. Bubić and Šušak (2015.) analysed optimal capital structure in terms of bankruptcy and founded that is generally more favourable for a company to have higher share of a capital than debt.

This paper gives new dimension and additionally introduces business continuity dichotomous variable as basis for determining financial ratios which can be good predictors of optimal capital structure or, in other view, variables that are immanent to optimal capital structure. Such approach is most likely unprecedented.

3. HYPOTHESES

These hypotheses were established after statistical analysis has shown which variable combination will have highest predictive contribution to the model. As results have shown, those variables are part of profitability and liquidity ratios. Accordingly, relationships between these financial ratio categories and capital structure are presented in **Table 2.** below:

Table 11. *Some recent researches on relationship between capital structure, profitability and liquidity*

Financial ratio category	Relationship with capital structure ¹	
	Positive	Negative
Profitability		Smith (2010.) Tsuji (2013.) Patel and Bhatt (2013.) Handoo and Sharma (2014.) Thippayana (2014.) Proença et al. (2014.) Serghiescu and Vaidean (2014.) Cole et al. (2015.) Vergas et al. (2015.) Sheikh (2015.) Jantarakolica and Sakayachiwakit (2015.) Guner (2016.)
Liquidity	Handoo and Sharma (2014.)	Smith (2010.) Proença et al. (2014.) Serghiescu and Vaidean (2014.) Jantarakolica and Sakayachiwakit (2015.) Sheikh (2015.) Guner (2016.)

These relationships between variables are a solid groundwork for establishing hypotheses which will be tested using statistical methodology and are formed as following:

Hypothesis 1 – variable Working Capital is statistically significant and it is in positive relationship with optimality of capital structure.

Hypothesis 2 – variable Return on Assets is statistically significant and it is in positive relationship with optimality of capital structure.

¹ Capital structure in these papers was measured with *debt* in numerator, but in this research it is measured as inversely (with emphasis on *equity* which is positioned in numerator) so it has to be paid attention to the sign of the relationship (it is inverted). So, negative relationship in these previous researches is equal to positive relationship in this research (this is important for hypotheses acceptance).

Ad 1) Theoretically, there is negative relationship between debt and liquidity (or positive relationship between equity and liquidity). In this research, for capital structure to be optimal, higher share of equity is desirable. Accordingly, optimality of capital structure should be in positive relation with liquidity because liquid companies have lower need for external financing to cover their »cash gaps«. Also, it is logical that less indebted companies have higher cash values because they don't have debt repaying burden. On the other side, there is one research which resulted with positive relationship (negative in our inverse situation) between capital structure and liquidity (Handoo and Sharma, 2014.). Possible theoretical explanation is that company, when borrowing money, gets additional cash flow, so it can be very liquid in the beginning of the debt repayment cycle. But this possible explanation will be ignored in establishing hypotheses because of thin theoretical background.

Ad 2) Previous researches stress the negative relationship between debt and profitability (or positive relationship between equity and profitability). In this research, optimal capital structure should be in positive relationship with profitability because stable companies generally have less need for external financing, unless they have expansion plans. Additionally, higher profitability can also change the capital structure in favour of equity.

4. DATA AND STATISTICAL METHODOLOGY

Financial data used in research was obtained from annual financial statements published for financial year 2011. and publicly available on *Croatian Financial Agency* official website. This data was used to calculate financial ratios which will be included in model as its key components. Sample comprises 96 small and medium enterprises (SMEs) which have been divided into two subsamples. First subsample comprises companies which have had optimal capital structure and second subsample comprises companies which haven't had optimal capital structure. There were two types of companies regarding legal designation – public limited companies and private limited companies both of which are characterised by limited liability of their owners to the assets that they have invested as company's capital. Business continuity data used to determine which companies had optimal capital structure was used from previous researches of same authors (Bubić and Šušak, 2015., pp. 324. – 332.). *Statistical Package for Social Sciences (SPSS)* was used for statistical analysis of data and financial ratios.

Binary logistic regression was used as method for statistical analysis. Aim is to form a model which will effectively classify companies which have had optimal capital structure and companies which haven't had optimal capital structure. So, the dependent variable will be dichotomously expressed optimality of capital structure. It will give insight which financial positions and their values are strongly connected with optimal capital structure. Determining "optimal" values can be very complex and it is always debatable. Aforementioned business continuity is used as reliable base for determining such value. Using particular financial ratio to determine whether company has optimal capital structure can be misleading. But business continuity can be used as single variable because of the fact that certain company which conducts stable business operations usually has acceptable values of key financial metrics. Data which can be observed from **Table 3.** implies that there was statistically significant relation between capital structure and opening of bankruptcy proceeding.

Table following on the next page

Table 3. *Chi-square test (opening bankruptcy proceeding - equity ratio and opening bankruptcy proceeding – long term debt to equity ratio)*

	Equity Ratio					Long Term Debt to Equity Ratio				
	Value	df	A. S. *	E.S. (2s) **	E.S. (1s) ***	Value	df	A. S. *	E.S. (2s) **	E.S. (1s) ***
Pearson Chi-Square	41,38 ^a	1	0,001			45,87 ^c	1	0,001		
Continuity Correction^b	38,63	1	0,001			43,14	1	0,001		
Likelihood Ratio	49,44	1	0,001			50,84	1	0,001		
Fisher's Exact Test				0,001	0,001				0,001	0,001
Linear-by-Linear Association	40,93	1	0,001			45,40	1	0,001		
N of Valid Cases	92					96				

*A.S. - Asymp. Sig. (2-sided), **E.S. (2s) - Exact Sig. (2-sided), *** E.S. (1s) - Exact Sig. (1-sided).

a. 0 cells (0%) have expected count less than 5. The minimum expected count is 15,47.

b. Computed only for a 2x2 table

c. 0 cells (0%) have expected count less than 5. The minimum expected count is 21,50.

Source: Bubić J., Šušak T. (2015). *Detecting optimal financial and capital structure: The case of small and medium enterprises (SME) in Republic of Croatia*. 10th International Scientific Conference on Economic and Social Development, Miami, 2015.

These results of *chi – square test* are reason why advantage is given to business continuity in spite of other variables which can be used in determining optimal capital structure (for instance profitability etc.). **Table 3.** served as a statistical confirmation of patterns evident in **Table 4.** From business continuity aspect, data presented in **Table 3.** and **Table 4.** pinpoints to higher probability that a company will avoid opening bankruptcy proceeding if it is highly capitalized and higher probability of opening bankruptcy proceeding if it is highly indebted.

Table 4. *Cross tabulation between the binary expressed fact of opening bankruptcy proceeding and the binary expressed equity ratio value and long term debt to equity ratio*

		Equity ratio		Total	LTD/E		Total
		< 50%	> 50%		Higher LTD	Higher E	
Bankruptcy	Bankrupted	43	1	44	38	10	48
	Non-bankrupted	16	32	48	5	43	48
Total		59	33	92	43	53	96

Source: Bubić J., Šušak T. (2015). *Detecting optimal financial and capital structure: The case of small and medium enterprises (SME) in Republic of Croatia*. 10th International Scientific Conference on Economic and Social Development, Miami, 2015.

5. BINOMIAL LOGISTIC REGRESSION MODEL – RESULTS OF RESEARCH

Table 5. contains financial ratios used for purpose of forming binomial logistic regression model. These are “distinctive” ratios which point out financial characteristics that companies with optimal capital structure have.

Table 5. *Financial ratios included in logistic regression model*

Financial ratio	Abbreviation	Formula
Working Capital	WC	Current assets – Current liabilities / Current assets
Return on Assets	ROA	Net profit / Total assets

Since there is recommendation that logistic regression model should have one independent variable per 50 observations (Hancock and Mueller, 2010., p. 227.), model in this research included two independent variables because sample consists of 96 observations of data which leads us to presumption that this criteria was met (despite of negligible shortage of observations). First independent variable presented in **Table 5.** is *Working Capital (WC)* and pertains to the group of liquidity financial ratios while second independent variable is *Return on Assets (ROA)* and pertains to profitability financial ratios. *ROA* can be used to determine whether it is profitable for a company to borrow financial funds by comparing it to interest rate – financial benefit of borrowing (Vidučić et al., 2015., p. 453.). *WC* is “part of current assets indispensable in business cycle for coverage of current liabilities until inventories or services are not sold and until sales are covered with cash flow” (Belak, 2014., p. 140.). It is notorious fact that liquidity and profitability are “two sides of one coin” and that their complementary use has synergic effect in financial analysis. Profitability can be informative, but it is very susceptible for manipulation and creative accounting. So, liquidity is used to add quality to financial analysis because it is more difficult to manipulate with this category.

Table 6. helps us to deal with possible problem of multicollinearity which can emerge when forming logistic regression model. Problem lies in strong inter-correlation between variables included in model. Although thresholds for high correlation are not unified and conventional, in this research it will be set at 0.9 (Pallant, 2007., p. 142.). Efficient way to deal with multicollinearity is to include in research financial ratios which belong to different groups (liquidity, profitability, turnover etc.) because it is evident that there is higher possibility for multicollinearity if financial ratios are composed of same financial positions.

Table 6. *Correlations between Financial Ratios included in research*

		WC	ROA
WC	Pearson Correlation	1	0,173
	Sig. (2-tailed)		0,101
	N	91	91
ROA	Pearson Correlation	0,173	1
	Sig. (2-tailed)	0,101	
	N	91	92

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

Correlation table shows positive weak correlation between *Working Capital* and *Return on Assets* which is not statistically significant at 5% level of significance. One factor that helps to avoid multicollinearity is selection of ratios which pertain to different groups of ratios (in this situation liquidity and profitability).

Table 7. Tolerance and VIF

Variable	Collinearity Statistics	
	Tolerance	VIF
(Cons.)		
WC	0,970	1,031
ROA	0,970	1,031
Multicollinearity threshold	< 0,1	> 10

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

It is also advisable to analyse *Tolerance* and *VIF* which are commonly called *Collinearity statistics*. Values which important to determine if there is multicollinearity are contained in last row of **Table 7.** (Pallant, 2007., p. 150.). According to these thresholds, multicollinearity problem is not present because *tolerance* is not lower than 0,1 and *VIF* is not higher than 10 for *Working Capital* and *Return on Assets*.

Table 8. Hosmer and Lemeshow Test

Chi-square	df	Sig.
11,820	8	0,159

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

In **Table 8.** *Hosmer and Lemeshow Test* is presented and it shows model fit. *Significance value* is used to determine if there is a good model fit. *Sig. value* higher than 0,05 indicates a good model fit (Pallant, 2007., p. 167.) just like we have in this case (0,159).

Table 9. Model Summary

-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
53,836	0,546	0,729

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

Due to lack of R^2 statistics in logistic regression, so called *pseudo R^2* is used for assessment of model's *goodness of fit*. *Cox & Snell R^2* and *Nagelkerke R^2* are used as measures of *pseudo R^2* . Higher values of these measures imply that the model fit is better. In our case *Cox & Snell R^2* amounts 0,546 and *Nagelkerke R^2* amounts 0,729.

Table 10. Classification Table

Observed		Predicted		
		Optimal CS (0 - NO, 1 - YES)		Percentage Correct
		0	1	
Optimal CS (0 - NO, 1 - YES)	0	38	4	90,5
	1	5	44	89,8
Overall Percentage				90,5

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

Table 10. displays classification table of binomial logistic regression model which presented very high overall classification efficiency of 90,5%. Furthermore, 89,8% companies which have been indicated as companies with optimal capital structure were classified correctly, while 90,5% of companies which haven't been indicated as companies with optimal capital structure were classified correctly.

Table 11. Variables in the Equation

	B	S.E.	Wald	df	Sig.
WC	0,757	0,366	4,270	1	0,039
ROA	22,914	7,497	9,342	1	0,002
Constant	-0,640	0,425	2,274	1	0,132

Software used in analysis: IBM Corp.: „IBM SPSS Statistics for Windows“, Version 22.0., Armonk: NY: IBM Corp., 2013.

All independent variables included in model are statistically significant, but *ROA* has higher contribution than *Working Capital*. According to the **Table 11.**, logistic regression model for optimal capital structure can be formed as follows:

$$\text{OCS} = -0,640 + 0,757 \cdot \text{WC} + 22,914 \cdot \text{ROA}$$

where abbreviations are:

- **OCS** – optimal capital structure model,
- **WC** – Working Capital,
- **ROA** – Return on Assets.

B values for both independent variables are positive which means that if their values are higher it is more likely that a certain company will have optimal capital structure.

Table 11. Hypotheses status (Accepted / Rejected)

No	Hypothesis	Status
1.	<i>Hypothesis 1 – variable Working Capital is statistically significant and it is in positive* relationship with optimality of capital structure.</i>	ACCEPTED
2.	<i>Hypothesis 2 – variable Return on Assets is statistically significant and it is in positive* relationship with optimality of capital structure.</i>	ACCEPTED

*Capital structure in these papers was measured with *debt* in numerator, but in this research it is measured as inversely (with emphasis on *equity* which is positioned in numerator) so it has to be paid attention to the sign of the relationship (it is inverted). So, negative relationship in these previous researches is equal to positive relationship in this research (this is important for hypotheses acceptance).

6. CONCLUSION

Because capital structure choice can have significant impact on perception of stability of a company, valuation and amount of taxes that company has to pay, finding optimal capital structure has always been a challenge to researchers. This research is sequel to previous research conducted by Bubić and Šušak (2015.) who analysed optimal capital structure in terms of bankruptcy and founded that is generally more favourable for a company to have higher share of a capital than debt. Accordingly, business continuity was used for determining which companies have optimal capital structure which means that the threshold was formed by taking into account a bankruptcy status of a company. As presented in **Table 11.**, both hypotheses

were accepted and that confirms that the results of this research efficiently corroborate theoretical remarks about capital structure determined in previous researches and mentioned in **Chapter 2** and **Chapter 3**. This gives additional proof that bankruptcy is »stable groundwork« for determination of optimality of capital structure. Results of logistic regression point out that one liquidity indicator (*Working Capital*) and one profitability indicator (*Return on Assets*) can be used to effectively classify companies (with very high overall classification efficiency of 90,5%). In other words, it is more likely that the companies which have higher *Working Capital* and *Return on Assets* ratio will also have optimal capital structure. Generally, liquidity ratios are often used to deepen the information provided by profitability ratios in order to see through fraudulent financial reporting.

LITERATURE:

1. Belak V. (2014). *Analiza poslovnje uspješnosti*. RRiF Plus d.o.o. Zagreb
2. Bubić J., Šušak T. (2015). *Detecting optimal financial and capital structure: The case of small and medium enterprises (SME) in Republic of Croatia*. 10th International Scientific Conference on Economic and Social Development, Miami, 2015.
3. Cole C., Yan Y., Hemley D. (2015). *Does Capital Structure Impact Firm Performance: An Empirical Study of Three U.S. Sectors*, Journal of Accounting and Finance Vol. 15(6)
4. Guner A. (2016). *The Determinants of Capital Structure Decisions: New Evidence from Turkish Companies*, Procedia Economics and Finance 38, 84 – 89
5. Hancock G.R., Mueller R.O. (2010). *The Reviewer's Guide to Quantitative Methods in the Social Sciences*, Routledge
6. Handoo A., Sharma K. (2014). *A study on determinants of capital structure in India*, IIMB Management Review, 26
7. IBM Corp. (2013). *IBM SPSS Statistics for Windows*, Version 22.0., Armonk: NY: IBM Corp.
8. Jantarakolica T., Sakayachiwakit W. (2015). *Determinants of Optimal Capital Structural of ASEAN Corporations*, Rev. Integr. Bus. Econ. Res. Vol 4(3)
9. Pallant J. (2007). *SPSS Survival Manual*, McGraw-Hill
10. Parab S.R. (2013). *A critical study of capital structure of selected industries in Gujarat*, Sardar Patel University, available: <http://shodhganga.inflibnet.ac.in/handle/10603/7334>
11. Patel N.M., Bhatt V. (2013). *Capital Structure and Profitability: Case Of National Stock Exchange*, Indian Journal of Applied Research, Volume 3, Issue 4
12. Proença P., Laureano R.M.S., Laureano L.M.S. (2014). *Determinants of capital structure and the 2008 financial crisis: evidence from Portuguese SMEs*, Procedia - Social and Behavioural Sciences 150, 182 – 191
13. Serghiescu L., Vaidean V.L. (2014). *Determinant factors of the capital structure of a firm- an empirical analysis*, Procedia Economics and Finance 15, 1447 – 1457
14. Sheikh (2015). *Capital Structure Determinants of Non Financial Listed Firms in Service Sector: Evidence from Pakistan*, Pakistan Journal of Social Sciences (PJSS) Vol. 35, No. 2 , pp. 1051-1059
15. Smith G.P. (2010). *What are the Capital Structure Determinants for Tax-Exempt Organizations?*, The Financial Review 45 845–872
16. Thippayana P. (2014). *Determinants of Capital Structure in Thailand*, Procedia - Social and Behavioural Sciences 143, 1074 – 1077

17. Tsuji C. (2013). *Corporate Profitability and Capital Structure: The Case of the Machinery Industry Firms of the Tokyo Stock Exchange*, International Journal of Business Administration Vol. 4, No. 3
18. Vergas N., Cerqueira A., Brandão E. (2015). *The determinants of the capital structure of listed on stock market nonfinancial firms: Evidence for Portugal*, FEP Working Papers, FEP-UP, School of Economics and Management, University of Porto
19. Vidučić Lj., Pepur S., Šimić Šarić M. (2015). *Financijski menadžment*, RRiF Plus d.o.o.

**16th International Scientific Conference on Economic and Social Development
– “The Legal Challenges of Modern World”**

